Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 23849–ME

MEMORANDUM OF THE PRESIDENT
OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND
THE INTERNATIONAL FINANCE CORPORATION
TO THE
EXECUTIVE DIRECTORS
ON A
COUNTRY ASSISTANCE STRATEGY
OF THE WORLD BANK GROUP
FOR
THE UNITED MEXICAN STATES

April 19, 2002

Colombia-Mexico-Venezuela Country Management Unit
Latin America and the Caribbean Region

MEXICO–FISCAL YEAR

January 1–December 31

CURRENCY EQUIVALENTS

(as of 18 April 2002)

Currency Unit	=	Peso
9.16 Pesos	=	US$1

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

AIDS	Acquired Immune Deficiency Syndrome
APL	Adjusted Program Lending
ASERCA	Apoyos y Servicios a la Comercialización Agropecuaria
BANCOMEXT	Banco Nacional de Comercio Exterior, S.N.C.
BANOBRAS	Banco Nacional de Obras y Servicios Públicos, S.N.C.
BANRURAL	Banco Nacional de Credito Rural, S.N.C.
BANSEFI	Banco del Ahorro Nacional y Servicios Financieros
CAS	Country Assistance Strategy
CCL	Contingent Credit Union
CAM	Comisión Ambiental Metropolitana
CNA	Comisión Nacional de Agua
CEM	Country Economic Memorandum
CFAA	Country Financial and Accountability Assessment
COMPRANET	Sistema Electrónico de Contrataciones Gubernamentales
CONAFOR	Comisión Nacional Forestal
CONAPO	Consejo Nacional de Población
CONASUPO	Compañía Nacional de Subsistencias Populares
CPAR	Country Program Assessment Report
CSO	Civil Society Organization
DAL	Decentralization Adjustment Loan
DIF	Sistema Nactional para el Desarrollo Integral de la Familia
DRD	Decentralization and Regional Development
ECD	Early Childhood Development
ENIGH	Encuesta Nacional de Ingreso y Gasto de los Hajores
ESMAP	Energy Sector Management Assistance Program
ESW	Economic Sector Work
FARAC	Fideicomiso de Apoyo al Rescate de Autopistas
FOVI	Fondo de Operación y Financiamiento Bancario a la Vivienda
FOVISSSTE	Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado
FSAP	Financial Sector Assessment Paper
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GEF	Global Environment Facility
GEF/MP	Global Environment Facility/Montreal Protocol
GNP	Gross National Product
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
IMSS	Instituto Mexicano del Seguro Social
IMSS-Solidaridad	Instituto Mexicano del Seguro Social-Solidaridad
INFONAVIT	Instituto del Fondo Nacional de la Vivienda para los Trabajadores
INI	Instituto Nacional Indigenista
IPAB	Instituto de Protección al Ahorro Bancario
ISSSTE	Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado
LIL	Learning and Innovation Loan
NAFIN	Nacional Financiera, S.N.C.
NAFTA	North American Free Trade Agreement
NGO	Nongovernmental organization
OAS	Organization of American States
OECD	Organization for Economic Cooperation and Development
OED	Operations Evaluation Department
OD	Operational Directive
OP	Operational Policy
PARE	Programa para Abatir el Rezago Educativo
PAREIB	Programa para Abatir el Rezago en Educación Inicial y Básica
PCF	Prototype Carbon Fund
PEMEX	Petróleos Mexicanos
PET	Programa de Empleo Temporal
POP	Persistent Organic Pollutant
PIDIREGAS	Proyectos de Impacto Diferido en el Registro del Gasto
PROBECAT	Programa de Becas de Capacitación para Desempleados
PROCAMPO	Programa de Apoyos Directos al Campo
PROCEDE	Programa de Certificación de Derechos Ejidales y Titulación de Solares Urbanos
PRODEI	Programa para el Desarrollo de la Educación Inicial
PROGRESA	Programa de Educación, Salud y Alimentación
PRONAFIDE	Programa Nacional de Financiamiento del Desarrollo
PSBR	Public Sector Borrowing Requirements
PSD	Private Sector Development
SAGAR	Secretaría de Agricultura, Ganadería y Desarrollo Rural
SAGARPA	Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación
SAL	Structural Adjustment Loan
SAT	Sistema de Administración Tributaria
SECODAM	Secretaría de Contraloría y Desarrollo Administrativo
SEDESOL	Secretaría de Desarrollo Social
SEMARNAP	Secretaría de Medio Ambiente y Recursos Naturales y Pesca
SEMARNAT	Secretaría de Medio Ambiente y Recursos Naturales
SIAFF	Sistema Integral de Administración Financiera Federal
SimSIP	Simulations for Social Indicators and Poverty
SME	Small- and medium-size enterprise
SSA	Secretaría de Salud
TAL	Technical Assistance Loan
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
WBG	World Bank Group
WHO	World Health Organization
WTO	World Trade Organization

IBRD		IFC	
Vice President	David de Ferranti	Vice President, Investment Operations:	Assaad Jabre
Chief Economist:	Guillermo Perry	Director, LAC:	Bernard Pasquier
Country Director:	Olivier Lafourcade	Manager:	Toshiya Masuoka
Lead Economist/Manager:	Marcelo Giugale	Task Manager:	Toshiya Masuoka
Task Manager:	Marcelo Giugale		

Team Production Support: Michael Geller

MEXICO
COUNTRY ASSISTANCE STRATEGY
TABLE OF CONTENTS

FIGURES

ANNEXES

MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND THE INTERNATIONAL FINANCE CORPORATION TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR THE UNITED MEXICAN STATES

I. SUMMARY AND MAIN MESSAGES

1. The World Bank Group's (WBG) previous Country Assistance Strategy (CAS) for Mexico was discussed by the Board of Executive Directors on May 13, 1999 (Report No. 19289-MX), and its Progress Report was considered on May 21, 2001 (Report No. 22147-ME). The central theme of that CAS was sustainability—economic and social—in the face of heightened uncertainty for the country and, consequently, for the WBG assistance program (notably, the end of the presidential *sexenio*, international financial volatility, the speed of the decentralization process, instability in the financial sector, and the *nonadditionality* of IBRD funding to the budgets of line agencies). Thus, the 1999 CAS called for flexibility in delivering assistance within a prudent overall financing envelope.

2. Over the CAS period, Mexico made remarkable progress along its development path, and is now entering a new era of opportunity for growth and poverty reduction. In the process surrounding the presidential election of July 2000, its political system showed a high degree of maturity and achieved a new level of openness, participation, and accountability. Its economic performance has also been strong. Seven years after a major macroeconomic crisis affected its banking system and sent millions of Mexicans into poverty, the country became one of the fastest-growing economies in Latin America, an investment-grade borrower, and has achieved considerable financial and commercial integration. While a succession of emerging economies stumbled (East Asia, Russia, Brazil, Argentina), Mexico continued growing. Even the 2001 recession in the United States was overcome—with a slowdown, but without crisis. As a result, Mexico's poverty headcount has sharply decreased, and is at present much lower than before the crisis.

3. The WBG has been a close partner of Mexico in its development progress. Using the program flexibility built into the last CAS, the WBG was able to deliver over the last three years assistance aimed at furthering the country's reform agenda at both the macro level (for example, fiscal, finance, decentralization) and at the sectoral, field level (for example, rural development, health, gender). Throughout, the primary focus has been poverty reduction, and the impact has been significant, especially in terms of intellectual contribution to policy design. The WBG's role in providing knowledge and advisory services is perhaps best shown by the role it played during the presidential transition—its collection of Policy Notes became an analytical bridge across administrations and, at the request of the incoming authorities, was published as a book.[1]

---

1. Giugale, M., O. Lafourcade, and V. Nguyen, eds., 2001, *Mexico—A Comprehensive Development Agenda for the New Era*, World Bank Publications, Washington, D.C.

In parallel, the WBG's financing flows toward Mexico remained strong and within the CAS envelope, the quality of its portfolio improved to highly satisfactory standards, and country exposure fell. None of the potential risks envisioned in the CAS materialized (the end-of-*sexenio* did not lead to a crisis; no externally or domestically generated macroeconomic shock took place; the financial sector stabilized and strengthened; and there was no reduction in projected counterpart funding). And new frontiers were reached in the relationship with the country—for the first time, the CAS Progress Report was made public, systematic CAS consultations with civil society were held, transition Policy Notes were published, an adjustment operation was implemented at the state level, a daylong summit between a Mexican President and the President of the WBG took place, previously closed sectors were open to analytical work (corruption, judicial, gender), and the WBG received, through its President, the country's highest honor given to a foreign institution (the *Aguila Azteca in Venera*).

4. The combination of country development and success in delivering assistance has placed the relationship between Mexico and the WBG at an encouraging high point. Yet, for all the progress achieved, 45 million Mexicans are still poor, inequality remains massive (as do disparities across ethnic groups, genders, and business sizes), and the already vast development gap between north and south continues to widen. The WBG will therefore maintain its support over the next three years, and help the government seize the unique opportunity for poverty reduction that the new political era has brought about—an opportunity that may not last long or repeat itself. This call for continuing support has been voiced not only by the government, but also by civil society and private business sector representatives consulted during the preparation of this CAS.

5. Addressing the development challenges pending in Mexico will take formidable efforts on several policy fronts. Those efforts can, however, be organized around five strategic objectives: (a) consolidating the macroeconomic framework; (b) accelerating growth through competitiveness; (c) human capital development; (d) balancing growth and poverty reduction with environmental protection; and (e) building an efficient, transparent, and accountable government. These objectives, which underlie the federal authorities' National Development Plan, will also be the motivating pillars of this CAS. To deliver the WBG's assistance, IBRD will retain a rich program of analytical work and offer a three-year, US$5 billion lending envelope (half of which will be fast-disbursing) that preserves a US$1.5 billion "cushion," balances macro- and micro-oriented activities, and caters to the three levels of government (federal, state, and municipal). That five-pillar IBRD strategy will be integrative and mutually reinforcing of IFC's program of interventions—in turn, geared to provide a wider spectrum of private entreprises with a better and broader business environment in which to operate, including a more developed financial market, better means to compete internationally and, critically, support in accessing industries that may become open to private participation. (The WBG's Private Sector Strategy is presented in Annex B10).

6. The strategy described above (five poverty-reducing pillars guiding IBRD's interventions, and IFC's support for broad-based private sector development) heeds the lessons learned during previous CAS cycles—the value of program flexibility, attention to portfolio quality, timely analytical work, interaction with subnational governments, balance between macro- and microeconomic interventions, and country ownership. These lessons give comfort that the risks embedded in this CAS are manageable—risks of large, negative macroeconomic shocks; Congressional paralysis; reform complacency; weak intra- and intergovernmental

coordination; unsuccessful *federalismo;* or infrastructure crises. Finally, the strategy presented here fits into, and exploits the synergies of, the array of comparative advantages across partner institutions operating in Mexico, especially the IDB and the IMF.

II. THE COUNTRY CONTEXT

(a) The Political Arena

7. The transformation of the Mexican political system toward a multiparty democracy acquired a new dimension with the election of President Vicente Fox in July 2000, thereby ending a period of one-party domination that had lasted for seven decades and, more profoundly, redefining the roles of the legislative, executive, and judicial branches and those of political parties and local governments. Breaking with a history of recurrent end-of-*sexenio* crises, this time the transition of power was remarkably smooth—due in good part to solid macroeconomic management. Greater political plurality has been a welcome factor both within Mexico and abroad, for it entails a search for consensus around pending reforms (and, indeed, around the kind of society Mexicans want), a tool for conflict resolution, and a mechanism to enhance transparency and accountability in the exercise of the government function.

8. Predictably, the election results raised unrealistic expectations for immediate change. And, predictably, after only a year and a half in office, the administration has made slower than hoped for progress in enacting its ambitious legislative and policy agenda. With none of the political parties having an absolute majority in Congress and with limited country experience in legislative pluralism, negotiations over the two major reforms so far proposed by the Executive (indigenous law and tax reform) were protracted and, eventually, passed with substantial modifications. Furthermore, the administration's legislative agenda over the next year will be conditioned by the mid-term Congressional elections of July 2003. Yet, the chances for reform are not negligible, because neither the administration nor the various political parties stand to benefit from legislative gridlock. To be sure, the agenda of pending reforms is a challenging one—it includes opening the power sector to private sector initiatives, a new labor code that can keep Mexican workers competitive as the country further integrates into the world economy, a new social security scheme for public sector employees that does not threaten fiscal sustainability or stiffen the labor market, the rationalization of water use, and an adjustment in the mandate of public development banks.

9. Those reforms, and the ensuing consensus-building efforts, will have to take into account another dimension of governing today's Mexico—the speed and depth of the decentralization process, or *federalismo*. Since the early 1990s, decisionmaking power has been gradually devolved to state and municipal governments. This process gathered momentum in 1997 when, after legislative elections, Congress was no longer dominated by a single party and political negotiations led to the transfer of responsibility for major budget lines (in the so-called *Ramo 33*) to subnational authorities. The results of the presidential elections of 2000 gave additional force to decentralization—*federalismo* being a priority for President Fox, himself a former state governor. As a result, policy decisions in key development areas (such as education, health, and the environment) are quickly becoming the prerogative of states and municipalities. While local responsibility is in general welfare-enhancing (because it brings decisionmakers and decision-beneficiaries closer together), it requires a clear framework of "rules of the game" if it is not to become a destabilizing element countrywide. Those rules are much more than technical

parameters, because they will determine whether the quality of government services Mexicans receive and, ultimately, the standard of living they enjoy, differ substantially across regions. In other words, the party controlling the federal government will have to establish working partnerships with 31 states (and one large federal district) and some 2,400 municipalities of which it controls only one third and one tenth, respectively.

(b) Recent Economic Developments

10. After an extended period of strong expansion, economic activity in Mexico experienced a sharp slowdown during 2001 as the downturn in the global economy, and in particular in the U.S. economy, spread across emerging markets. Growth of Mexican manufactured exports, nine tenths of which go to the United States, plummeted from an average annual growth rate of 20 percent to minus 3 percent last year. Such a pronounced drop in external demand and the related slump in manufacturing investment led to a contraction of real GDP growth during 2001, down to -0.3 percent, in contrast to the 5.6 percent average annual growth rate observed over the preceding five-year period.

11. Even during the contraction, the economy proved resilient in many ways—thanks in large part to sound macroeconomic management. Whereas during the rapid economic expansion of 2000 there was a relatively expansionary fiscal stance and a tight monetary policy, the new authorities during 2001 targeted a lower budget deficit (0.65 percent of GDP), and implemented budget rules automatically cutting expenditures when revenues turn out lower than budgeted. Monetary policy was eased, although cautiously, in the face of strong capital inflows, weakening of domestic demand, and lower inflation expectations. Cautious monetary management, the appreciation of the currency (due to the strength of capital inflows), and the slowdown in growth, all combined to keep inflation in check—the 2001 year-end inflation rate fell to 4.4 percent, well below the initial target of 6.5 percent.

12. The external accounts remained manageable. The balance of payments' current account deficit stayed practically unchanged from the previous year (at 2.8 percent of GDP), as lower manufacturing export revenues and lower oil prices were largely offset by a similar reduction in imported intermediate inputs and capital goods. Mexico has continued to enjoy favorable access to external financing and steady investment flows. This simultaneously allowed for the bulk of the current account's deficit to be financed through foreign direct investment, an accumulation of international reserves, a strengthening of the peso, a reduction in private investors' perception of country risk as measured by sovereign bond spreads, and a significant reduction of domestic interest rates. As of March 2002, Mexico's sovereign bonds have investment-grade rating by all three major international rating agencies, making it possible for a broad range of foreign institutional investors to buy Mexican bonds. The economy thus seems well positioned for a strong recovery upon the rebound of economic activity in the United States, expected in the second half of 2002.

13. Fiscal discipline is a key priority for the administration. As part of that discipline, the government proceeded with the publication of a broadened fiscal deficit measure, known as the Public Sector Borrowing Requirements (PSBR),[2] which is projected at 4 percent of GDP for

2. The PSBR includes some quasi-fiscal operations that are not or are only partially included under the traditional fiscal deficit measure, such as the total interest cost of liabilities related to bank and debtor support programs, the deferred cost of investment projects (PIDIREGAS) in the energy sector, the net financial intermediation by

2002 (in contrast to the budget deficit target in its traditional definition at 0.65 percent of GDP). The shift of the attention to the PBSR was part of the motivation behind new tax legislation enacted in December 2001 that is expected to increase tax revenue by 1.2 percent of GDP in 2002. This additional income has been allocated to offset low oil prices, and to finance priority social expenditures. In its recently published medium-term financing framework (PRONAFIDE), the government stated its intention to move gradually to fiscal balance (on a PSBR basis) by 2006, something that will require further fiscal consolidation in the near future. Mexico has no active IMF program and no outstanding obligations to the IMF (see Section VI).

14. Over the CAS implementation period, the Mexican economy is expected to recover from its current, shallow recession toward the economy's medium term potential annual rate of growth of about 4-5 percent. Even though the recovery of demand for Mexican manufactured exports will initially be the driver of the economic expansion, the strong rebound expected as of the second half of 2002 is projected to be broad-based, i.e., a simultaneous and balanced growth of consumption, investment and export demand. This growth pattern is expected to lead to an increase in the country's balance of payments' current account deficit from the current 2.8 percent of GDP to about 4 percent of GDP by 2004 and stabilizing at that level thereafter. Foreign direct investment flows will continue to finance the bulk of the country's external deficit. Further fiscal consolidation is projected to take place not only to make progress in attaining fiscal sustainability but also as a key instrument in aggregate demand management and price stability (Table 1).

Table 1. Mexico—Main Macroeconomic Indicators

Indicator	Actual		Estimated	Projected			
	1999	2000	2001	2002	2003	2004	2005
Gross Domestic Product (% growth)	3.8	6.9	-0.3	1.5	4.1	4.5	5.0
Consumption	4.2	8.7	1.7	1.4	3.7	3.9	4.9
Investment	4.1	8.8	-9.2	4.0	6.6	6.6	5.0
Exports	12.4	16.0	-5.0	2.7	6.0	6.1	6.2
Imports	13.8	21.4	-6.0	4.0	6.5	5.9	5.9
Balance of Payments							
Current Account (US$ billion)	-14.4	-17.7	-17.5	-22.7	-26.5	-29.0	-31.1
Current Account (as % of GDP)	-3.0	-3.1	-2.8	-3.5	-3.9	-4.0	-4.0
Foreign Direct Investment (US$ billion)	11.9	14.2	21.0	13.6	14.4	15.8	16.6
Fiscal Balance (as % of GDP)							
Traditional definition	-1.2	-1.2	-0.7	-0.6	-0.3	-0.3	0.0
Broadened PSBR	-6.3	-3.7	-3.8	-4.0	-3.1	-2.6	-2.1
Inflation (% year-end)	12.3	9.0	4.4	4.5	3.5	3.0	3.0

III. MEXICO'S DEVELOPMENT CHALLENGE: POVERTY REDUCTION IN THE NEW ERA

15. Through fast and sustained growth, Mexico has over the last six years made solid progress in combating poverty, and has left behind the devastating social effect of the 1994–95 crisis—which in a few months, fully undid the 10-percentage-point reduction in poverty levels

development banks, and the inflation component of indexed bonds. The PSBR excludes nonrecurrent revenues from privatization and unrealized capital gains.

painstakingly achieved over the preceding decade. From 1994 to 1996, the share of the population in poverty (defined as having a level of per capita consumption below what is necessary to meet basic food and nonfood needs)[3] drastically increased, from 50 to 61 percent at the national level. Since 1996, however, there has been an impressive turnaround, with the share of the population in poverty in 2000 having declined to 46 percent nationally. The share of the population in extreme poverty (defined as not being able to meet basic food needs)[4] has also fallen dramatically. Poverty, and especially extreme poverty, remains much higher in rural than in urban areas, but in both urban and rural areas, poverty is now below the 1994 precrisis level (Table 2).

Table 2. Share of the Population in Extreme Poverty and Poverty in Mexico

	Extreme Poverty					
	1989	**1992**	**1994**	**1996**	**1998**	**2000**
Urban	18.13	16.79	10.95	18.16	16.25	8.45
Rural	41.38	44.66	49.78	60.47	57.06	46.08
National	27.04	24.42	21.46	29.72	27.31	18.02
	Extreme and Moderate Poverty					
	1989	**1992**	**1994**	**1996**	**1998**	**2000**
Urban	50.70	49.14	40.64	53.25	49.97	36.33
Rural	69.32	73.26	78.82	84.84	82.06	73.29
National	57.84	55.74	50.97	61.88	58.66	45.73

Source: World Bank staff estimates based on the ENIGH surveys. The poverty measures are based on a comparison of total per capita current consumption (not adjusted to the national accounts) with poverty lines representing the cost of basic needs and computed following the INEGI/CEPAL method.

16. The lesson from the 1990s is clear—while many factors certainly play a role (notably, efficient social expenditures), growth is the most important determinant of poverty in Mexico. This close link between growth and poverty was a central theme of the previous CAS and remains so in this document, not only because of the obvious improvement that growth brings to the income of the poor, but also because of the positive synergies that it brings to their nonmonetary welfare (such as infant mortality, life expectancy, school enrollment, and access to safe water). Growth in Mexico is "propoor," because the distribution of gains in nonmonetary indicators favors the poor (for example, when enrollment rates increase, the poor are more likely to benefit from the increase than the nonpoor because the nonpoor already send their children to school). This should help Mexico meet, in some cases ahead of the 2015 deadline, the Millennium Development Goals (especially the extreme poverty target) (see Table 3).[5] WBG estimates suggest that, in Mexico, an annual average GDP growth rate of 5 percent would reduce infant and under-five mortality by almost half by 2015, life expectancy would increase by more than five years, and net primary enrollment would come close to 97 percent. More generally, such an overall rate of growth would bring the level of extreme poverty (defined on a US$1/day basis) down to 5 percent of the population by 2015 (that is, less than a third of the level in 1989).

3. That level of consumption translates into a Mexican peso value of 970 and 776 per month per person in urban and rural areas, respectively, in 2000 prices.
4. A Mexican peso value of 485 and 443 in urban and rural areas, respectively, per month per person in 2000 prices.
5. Table 2 accounts for seven of the eight Millennium Development Goals; at present, there is no sufficient data to assess fulfillment of the eighth such goal—Global Partnership for Development.

Table 3. Mexico and the Millennium Development Goals

Targets	Position of the World	Current Position of Mexico
1. Reduce the proportion of people living in extreme poverty and suffering from hunger by half between 1990 and 2015.	20 percent of the world population live on less than US$1 a day (WBG estimate for 2000).	Using the US$1/day poverty line (which differs from the poverty lines used in Table 1), an estimated 13.2 percent of Mexico's population was living in extreme poverty in 2000, versus 16.2 percent in 1989. The prevalence of malnutrition among children under age five decreased from 14.4 percent in 1988 to 7.5 percent in 1999.
2. Achieve universal completion of primary education by 2015 for both boys and girls.	90 percent of the world's elementary-school-age children (6–14) are enrolled (WBG estimate for 1997).	According to the 2000 population census, 91.3 percent of Mexico's elementary-school-age children (6–14) are enrolled.
3. Eliminate gender disparities in primary and secondary education by 2005, and for all levels by 2015.	Worldwide, there is a gender gap of 7.6 percent in the primary education Gross Enrollment Ratio (WBG estimate for 1996).	There is only a 0.6 percentage point gender gap in elementary education enrollment (ages 6–14) in Mexico (Population Census 2000). However, the gender gap increases at higher levels of schooling.
4. Reduce infant and child mortality rates by two thirds between 1990 and 2015.	Worldwide, the infant mortality rate per 1,000 live births was 54.2 (WBG estimate for 1999).	According to WBG data, the under-five mortality rate in Mexico was 35.8 per 1,000 in 2000, compared to 46.0 per 1,000 in 1990.
5. Reduce maternal mortality rate by three quarters between 1990 and 2015.	Worldwide, there are 400 maternal deaths per 100,000 live births (estimates depend on method used; UNFPA 1995).	According to Mexico's Ministry of Health, the maternal mortality rate has been reduced from 54 per 100,000 in 1990 to 34 per 100,000 in 2000.
6. Halt and reverse by 2015 the spread of HIV/AIDS, malaria, and other diseases.	In 1999, the worldwide prevalence rate of HIV/AIDS among adults aged 15–49 was 1.07 percent (WHO data).	In 1999, the prevalence rate of HIV/AIDS among adults aged 15–49 in Mexico was 0.3 percent. Among women aged 15–24, it was in the range of 0.05–0.08 percent. Among men aged 15–24, it was in the range of 0.33–0.48 percent (WHO data).
7. Ensure environmental sustainability. One indicator is access to an improved water source.	Worldwide, in 2000, approximately 80 percent of the population had access to water.	In Mexico, access to an improved water source increased from 83 percent of the population in 1990 to 86 percent in 2000 (WBG data).

17. Mexico's achievements in poverty reduction and development are, however, overshadowed by four persistent characteristics of the country's social map: (a) although reduced, absolute poverty numbers remain unacceptably high (some 45 million Mexicans are still poor); (b) there is sharp inequality in the distribution of income, which seems immune to the growth process and so far resilient to policy interventions (by current Gini measurements, Mexico's is the one of the most unequal economies in Latin America; see Table 4); (c) the incidence of extreme poverty in rural areas is abnormally acute (in 2000, almost one in every two Mexicans living in rural areas was extremely poor); and (d) there is a widening development gap between the southern region and the rest of Mexico (southerners are far poorer, less educated, less likely to have running water, and more likely to die younger). These characteristics gather additional urgency when seen in the light of the available employment opportunities for the poor—while formal unemployment has remained low, some 1 million new jobs are needed each year just to accommodate new entrants into the labor force (at the peak of its recent growth performance, the Mexican economy managed to create only about 600,000 such jobs).

Table 4. Inequality in Total Current Income (Gini Coefficient)

Year	National	Urban	Rural
1984	0.473	0.442	0.448
1989	0.519	0.498	0.444
1992	0.529	0.498	0.434
1994	0.534	0.508	0.419
1996	0.519	0.493	0.452
1998	0.543	0.511	0.480
2000	0.539	0.505	0.470

18. Both the achievements and the remaining challenges in reducing poverty and inequality (and creating jobs), point to a new agenda for Mexico's development—one that combines the effect of a solid macroeconomic framework and sustained growth with micro interventions by sector and region in order to bring the benefits of growth to all Mexicans. This comprehensive agenda, and the macro–micro links that it implies, can be organized around five challenges that are embedded in the country's 2001–06 National Development Plan—(a) consolidating the macroeconomic gains of recent years; (b) accelerating growth through competitiveness; (c) developing the stock of human capital; (d) balancing growth and poverty reduction with environmental protection; and (e) building an efficient, accountable, and transparent government.[6]

(a) Consolidating Macroeconomic Gains

19. Since the financial crisis of 1994, Mexico's macro framework has had three pillars: (a) a tight and fairly independent monetary policy, (b) a flexible foreign exchange regime, and (c) a conservative fiscal stance. This arrangement not only took the economy out of its crisis, but delivered a respectable rate of growth, single-digit inflation, a viable external balance, a comfortable debt position, and three investment-grade sovereign credit ratings, all despite four major international crises that dampened economic prospects worldwide (East Asia in 1997, Russia in 1998, Brazil in 1999, and Argentina in 2001). It thus seems sensible, over the coming years, to stay the course in macroeconomic policy, with one exception: fiscal management needs further strengthening.

20. The challenge of strengthening Mexico's fiscal and, thus, macroeconomic framework, involves policy efforts in several areas: (a) completing the tax reform initiated in December 2001 (whereby some major loopholes in the tax code were closed) and, equally important, improving the quality of tax administration; (b) establishing budget rules to stabilize revenues, reduce oil dependency, and avoid pro-cyclical fiscal policies (the country's oil revenue stabilization fund provides a good platform from which to design those rules); (c) addressing the public sector's implicit and contingent liabilities accumulated during past banking and transport sector rescues (by IPAB and FARAC), and currently building up through the deficits of various public housing

6. Mexico's National Development Plan 2001-06 is in fact a broad government agenda that covers areas that go beyond (although are not unrelated to) economic development. It presents three main objectives: (a) Social and Human Development (education, equity, collective initiative, harmony with the environment, confidence in public institutions); (b) Growth with Quality (macroeconomic management, competitiveness, inclusive development, regional development, sustainable development); and (c) Order and Respect (sovereignty, national security, democracy, federalism, population dynamics, corruption, public security, justice). See www.presidencia.gob.mx.

institutions and guarantees in infrastructure contracts (INFONAVIT, FOVISSSTE, PIDIREGAS), or latent in the actuarial imbalances of the federal and state public-employee pension systems (ISSSTE); and (d) ensuring, through hard-budget constraints, that Mexico's rapidly unfolding decentralization process remains fiscally sustainable, both for the federation and for the states (see below).

(b) Accelerating Growth Through Enhanced Competitiveness

21. In the past, Mexican governments sought to foster growth by bolstering aggregate domestic demand, the result of which were short-lived growth spurts brought to a halt by balance-of-payment crises. Today, with the country already integrated in and enjoying the benefits of the global economy, particularly in NAFTA, long-term growth acceleration will be sustainable only if achieved through an economywide enhancement in competitiveness. This needs to encompass both export-oriented firms (which in Mexico tend to be large formal corporations) and those catering for the domestic markets (which are usually smaller or informal). A large array of factors contribute to a country's competitiveness. This section focuses on the four challenges which, at present, could most add to Mexico's competitiveness: (a) enhancing the quality of its physical infrastructure, (b) broadening the reform of its financial sector, (c) raising the productivity of its agriculture, and (d) integrating middle-market and micro- and small enterprises into the "new" Mexican economy.

22. Despite major advances in creating an open and supportive environment for private businesses to operate in Mexico, the infrastructure sector has not fully benefited from the efficiency enhancing effect of private participation—an uncomfortable position for a country that is estimated to need additional infrastructure investments worth 2 percent of GDP per year over the next 10 years, and has limited public sector resources to pay for it. For example, the energy subsector (petroleum, natural gas, and electricity) still faces the challenges of structural reform, to unbundle activities, create strong and independent regulatory bodies, and establish a robust competition framework. The transport system is in a similar position. Although Mexico has enhanced the quality and efficiency of its airports and ports (mainly through private-sector-led competition), the quality of its road network is declining, reflecting years of inadequate maintenance and poorly designed private concessions.[7] From highways to secondary and rural roads, the upcoming challenge is to find contractual arrangements with private partners for federal and local governments that ensure both financial and physical sustainability. To improve export competitiveness, more attention is needed to facilitating multimodal transport and associated logistical improvements.

23. Sustainability is an even more immediate issue for the water and sanitation subsector, which faces a crisis in the near term. Weak pricing policies, payment enforcement and property rights, and unclear definition of responsibilities and varying institutional capacities across levels of government contribute to the problem. While aggregate figures of service coverage compare favorably to most other Latin American countries, one out of eight Mexicans (mostly poor) lack access to clean water, and one out of five lack sanitation service. The government is aware of the health risks associated with these deficiencies and has declared them a matter of national

7. An attempt in the last decade to expand the highway network via an aggressive toll road concessions program ended up in a highway sector crisis as a result of unrealistic demand assessments and faulty financial design, with many private concessionaires eventually having to be bailed out by the federal government under a special FARAC program.

security. As with other parts of the country's infrastructure, a sustainable solution to the water problems will call for private–public partnerships.

24. Private participation has also been limited in another critical component of Mexico's infrastructure—housing. The country has an estimated housing deficit of about 4.6 million housing units, a gap that is rapidly expanding as some 700,000 new families are formed each year. Meeting that pent-up demand will involve bringing private financiers to a market that has always been dominated by public financial institutions dispensing subsidies which, in turn, have been financed through social security contributions and payroll taxes. The government recognized the magnitude of the necessary reform, especially in transforming dispersed subsidies into means-tested, up-front, demand-side contributions, restructuring major public institutions (notably INFONAVIT, FOVI, and FOVISSTE), facilitating the development of primary and secondary housing finance markets, opening a new role for microfinance institutions for housing and home improvements, and coordinating the related federal level agencies (SEDESOL, Housing Commission, etc.) with each other and with state and municipal authorities. In the urban context, that coordination will also be critical to provide the housing market with a viable physical context—that is, with an integrated, metropolitan-area-based approach that combines basic urban infrastructure and services with effective land planning and titling, affordable urban transportation, and environmental preservation.

25. The second task implicit in the challenge of enhancing Mexico's competitiveness is to build a broad-based and efficient financial sector. The country has overcome the traumatic banking crisis of 1995; it has succeeded in establishing an adequately capitalized, competitive banking industry that operates within solid supervisory and regulatory parameters, that has received abundant foreign direct investment, and that enjoys a more conducive legal framework for loan recovery. While the crisis-driven assumption of bad loans and resolution of unviable banks has created a large, long-term debt for the government, asset recovery and debt management is being handled effectively (through the so-called IPAB). These are hoped to set the stage for a long-awaited recovery of domestic credit that contracted during the past six years. However, several areas of the financial sector beyond banks remain in need of reform. First, the mandates (and, thus, practices) of the public development banks will have to be adjusted to the new realities of the markets in which they have been operating (for example, BANOBRAS in the current, more fiscally decentralized and more market-driven framework for subnational borrowing) and to ensure that they complement, rather than compete with, private initiative (for example, BANRURAL's role in giving access to credit to the rural, unbanked poor).

26. Nonbank credit institutions, especially those serving the poor and populations in the rural areas, will likely play a more prominent role, calling for matching supervisory arrangements (for example, implementing recently passed legislation governing microcredit, saving and loans, and financial cooperative institutions). Third, while major progress has been achieved in giving private-sector workers adequate mechanisms for long-term saving, the reform of the public-employee pension systems (both federal and state) has not begun and, in some cases, will require a revision of the cross-funding arrangement that those systems operate (for example, financing health insurance or mortgages). Finally, Mexican capital markets remain largely untapped as a source of finance, notably long-term finance. Improvements in information disclosure, protection of minority shareholder rights, corporate governance, and the like are still under implementation. Further private sector participation is needed to broaden the institutional investor base and strengthen still nascent capital market infrastructure.

27. With adequate physical infrastructure and a more effective financial sector, Mexico will be well placed to tackle the third constraint to its competitiveness—the low productivity of its agriculture and the integration of its rural sector into the rest of the economy. This sector has, arguably, had the most drastic structural reforms over the last decade (GATT- and NAFTA-driven trade liberalization, elimination of price interventions, constitutional reform of land tenure), but the results have been disappointing (stagnating growth, lack of external competitiveness, increased rural poverty) in spite of much public support (PROCAMPO, PROCEDE, *Alianza para el Campo*, CONASUPO, ASERCA, among others). Past reforms have not resolved decades of structural limitations in the capacity of smallholders to access assets, to participate in better-functioning factor and goods markets (land, financial services, labor, warehousing, technology), and to add value in the marketing chain, all of which have severely constrained the contribution of the rural sector to the growth process. This presents a major policy challenge because the NAFTA agreement will put the sector in open competition with Canada and the United States as of 2008. The key will be to redesign and coordinate official support programs so that they promote diversification into higher-value crops or shifts into more productive on-farm and off-farm activities. The government is aware of these challenges and has already put in motion a number of initiatives: (a) it enacted a new Rural Development Law that provides the framework for future policy and institutional intervention in the sector; (b) it approved a Sector Development Plan that emphasizes competitiveness, on-farm and off-farm employment generation, promotion of rural enterprises, rural finance, and regional development; (c) it enacted the Capitalization Law that disconnects the PROCAMPO payments from planting and permits "cashing-out" the discounted value of the whole of those payments against viable investment projects; and (d) it is restructuring and decentralizing its support programs for enhanced integration and relevance.

28. Finally, the effort to enhance competitiveness will worsen income distribution if it leaves behind the mass of middle-market and micro- and small (mostly informal) enterprises that make up Mexico's "other economy" and that, by some estimates, may account for as much as three quarters of total employment. These homegrown enterprises represent a core of the Mexican private sector, and if left behind, could become an Achilles' heel for Mexico's long-term growth and poverty reduction. Improving investment climate for these enterprises is therefore critical. Indeed, proceeding with the comprehensive infrastructure and financial sector reforms described earlier, eliminating labor-related rigidities (see below) and, importantly, rationalizing and decentralizing the 200-odd federally funded, size-specific support programs are also essential to mitigate the tradeoff faced by the typical informal entrepreneur—to avoid regulatory costs by remaining small and informal ("under the regulator's radar") or to abide by the regulations in order to expand and reap economies of scale. The government has made a good start on this by launching an Enterprise Development and Competitiveness Plan for 2002–06—an overall strategy to foster the provision of microfinance including private sector initiatives, technological upgrading, and business development services.

(c) Human Capital Development

29. Over recent decades, Mexican governments have implemented several nationwide programs to reduce poverty. The record of those programs, especially earlier ones, is mixed and their sustainability is unproven. Yet, past efforts provide a solid platform from which to tackle the poverty and the inequality problems on a more permanent basis, not through open-ended

transfers but, rather, through human capital development. This encompasses reform challenges in education, health, social protection, labor markets, and in the group-specific needs of indigenous peoples, women, and the rural poor.

30. Mexico's education system continues to be the focus of many quality-improvement and outreach programs (Carrera Magisterial, PRODEI, PARE, Escuelas Comunitarias, PAREIB, Telesecundaria, among others). Many of these programs are achieving their objectives. Access to primary education is universal, secondary enrollment is high and continues to increase, and per capita educational expenditure has been expanded. This provides a good stepping stone from which to address a broader challenge in Mexico's public education—to bring the system to the next level of quality, a level compatible with the demands of a modernizing economy. The current teacher-centered teaching model, which effectively emphasizes memorization to the detriment of comprehension and was designed for the average student, has to be abandoned in favor of cooperative, student-driven learning by investigation, where the teacher is not the source of knowledge and the custodial controller of the students but, rather, the class facilitator.

31. That new teaching approach will require adjustment in the curriculum (which will have to put more weight on critical thinking and communication); in time-on-task (more time devoted to classroom teaching and less to classroom administration and mechanical repetitions—it is estimated that a Mexican primary school teacher spends less than half of the prescribed 810 classroom hours per year actually teaching); in the school environment (teachers will need to have more say about the type and amount of textbooks, material, and infrastructure that their individual classes get, and the government's near monopoly in textbook production will need to be eliminated to give room to creative competition); and, most critically, in the nature of the mechanisms for teacher and school accountability (supervisor and parent participation will have to focus less on process and more on actual results, as measured by published student scores in standardized national tests). In all these reforms, the teachers themselves (individually and collectively through their unions) and the states (which, as recipients of the education decentralization process, will need to be in charge of human resource management in the sector) will have to be included as partners. All this amounts to a change in the culture of Mexico's education system, a change that will take time but that can start during the current *sexenio*.

32. A change in culture is also the key to improving quality in the health sector. In the past, Mexico used centralized institutions and vertical programs to control infectious diseases and increase prevention and education. This brought about major first-generation successes—lower maternal and infant mortality, higher vaccination rates, and higher life expectancy. These and other factors have changed the country's epidemiological profile, and now chronic diseases and injuries are becoming the main causes of death and disability, new health threats are emerging (such as AIDS and pollution), and increasingly sophisticated consumers demand advanced—technology medicine. These second-generation issues call for a change in the government's role away from command-and-control and toward facilitating private provision, while ensuring universal access to an essential health package.

33. To fulfill its new role in the health sector, the government will need to put in place new institutional and financing arrangements and a different market structure for health services. The current public health institutions (SSA; IMSS; IMSS-Solidaridad; ISSSTE; the health services of PEMEX, the states, the Federal District, the police, the armed forces, and other parastatals) each finance and operate health systems with their own facilities and physicians. This raises costs and fails to pool risk. The fragmentation among public health institutions shelters them from private

competition and hampers efforts to set an adequate legal and regulatory framework for regulation of private health providers. It perpetuates the subsidization of supply rather than means-tested demand, and precludes the objective of universal coverage. Furthermore, the current industry structure makes it difficult to accommodate another institutional arrangement that is sweeping the provision of public health service—decentralization to state and municipal responsibility.

34. While education and health undoubtedly top Mexico's list of social investment needs, it remains a challenge to set up mechanisms able to protect that investment. The country's progress in social assistance and social insurance has been significant. Some of its social assistance programs are world models—notably OPORTUNIDADES (formerly known as PROGRESA), a direct income transfer arrangement for poor, rural women conditional on the use of selected education, health, and nutritional services by themselves and their children. The general direction in food-related programs (like Liconsa, Tortibono, Diconsa, and DIF Breakfast) has been the right one: means-testing has largely replaced universal subsidization, and program decentralization to the state and municipal level is proceeding. The same appears to be the case for income-generating interventions (PET, PROBECAT, Apoyos Productivos, among others). Yet, important gaps in social risk coverage still exist. The social security system covers only one in every five of the urban elderly population, and only 2 percent of the total poor. Critical social assistance tools (like preschool and ECD programs) have at best limited reach in rural, indigenous areas. And poor, urban, school-aged children too often drop out of both ends of the school system. In social insurance, the pension system and negative income tax regime have, by nature, benefited the formal, middle-class workers, and left out the informal, the poor, and the unemployed.

35. Even though building and protecting human capital is the key to reducing poverty, human capital does not by itself reduce poverty. The poor need to be able to earn income with that capital. The link between human capital formation and actual poverty reduction is provided by the labor market. It is therefore a serious concern that the legal and regulatory framework for Mexico's labor market is outdated (part of it dates back to 1917) and constitutes an impediment for workers, especially poor workers, in an increasingly globalized economy. The current system of severance payments; collective bargaining and industry-binding contracts (*contratos-ley*); obligatory union memberships (*cláusula de exclusión*); compulsory profit sharing; restrictions to temporary, fixed-term and apprenticeship contracts; requirements for seniority-based promotions; registration of firm-provided training programs; and liability for subcontractors' employees (*patrón indirecto*) do not benefit the employees. As a result, roughly one in every two Mexican workers remains in the informal labor market, about half of them against their will. It is also not surprising that NAFTA investors resent Mexican labor regulations and pass the cost on to workers through lower wages—those regulations impose a "tax wedge" worth 31 percent of payroll, compared with 12 and 19 percent in Canada and the United States, respectively.

36. Finally, the challenge of human capital formation is particularly difficult for three, overlapping social groups—women, indigenous populations, and the rural poor. Socially ascribed gender roles have placed women at a clear disadvantage in terms of both health (especially reproductive health), education, labor, and personal safety. Similarly, about 1 in 10 Mexicans defines himself or herself as indigenous and holds, and may respond to, a different set of economic values, whereby assets (especially land) are nontradable sources of group identity, community benefit is held in higher regard than individual profit maximization, traditional social

governance bodies are trusted over those dictated by the country's laws, social organization is based on prestige and civic duty, and the language of preference (and frequently the only language) is not Spanish. The recently passed Indigenous Rights Bill is an attempt, although a contested one, to recognize those differences. Correlated with that ethnicity, the incidence of extreme poverty in rural areas, especially in the *ejidos*, is disproportionately high—and persistent. Past reforms in the sector have not resolved decades of structural and cultural limitations on the capacity of poor farmers to access input and output markets. Nor have they addressed the heterogeneity of the rural sector and its regional variations. As a result the sector remains uncompetitive, segmented between farm and off-farm employment, and unable to capture the externalities of conglomeration between urban centers and rural areas.

(d) Balancing Growth and Poverty Reduction with Protecting the Environment

37. Mexico's economic growth has been predicated, in great part, on the mining of natural resources and, in the absence of a coherent approach to environmental protection, has contributed significantly to polluting the environment. Water, forests, biodiversity, and air quality are being depleted in order to foster growth, which "green" national accounting shows has cost the country some 10 percent of GDP per year. Such degradation has now become a binding constraint to Mexico's external competitiveness, and to its ability to access new markets, attract foreign investments, and further develop its tourism industry. As a member of NAFTA, WTO, and the OECD, the country is compelled to enhance its environmental standards and compliance mechanisms. There is growing international awareness that exports based on polluting production carry negative global externalities and constitute an unfair competitive advantage. Moreover, the deterioration of the environment is already becoming a physical impediment to production. For example, the depletion of aquifers (100 of Mexico's 257 aquifers are being overexploited) is a direct impediment to industrial activity in the northern states, where most of Mexico's economic dynamism is located. In other words, at the current rate of environmental degradation, growth and, hence, poverty reduction, are no longer sustainable.

38. Yet, the relationship among poverty and environmental degradation presents the characteristic of a vicious circle—in many rural areas, depleting natural resources appears to be the only way for the poor to survive because they lack access to markets, public services, infrastructure, and, plainly, better alternatives. This calls for a revision of existing development programs and incentive structures, whereby pricing policies and subsidies (in water, energy, agriculture) that claim to assist the poor, actually convey perverse signals and induce overuse, misallocation, and waste of environmental assets. Thus, unless the implicit short-term tradeoffs between social protection and environmental protection are addressed, environmental programs are likely to fail.

39. Environmental management in Mexico also entails difficult institutional challenges. First, the definition of property rights over natural resources, both on individual and community bases, remains incomplete, as does the enforcement of those rights and the ensuing protection responsibilities (especially in a large country like Mexico, where enforcement must also rely on market-driven instruments, social communal control, public disclosure programs, and voluntary compliance). Second, decentralization of environmental management (a very desirable arrangement for a function so dependent on local knowledge) is now under way but faces uneven institutional capacities across states and municipalities and weak fiscal incentives for those subnationals to tax polluters and recover the cost of environmental usage (one clear example is

water management where further decentralization at the watershed level would be warranted). Finally, mainstreaming the environment through sector policies and programs has remained an elusive objective of the federal government; the Environmental Ministry has suffered in the past from its sectoral confinement but is now taking steps to obtain commitments from sectoral ministries (Agriculture, Energy, Infrastructure) toward the achievement of environmental objectives.

(e) Building an Efficient, Accountable, and Transparent Government

40. The challenge of putting the Mexican economy on a sustainable, rapid, poverty-reducing, environmentally-balanced growth path will tax the government's capacities, and calls for their enhancement. Improving the quality of government (understood to be a more effective, more efficient, and more transparent body of providers of public goods) is, however, a multifaceted, multiyear task the full completion of which will likely span into the long-term. It will therefore be imperative to focus on four critical areas where the marginal returns in terms of quality improvement are highest—decentralization, the judicial system, anticorruption, and civil society organizations.

41. As mentioned, decentralization in Mexico is already under way and progressing rapidly. It has tremendous potential for improving the quality of government services by bringing policymakers and final beneficiaries closer together. It can rightly change the role of the federal government away from pursuing those results that the subnational governments can achieve on their own, and toward capturing nationwide externalities. But ill-conceived or poorly implemented decentralization also has the potential to be a destabilizing factor for service delivery and public finances at all levels and, ultimately, for the country's macroeconomic performance. The Mexican government has thus sought to avoid these dangers by imposing hard budget constraints on states and municipalities (through, among other things, renouncing its own powers to hand out discretionary transfers, establishing a regulatory link between credit access and credit ratings, and assisting those states that seek adjustment—for example, *Estado de Mexico*). However, in the medium term, subnational fiscal discipline will have to be supplemented with a framework more conducive to decentralization, something that entails reform in the tax-sharing system (or "Fiscal Pact"), a clearer assignment of expenditure responsibilities (and for policymaking around those expenditures), and better reporting and coordination among levels of government.[8]

42. The judicial system is the second governance front where the payoffs of reform will be particularly high for improving the overall quality of the government function (and simultaneously, of the business environment for private-sector-led growth). Although currently void of comprehensive and systematic evaluations, this is an area where consensus seems to exist on the broad diagnosis—the system provides services in insufficient quantity and of poor quality, is not free of corruption, and is not equally accessible to the nonaffluent. The cause of such

8. It is important to note that the devolution of taxes and the assignment of expenditure responsibilities are much more than technical matters, because they will define the type of federal nation Mexico wants to be. For example, the amendment of the Fiscal Pact to devolve taxes will call for a parallel amendment of the transfer formulas which, in effect, currently carry resources from richer to poorer states and smooth development disparities across regions. Similarly, full decentralization of expenditure responsibilities may or may not be conditional on minimum standards of achievement (say, in education) meant to ensure a certain level of national homogeneity.

weak performance, and the reform challenge, is a combination of outdated substantive and procedural laws (including those that allow for recourse at higher levels of government or *amparos*), overlapping federal–state jurisdictions, inadequate administrative structures and processes, inadequate human resource management, and underfunding. Although Mexico is quickly advancing toward judicial and electoral independence from political powers (at the federal and state level), it will need further development of alternative dispute resolution mechanisms for efficiency and participation purposes.

43. Third, improvement in the quality of Mexico's government function will undoubtedly involve the strengthening of anticorruption mechanisms. While systematic diagnosis and documentation of the problem is recent and incomplete, available indications and surveys suggest that there is a pent-up demand for transparency. The federal government is responding with agency-based anticorruption strategies that often involve private sector support and client participation. Addressing the corruption problem will, however, be difficult and will take time. It will thus be critical to focus first on key incentive-setting institutions: (a) SECODAM and the *Contaduría Mayor de Hacienda* (the government's internal and external auditors, respectively), and core federal agencies to reduce corruption opportunities; (b) a career civil service must be established, where promotion and compensation are market competitive and performance based and where official information (records, accounts, decisions) is kept confidential only by specified exception; and (c) several societal institutions will require specific support, notably, the judicial system (addressed above), the police (to break the link between crime and corruption), and the media (the role of which in the new, more open Mexico is likely to expand, testing the strength of the legal protection framework for its operation). In addition to setting up a conducive framework, the implementation of the federal government's Integrated Financial Management System (SIAFF) remains incomplete (instituting legislation, inter-agency harmonization, and training are still required for the SIAFF to be fully operative).

44. Finally, civil society organizations (CSOs) will play a critical role in enhancing government quality, as partners in the design of development policy and as a means for public accountability during implementation. Mexico has a long and evolving tradition of social organization—from small, voluntary, and philanthropic foundations dealing with localized issues to professional, technically-competent entities influencing public policy in trade, democracy, human rights, anticorruption, environment, and women's rights. The new administration has taken positive steps to foster CSO participation. *Alianza Ciudadana*, a national office for public–private partnerships and reporting directly to the President, was inaugurated. CSOs have been regularly invited to debate specific issues of national relevance. Several line ministries have engaged CSOs around sectoral strategies and programs (notably, SEDESOL's *Consejos de Consulta Ciudadana* in social assistance, SAGARPA's *Consejos Regionales de Desarrollo Sustentable* in regional development, and INI's *Fondos Regionales* for indigenous peoples). And several respected civil-society leaders were appointed to new posts within the government. Yet, despite that significant progress, the environment in which CSOs operate remains a constraining one: the legal and fiscal framework does not facilitate their emergence; their institutional capacity to engage in policy debate and seize new opportunities to participate (for example, in public expenditure monitoring) is uneven; inter-CSO coordination is weak (especially, between highly-representative but often isolated community-based organizations and technical organizations with access to decisionmakers); and they face a persistent (although at present declining) culture of exclusion in parts of the public sector.

IV. THE WORLD BANK GROUP'S ASSISTANCE STRATEGY

(a) The Lessons of the Previous CAS

45. The fiscal 1999–2002 CAS period was driven by the theme of "sustainability," both economic and social. The uncertainties of the then-upcoming presidential elections, and the preceding record of end-of-*sexenio* crises, called for flexibility in the design of the assistance program. There lies the first lesson of the now-closing CAS: when properly used and with clear selection criteria, flexibility works. The WBG was able to support macroeconomic and financial sector sustainability through adjustment operations for which political consensus around the necessary reforms existed (as in the decentralization and banking areas); to refrain from others where such consensus was lacking (as in fiscal reform, for which the WBG focused on diagnosis and analysis); and to seize opportunities for intervention in key development sectors as they presented themselves (as with the Gender LIL). These and similar efforts were carried out within a predefined financing envelope that respected cautious exposure limits.

46. The second lesson from the previous CAS is the high value of good analytical work, independent of the likelihood of immediate actual reforms. In Mexico, investment in country knowledge tends to have large returns but long "payback" periods. The "seed" value of ideas is particularly high. Thus, when the issue is important for development, the WBG must assist in understanding it, preparing suitable policy responses, and using its unbiased observer role to foster consensus among stakeholders. This conceptual readiness positions the institution well to respond at short notice—for example, the WBG's support to the recently approved reforms in the fiscal code started a year earlier with the Fiscal Reform CEM. Similar advanced investments in knowledge will be made in the coming years—in areas like judicial systems, anticorruption mechanisms, labor legislation, and public development banks.

47. Third, tailoring assistance to the level of government effectively responsible for policies and programs pays off. Following the deepening of the political decentralization process in Mexico during this CAS period, the WBG put heavier strategic emphasis on working with municipal and state governments, both in investment (for example, DRD III) and adjustment (for example, *Estado de Mexico SAL*) operations, and in analytical work (for example, Public Expenditure Reviews in Guanajuato and Veracruz). This will help the WBG adapt its future assistance to the deepening federal nature of its Mexican client.

48. Fourth, for most Mexican counterparts, technical quality is what makes IBRD's intellectual and project assistance attractive, not its advantageous financial terms (although these terms remain attractive for the financial authorities). In Mexico, IBRD loans are not additional to the budgets of the implementing sectoral ministries (their individual allocations are determined in the federation's budget independently of how they are funded). In spite of this *nonadditionality*, which is very likely to remain in future operations with the federal government, the authorities still see IBRD participation as a catalyst for best practices in design, support in implementation and, critically, market credibility through the commitment of resources by an independent party.

49. Fifth, IBRD, through policy dialogue, knowledge management, and advisory services, has been widely acknowledged to have substantially contributed to a smooth process of transition between presidential administrations. The production, discussion, and publication of the comprehensive collection of policy notes (some 30 sectoral notes, five thematic notes, and an

overall strategy-setting synthesis) proved to be an instrumental input for the incoming government, because they distilled the sector-by-sector observations that the Bank accumulated during more than five decades of relationship with the country, provided diagnostic analyses of the main issues, and put forward policy options to resolve them. This gave an early *tour d'horizon* to the new authorities, helped them set priorities.

50. Sixth, effective assistance strategy requires a balance between interventions that foster growth within a sound macroeconomic framework and those that pursue microeconomic objectives necessary for sectoral efficiency. Over the CAS period that now closes, the IBRD support carried that balance, delivering both broad, rules-establishing operations (for example, the Decentralization Adjustment Loan) and investment projects that enhanced the quality of specific sectoral expenditures (for example, Education APL). This combination of mutually reinforcing, macro and micro priorities will remain in the upcoming CAS cycle.

51. Seventh, as with the previous CAS, recurrent evidence cautions against overreliance on quantitative, time-bound benchmarks when designing strategy. The large array of factors outside the WBG's (and, sometimes, the government's) control lessen the value of those benchmarks—some outcomes were obtained even without the predicted policy action taking place (for example, large foreign investment in the banking industry without reform of the judicial system), while others were missed even though that action took place (for example, slow growth in 2001 despite a sound macroeconomic policy mix).

52. Eighth, as for IFC, a major lesson of the past years in Mexico and other countries is that the Corporation is coming under increased pressure to balance its multiple objectives of profitability, efficiency, and outreach, as it seeks to serve smaller (and often riskier) companies and pioneer (often more complex) projects. In Mexico, IFC has so far been able to maintain a good balance with the combination of large, medium, and small clients, intervention through financial intermediaries, and targeted small projects with high probability of success.

53. Finally, a 10-year retrospective Country Assistance Evaluation was completed in 2000, covering only partially the now-closing CAS period. It points to a varying degree of effectiveness and relevance over the different CAS cycles, and emphasizes the role of government ownership in guiding the WBG's assistance (see Box 1).

Box 1. Country Assistance Evaluation

The WBG assistance program to Mexico during fiscal 1989–2000 was reviewed by OED, and the report, Mexico–Country Assistance Evaluation, has been discussed at the CODE. The report found that the WBG's assistance program was adequately adapted to the country's rapidly changing developmental challenges and noted that the Mexico operations of the period received more favorable OED ex post evaluations for outcome, likely sustainability, and institutional development impact than other operations in the region and Bankwide. Still, the report concluded that the effectiveness of the program varied over time and should be, overall, considered as partially satisfactory. ESW was considered marginally effective, partly because Mexican officials under the previous governments did not want to accept outside intellectual influence, or at least did not acknowledge it.

The CAE found that the Bank had positive impact in primary education and health services, the transport sector, and in reforms in contractual savings. It also found that there were significant lapses in the Bank's effective engagement in the financial sector during FY92-94 and on environmental issues in FY96-99. Also, the CAE stated that Bank lending had the most impact at times of crisis, when Mexico's access to capital markets was curtailed. The CAE stressed that the Bank's experience since FY89 showed that, due primarily to the quality of human capital available to the Government and changing nature of the country's development tasks, it was increasingly challenging for the Bank to have non-financial value added in Mexico.

During the most recent period of evaluation, fiscal 1997–2000, the report concluded that the WBG's assistance program was relevant but too ambitious, relative to which the results were partially satisfactory. The ambitiousness of the 1996 CAS program led the government to expect high levels of new commitments and disbursements that were not fully met due to lack of policy progress and a tighter-than-expected fiscal stance, creating a shortage of counterpart funding.

For the most part, the program in the 1999 CAS was not yet at a stage to be considered in the report.

(b) The Lessons of IBRD's Portfolio

54. Mexico's portfolio performance remains satisfactory with only two projects rated unsatisfactory (3.7 percent of commitments), as of March 14, 2002. The Bank's portfolio in Mexico includes 28 active projects, including six GEF/MP projects, with about US$5.3 billion in net commitments and an undisbursed balance of around US$2.8 billion. The year-to-date disbursement ratio for investment loans was 6 percent. Proactivity and realism indexes for the portfolio are both at 100 percent. Financial management and procurement performance has been impeccable (see Box 2).

Box 2. Procurement and Financial Management in Mexico's Portfolio

The Country Procurement Assessment Review (forthcoming April 2002) concluded that procurement in IBRD projects was satisfactory and free of major problems, because the agencies responsible for project implementation carry out procurement in accordance with WBG policies and procedures, using its standard bidding documents. Two procurement audits and 10 agency procurement capacity assessments carried out in the past two years found no major issues. In April 2002, the government, together with IBRD, OAS, and NGOs, sponsored an International Conference, *México Unido Frente a la Corrupción*, at which the Plan of Actions put forward in the CPAR was discussed.

The CPAR states that Mexico needs to: revise the current public Procurement Laws to differentiate procurement of goods and services from selection of consultants in order to obtain better designs and advice; standardize bidding documents among its 3,000 agencies to avoid arbitrary specifications or conditions; create a procurement career track to ensure availability of qualified staff; and fully implement the rule of calling for bids only when final designs are completed.

The first Country Financial and Accountability Assessment (CFAA) will be completed within fiscal 2002, and on-demand subnational level assessments are scheduled as of fiscal 2003. For all IBRD projects, annual audit reports have been reviewed and considered acceptable. Most of them have been received on a timely basis. Misuse of funds has not occurred in any IBRD project in Mexico. The use of COMPRANET, the federal government's innovative system for electronic bidding, was successfully piloted in an IBRD project and will be expanded. The presence of a senior financial management and procurement team in IBRD's Mexico Office has proven instrumental in these achievements.

Despite these satisfactory developments, the government's information systems do not yet have classifications that are sufficiently detailed and harmonized. IBRD continues to work on procurement and financial management with its Mexican client as part of the government's anticorruption strategy and promotion of access to information. All new investment projects are required to have a Financial Management Specialist as a member of the task team throughout the project cycle, to carry out a financial management assessment at entry, and to establish adequate mechanisms for constant monitoring.

55. Over the last CAS period that now concludes, a number of general observations can be made about those projects that performed less well than others (see Box 3). First, some projects have been affected by broad changes in the political and legislative environments. Implementation was slowed down by the transition of administrations both before and after the July 2000 presidential election, especially in terms of delayed project signing and effectiveness. Similarly, an accelerated devolution of budget and execution authority from the federal to state

governments has necessitated a time-consuming reorientation of several projects that were originally designed for the federal level.

56. Second, the previously mentioned nonadditionality of IBRD project funding has made sectoral ministries increasingly reluctant to give budget priority to implementing Bank-financed programs, which must compete with others while being handicapped by stricter fiduciary and safeguard requirements (this is especially true of the infrastructure sectors). This underscores the continuous need for superior quality in IBRD's technical inputs, both at the stage of project design and during implementation.

57. Third, in a handful of high-risk-high-reward cases, IBRD-financed operations have been buffeted by volatile policy and political debates (for example, housing finance). This riskiness, which sometimes was a delaying factor, is also a healthy feature of IBRD's portfolio, as the institution seeks to explore new avenues for civil participation that can give sustainability to the government's reform efforts.

58. Finally, as already noted in the May 1999 CAS, decentralization of IBRD's Country Department to the field, particularly in the fiduciary area, has resulted in faster response times and better results on the ground. Mexico-based staff are now taking on an expanding share of task management, enabling the Bank to respond to the client in a more timely manner and, in some sectors, to open up new lines of cooperation—for example, anticorruption programs with SECODAM and rapprochement with subnational governments. While there is no hard evidence of cost savings out of the Department's decentralization process, those costs have not increased either—while client service has improved.

Box 3. What Went Well and Not So Well in This CAS Cycle

IBRD-supported programs have had both successes and failures over the last four years. Here are some examples of both.

The lack of progress in the transport sector, evidenced by a long delay in the signing and effectiveness of the Federal Highway Maintenance loan and the long gestation of the Highway Finance SECAL, not only reflects Bankwide trends, but is especially emblematic of the nonadditionality conundrum in Mexico. In those sectors where the Bank's technical contribution does not substantially outweigh the cost of its procedural, fiduciary, and safeguard requirements, assistance opportunities will remain limited.

The decentralization agenda (that is, working with subnational governments) has generally had positive results, although advances have been uneven. A major achievement is the work done under the *Estado de México* SAL in fiscal 2000, the first-ever adjustment operation with a Mexican state. The loan, and the multisectoral policy package it supported, helped the state redress its fiscal imbalances in the context of a comprehensive, cross-sectoral adjustment program—something that both became a model for other states and, critically, protected the national macroeconomic framework over the presidential transition. This followed on the heels of the Decentralization Adjustment Loan (fiscal 1999) which had helped consolidate the federal framework for subnational fiscal autonomy and creditworthiness. The necessary complement of state-level or city-based poverty-focused investment programs, especially in infrastructure, is still in process for a number of reasons: (a) lingering political transition uncertainties at several levels of government, (b) lack of a solid financial intermediation channel (BANOBRAS has been undergoing internal structural changes over the last few years and is still redefining its mandate); (c) IBRD is only starting to develop knowledge about the institutional capacity of this new set of clients (PERs were completed recently for Guanajuato and Veracruz, and assessments of the fiduciary and safeguard systems in a few selected states are in their early stages); and (d) the modality of the Bank's financial relationship with the states had to undergo (and successfully underwent) a thorough legal review to give confidence that it meets Constitutional provisions. Those delaying factors were, in effect, startup investments, as they have now solidly set the stage for an expansion of IBRD support to subnational entities.

Finally, the IBRD's engagement in the human development sectors continues to be successful. At the request of the government, the Bank's technical involvement and financing role in health and education were stepped up significantly during the CAS cycle that now concludes. More generally, IBRD's program has had great success in the unprecedented level of dialogue and cooperation surrounding its analytical work, where the Bank has come to be perceived as a trusted advisor. (A notable example has been the publication of *Mexico—A Comprehensive Development Agenda for the New Era*, the collection of transition notes whose dissemination included a large number of Mexican states, plus the United States and Europe.)

(c) The Lessons of IFC's Portfolio

59. As per the CAS Private Sector Strategy cycle that now closes, IFC's activity in Mexico has followed three priorities: (a) assisting the Mexican private sector in gaining greater and more evenly distributed access to external private financing; (b) improving the efficiency of domestic financial intermediation and mobilizing domestic resources; and (c) helping private firms grow and enhance their international competitiveness. These have translated into IFC's sectoral focus on financial sector development, support for middle-market firms, private infrastructure, and the social sectors. In addition, sustainable development, an area that had not been explicitly identified for IFC in the previous CAS, has received increased emphasis. More specifically, from fiscal 1999 to date, IFC approved operations totaling US$907 million, including syndications of US$301 million, for 27 projects, of which 10 were in general manufacturing and services (middle-market firms), 8 were in the financial sector, 5 in infrastructure, 2 in health and education, and 2 in environmental sustainability. IFC has also continued to expand into new, high-impact areas. This is reflected in project approvals in such areas as hospitals and primary schools (fiscal 2000), a private railway project in Chiapas (fiscal 2000), housing finance (fiscal 2001), microfinance (fiscal 2001), cleaner fuel (compressed natural gas) for automotives (fiscal 2001), and sustainable forestry products (fiscal 2002).

60. Mexico has IFC's third-largest exposure, representing 7.4 percent of IFC's total disbursed portfolio (net of specific reserves). As of February 28, 2002, IFC's disbursed and outstanding portfolio in Mexico consisted of investments in 47 companies, with total exposure of US$708 million for IFC's own account and US$422 million for participants. IFC's investments in Mexico cover a broad range of sectors. On a volume basis, the financial sector, infrastructure (utilities and transportation), chemicals, food and agribusiness, and general manufacturing and services are the sectors with the highest level of IFC investment. The financial sector (30 percent) and infrastructure (21 percent) have received the largest shares of investments, reflecting IFC's strategic priorities in these sectors.

61. Overall, IFC's portfolio in Mexico is of high quality and has managed to withstand economic cycles. As of February 28, 2002, only 0.6 percent of IFC's loan portfolio was in nonaccrual status, ranking among the best in the Corporation. This stellar performance was attributable to Mexico's flexible macroeconomic management and increased private sector resilience (honed through the liberalization process since the early 1990s), and to IFC's project selection, emphasis on due diligence, and early involvement in project structuring. IFC's strategic emphasis during the previous CAS period on frontier (or riskier) types of projects and sectors, such as the social sector, middle-market firms, subnational infrastructure, and microfinance, has not to date affected the aggregate quality of the Mexico portfolio. With the economic slowdown in 2001, declining capital flows to developing countries, and stress on IFC's global portfolio, maintaining the quality of new projects at entry, and of portfolios of Mexico's size, is expected to become increasingly important for IFC's strategy implementation and overall

performance. (See Box 4 for a discussion of the linkages between the private sector strategy and IBRD–IFC assistance to Mexico.)

Box 4. Private Sector Strategy: Linkages in IBRD–IFC Assistance to Mexico

Mexico, with three consecutive CASs with a private sector strategy, represents a primary example of an integrated WBG approach to PSD. Over the three CAS periods, the WBG's PSD strategy has become more coherent, with its activity progressively integrated between the IBRD and the IFC, as the following examples indicate (more details of the WBG's approach to PSD in Mexico are provided in the Private Sector Strategy presented in Annex B10):

- *The financial sector*. The IBRD's assistance in enhancing the regulatory and supervisory environment and the strengthening of the banking sector and the financial sector infrastructure would help set the stage for the IFC's increased involvement in direct and indirect assistance to viable Mexican financial intermediaries, including capital market institutions. The IBRD's assistance in urban development and housing would also be complemented with the IFC's assistance in developing housing finance institutions and mortgage markets.
- *Infrastructure*. A number of subsectors where the IBRD's assistance helped improve the regulatory framework have provided increasing opportunities for the IFC's sequential involvement in helping structure and mobilize a financial package for pioneering private infrastructure projects. This synergy is expected to continue in the areas that could be further liberalized, such as water and energy.
- *SMEs*. IBRD's nonlending services in SME development would benefit from the IFC's complementary experiences with impediments to private sector development generally, and with SMEs in particular. This IBRD activity would in turn support the IFC's increasing focus on assisting SMEs and middle-market companies through financial intermediaries.
- *Health and education*. IBRD's assistance in reforming and improving the public services in this area would continue to be supplemented by the IFC's support for private service providers, helping enhance public–private complementarities.

(d) The Role of the WBG in Mexico's New Era

62. As described earlier, Mexico faces formidable development challenges—consolidating its macroeconomic framework, enhancing its competitiveness, developing its human capital, protecting its environment, improving the quality of its government. The country is, however, in an enviable position from which to meet those challenges given that it is a middle-income nation with a relatively sophisticated institutional capacity, membership in the OECD and WTO, access to international financial markets, and a free-trade agreement with the largest economy in the world (NAFTA). Mexico is an investment-grade sovereign borrower, has an annual GNP per capita of US$5,080,[9] already meets several of the Millennium development goals, and boasts several private conglomerates that are global leaders in their field. Its political system is stable and representative, and its most recent presidential election was an example of participatory democracy and smooth transition.

63. Against this background, it is natural to ask: What is the value added of the WBG for Mexico in the new era? Or, in other words, should the country "graduate"? Mexico should indeed seek graduation, but along a gradual path and as a long-term objective. Within the three years covered in this CAS, the WBG should maintain, and where necessary enhance, its engagement in Mexico, in both an intellectual and financial capacity. There are several reasons

9. World Bank Atlas methodology. Datum is for the year 2000.

behind this view, which represents the expressed desire of the Mexican government and the broad message of the civil-society consultation process underpinning this CAS.

64. First, as mentioned, there are still some 45 million Mexicans living in poverty. And the country's average income indicators disguise deep disparities—between the 10 percent of the population that accrues more than 40 percent of the income and the rest of the Mexicans that do not, between urban and rural areas, north and south, large outward-looking corporations and small domestically-oriented entrepreneurs, indigenous and nonindigenous people, men and women. The WBG will respond to the authorities' request and employ its analytical and financial resources as a contribution to closing those development gaps.

65. Second, growth will be a necessary (although not sufficient) condition for poverty and inequality reduction. In turn, achieving higher, long-term growth in Mexico calls for the implementation of a large, pending reform agenda by the federal government in areas such as labor, energy, the financial sector, fiscal federalism, and water. It has been the lesson from past CASs in Mexico, and the recommendation of the recent Bankwide Task Force on Middle-Income Countries,[10] that the WBG's analytical and financial support, together, can prove instrumental for governments that are committed to such reforms and have the political will to see them through. On the one hand, the WBG technical assistance effectively transfers international best practices that enhance the quality of the reforms. On the other hand, by committing its own resources through investment or policy-based operations, the WBG lends critical market credibility to the reforms in question and facilitates further private sector financing. This is the essence of the "growth rationale" for WBG intervention: WBG funding is not necessarily linked to balance-of-payments or fiscal gaps; rather, it is a catalyst because it seeks to ensure that the growth process is credibly sustainable and, thus, the country is creditworthy, so private sources can fill those gaps. Recent examples of this in Mexico are the Banking Restructuring Facility Loans I and II, the Decentralization Adjustment Loan, the forthcoming Tax Rationalization and Environmental SALs, and IFC's intervention in private sector projects.

66. Third, the rapidly unfolding process of decentralization has changed the nature of the policymaker in Mexico. In most of the key development areas (education, health, business environment, natural resource management, just to name a few), the federal government no longer decides policy unilaterally. State governments now have primary or shared responsibility for legal, regulatory, and institutional frameworks (and, certainly, for the implementation of programs). Increasingly, the federation has or should have a subsidiary role—focusing on interventions with externalities at the national level. For those states taking on new tasks, the continuing presence of the WBG is particularly critical. Not only do they face a large agenda of first-generation reforms (like setting up effective payment enforcement mechanisms for public services), but they also generally have limied technical expertise and have access only to domestic financial markets.[11] Moreover, the WBG often helps catalyze federal–state

10. World Bank. 2001. *Report of the Task Force on the World Bank Group and the Middle-Income Countries.* Washington, D.C.

11. Mexican states are constitutionally forbidden from entering into debt contracts with foreign lenders or in foreign currency. To facilitate subnational financing, in 1939 the federation created a development bank (BANOBRAS) primarily to channel funding from the official multilateral and bilateral donors to states and municipalities. The WBG, and other donor agencies like IDB, have over the years funded subnationals through

coordination. While the WBG has worked with Mexican states and municipalities for decades, it has since 1999 supported the country's decentralization process with enhanced strategic emphasis on state-level analytical and financial interventions, with encouraging results (for example, the *Estado de Mexico* SAL).[12]

67. Fourth, the presidential election of 2000 and the additional impetus it gave to the process of federalism has opened a unique window of opportunity to address long-awaited and much-needed reforms at the federal and state levels. The next three years will be crucial in seizing that opportunity. This makes it desirable to use the full capacity of the WBG's instruments. In terms of IBRD lending, this will mean respecting a prudent exposure "cushion" while deploying the feasible financing envelope as the implementation of the pending reform agenda allows.[13]

68. Finally, because of the size of its economy and its prominence among emerging-market borrowers, Mexico's development process carries regional and global externalities. These externalities can directly affect poverty counts elsewhere as the effect of the 1995 Tequila Crisis demonstrated—particularly in this era of heightened risk perception over, and reduced capital flows to, emerging markets in general.

(e) The WBG Strategy, Program Selectivity, and Partnership Over the Next Three Years

69. Poverty reduction will remain the overarching and ultimate objective of the CAS . The lessons of the previous CASs and the critical role that the WBG can play in seizing the poverty-reduction opportunities available in today's Mexico suggest that the optimal strategic path over the next three years is one of continuing, close involvement, and where gross financial flows are used to support reforms that address the main development challenges the country faces. Those flows will fit within an overall IBRD lending envelope of US$5 billion over fiscal 2003–05 (half of which in fast-disbursing operations), evenly distributed across years. This strategy will place the country and the WBG in a flexible position from which to define a new assistance plan three years from now.

70. More specifically, the WBG's strategy will be based on five pillars: (a) macroeconomic stability; (b) competitiveness; (c) human capital development; (d) environmental sustainability;

BANOBRAS with sector-specific investment operations and, more recently, with policy-based adjustment lending.

12. Given the relevance of the *Estado de México* SAL as a source of not only demonstration effect for other Mexican states but also of lessons in subnational adjustment operations valid for other countries, the WBG will respond to a request by *Estado de México* authorities and publish a book distilling that experience.

13. An argument can be made in favor of holding back new IBRD lending commitments in order to create even more "room to maneuver" in case Mexico runs into an external financing crisis. That argument should, however, be weighed against several factors. First, IBRD's yearly gross commitments amount to some US$1.7 billion, while Mexico's average gross annual financing needs exceed US$60 billion; in other words, even if IBRD refrained completely from lending to Mexico over the next five years, it would still not have enough lending room to effectively fund the country through a close-down of access to international financial markets. Second, with Mexico among emerging market borrowers with ample access to external financing (and one of the very few with sovereign investment grades), only an international financial crisis of massive proportions and long duration could close down that access; such a situation would likely call for a complete reconsideration of the country assistance strategy, rather than a relative small increase in lending. Finally, and more fundamentally, Mexico today faces a historic opportunity of reform, one that has not presented itself in the last 70 years. Letting that opportunity slip away could be the cost of holding back IBRD assistance and overcushioning IBRD exposure.

and (c) good governance. For each pillar, a program of sectoral interventions—intellectual and financial—is proposed. In all cases, IBRD will heed the experiences of the now-concluding CAS and, thus, will invest heavily in early analytical contributions, work with all levels of government (federal, state and municipal), and preserve a balance between macro- and micro-oriented activities in its work program.

71. As explained in Section III, the five pillars which conceptually underpin Mexico's National Development Plan 2001-2006 are mutually reinforcing, and hence, equally essential for sustainable poverty reduction. The WBG fully supports the Government's comprehensive approach to development and stands ready to work in each of the priority areas defined by Government. However, within the Government's priorities, specific areas for WBG involvement have been selected in accordance with a number of strict criteria as follows. The overarching criterion is the likely poverty-reduction impact of a given WBG intervention, albeit recognizing that such impact is not always direct, quantifiable, or immediate. Nor are the impacts exogenous to each other—the poverty-reducing effect of, say, rural finance reform is much enhanced by the existence of an efficient judicial system. In this context and based on the country's circumstances, the CAS program contains interventions within each sector that will: (a) contribute most to the poverty reducing objectives of sectoral strategies; (b) have the most "spill-over" effects to other sectors of WBG involvement; (c) enjoy a high degree of "ownership" among relevant stakeholders; and (d) best exploit the WBG's comparative advantages, taking into account the planned activities of the full range of other domestic and international development partners (see Table 5).

Table 5. Partnerships in Mexico's Development Framework

Development Challenges	Macro economic Stability	Accelerating growth through enhanced Competitiveness				Human Capital Development		Environment	Good governance		
Partner/ Activity	Macroeconomic management/Fiscal Strengthening	Infrastructure	Financial sector	Rural Development	SME development	Education/Health	Social protection	Environmental management	Decentralization	Judicial System	Anti-corruption/Role civil society in government accountablity
Government	High Focus	High Focus	Significant Focus	Significant Focus	Significant Focus	High Focus	High Focus	Significant Focus	Significant Focus	Significant Focus	High Focus
IMF	High Focus	Little Focus	Some Focus	Little Focus	Little Focus	Little Focus	Little Focus	Little Focus	Some Focus	Little Focus	Little Focus
IDB	Little Focus	Significant Focus	Some Focus	Some Focus	High Focus	Significant Focus	High Focus	Some Focus	Significant Focus	Some Focus	Some Focus
World Bank (IBRD)	Significant Focus	Some Focus	Some Focus	Significant Focus	Some Focus	High Focus	Some Focus	Significant Focus	High Focus	Significant Focus	Significant Focus
IFC	Little Focus	High Focus	High Focus	Some Focus	High Focus	Significant Focus	Little Focus	Some Focus	Little Focus	Little Focus	Little Focus
private sector	Little Focus	Significant Focus	High Focus	Some Focus	High Focus	Some Focus	Little Focus	Some Focus	Little Focus	Some Focus	Some Focus
civil society	Little Focus	Little Focus	Little Focus	Significant Focus	Some Focus	Some Focus	Some Focus	High Focus	Some Focus	Significant Focus	High Focus

Little Focus Some Focus Significant Focus High Focus

72. As the preceding suggests, the WBG's assistance will be closely coordinated with that of other key external agencies supporting Mexico. For example, while the WBG will play an important role in supporting some aspects of macroeconomic management (like tax administration), it will only play an observer role in others (like monetary policy, to be primarily supported by the IMF). Similarly, the WBG will provide selected analytical support in the area of social protection, while IDB will finance the authorities' flagship OPORTUNIDADES (PROGRESA) program. Finally, IBRD will follow IDB's lead in the financing of infrastructure investment under the Puebla-Panama Plan. [For more details on coordination with other partners, see Section VI].

73. WBG support presumes that several conditions are in place, as follows: (i) that sound macroeconomic management, including a continuing, satisfactory dialogue with the IMF; (ii) that all targeted interventions are "owned" by the respective counterparts, defined to include stakeholders whose political support is instrumental in implementation; (iii) that intragovernment coordination remains conducive to reform dialogue and project implementation; and (iv) that the solid record of procurement and financial management of IBRD projects is maintained. Slippage in these areas will trigger a shift in the WBG program toward a "downside" scenario of reduced exposure.

74. As with all WBG operations, it should be noted that its support will depend on the conduciveness of legal and regulatory environments and, when necessary, on the political consensus for the required reforms (for example, in taxation, banking, labor, public pensions); lacking that consensus, lending will be correspondingly lower. Naturally, the speed at which reforms will be implemented cannot be predicted with precision and, therefore, the WBG assistance will be adjusted accordingly. However, an indicative program of financial and non-financial interventions is presented in Tables 6 and 7 (and Annexes B3 and B4) for each development pillar.

75. As an integral part of the overall WBG strategy described above, the IBRD and IFC will work closely together in the implementation of a Private Sector Strategy (see Annex B10) aligned along the five pillars, especially competitiveness and human capital development through private sector initiative. IFC's interventions will thus focus on giving private entrepreneurs a more developed financial sector (and more evenly distributed access to financing); better means to compete internationally; support to invest in areas newly opened to private participants (for example, the social sectors and infrastructure); and assistance in internalizing sustainable development and corporate governance practices. The volume and composition of IFC's activities will depend on market conditions, private sector's access to international financial markets, and reform progress—in general, IFC's role is stronger when and where access to international financial markets is limited, which has not been the case for top-class Mexican firms in recent years. IFC's role has thus remained relatively more active in other parts of the private sector, and in industries that may become open to private sector participation.

(f) Sectoral Support Strategies and Tools To Deliver Them

76. The general strategy described above will be delivered through a set of sectoral strategies and corresponding analytical and financial products. These are listed in Table 6, alongside the

primary development objectives they will serve, and the benchmarks for monitoring their progress.[14] Their conceptual thrust is explained below for each sector.[15]

77. *Poverty and Inequality Monitoring and Analysis.* As mentioned, poverty reduction is the ultimate, overarching objective of this CAS, and the common theme of all its sectoral strategies. It is therefore crucial that the WBG maintains a thorough understanding of the determinants and trends in poverty and inequality. IBRD has completed two Poverty Assessments for Mexico, based on the 1996 and 2000 household surveys; it will complete a third assessment on the results of the 2002 survey. It will also analyze how business cycles affect the poor, what poverty programs can do to smooth negative impacts, and how OPORTUNIDADES (PROGRESA) has influenced the welfare of its beneficiaries. IBRD has also, in recent years, studied the causes of Mexico's deep disparities (for example, earning differentials; the way technology diffusion affects returns to education), and will now devote further efforts to assist the Government in the design of growth-friendly policy options to reduce inequality (Growth and Inequality, FY04).

(i) Consolidating Macroeconomic Gains

78. *Macroeconomic Framework.* The analysis of poverty dynamics in Mexico shows that macroeconomic sustainability is a necessary, although by no means sufficient, condition for poverty reduction. This CAS will contribute to that sustainability through two main channels. Firstly, IBRD will support, with fast-disbursing lending, the design and implementation of critical macroeconomic reforms as they are put forward by the authorities. A notable example of this is the Tax Rationalization SAL and accompanying Technical Assistance Loan expected to be delivered in fiscal 2002. In the event that the labor market reform is implemented, IBRD will support it through a Labor Reform SAL. Secondly, IBRD will devote ample analytical efforts to key macro issues like public expenditure management, fiscal responses to economic shocks, public debt management, international factor mobility, and labor markets convergence. A technical dialogue will be initiated on shifting public expenditure management (in particular, investment expenditures) toward a result-based approach, to lay the foundations for result-based management of the country's development process in the future. Finally, IBRD will continue its close monitoring of macroeconomic developments in the country, as a means to inform its policy dialogue with the authorities and adapt the implementation of its assistance strategy. This monitoring will cover short-term developments (for example, through short-term risk notes) and more fundamental, long-term structural trends (for example, through Country Economic Memorandums).

(ii) Accelerating Growth Through Enhanced Competitiveness

79. *Infrastructure.* The change in administration has opened a new opportunity to bring reform, especially private participation, to core infrastructure facilities. Because of the analytical basis that the WBG has built over the years in this area, its strategy is now to support the implementation of that reform. For example, recently completed sector work on *urban*

---

14. Further details are provided in Table 7 and Annex B3—Financial—and Annex B4—Nonfinancial.
15. In the previously mentioned day-long summit between President Fox (and his economic cabinet) and President Wolfensohn (and WBG senior management) on December 8, 2001, five areas of the proposed WBG strategy were identified as subjects for special emphasis: the "poorest among the poor" (especially those living in Mexico's southern region), education, health, judicial reform, and anticorruption mechanisms.

development and low-income housing will provide the conceptual basis for financial support to a nationwide urban upgrading initiative. The program will emphasize management of major metropolitan areas (logistically, financially, fiscally) in a way that carefully balances urban development with environmental sustainability, urban land management, institutional reforms, and rationalization of low-income housing subsidies. Similarly, the ongoing IBRD support to the design of a national program for the modernization of the *water and sanitation systems* throughout Mexico (with legal, regulatory, and institutional reform at the federal, state, and municipal levels, as a means to induce water conservation and enhance private sector participation) will be expanded through a Water & Sanitation Investment Loan in fiscal 2003. Also building on recent sector work, a *Highway Finance* loan in fiscal 2004 will support the government in improving the design and financial engineering of private highway concessions, as required to ensure fiscal and physical sustainability, and synergy between the old and new parts of the national, state, and local road networks.

80. A *Power Sector Reform* operation (fiscal 2005) is envisioned to support the reform, if approved by Congress, in the petroleum, natural gas, and electricity sectors which is being contemplated by the government and will give larger participation to private agents. A GEF project and a parallel IBRD Technical Assistance operation (fiscal 2003) are being developed to complement and facilitate the mainstream power sector reforms with an off-grid rural electrification program. If successful, this could be extended to a full-fledged national effort. IBRD funding and advisory services will be offered to help the authorities design a strategy to increase the share of renewable energy sources (including sugar-cane based resources) as part of the ongoing ESMAP program, and to develop carbon trading under the Prototype Carbon Fund (PCF). To make sure that the various infrastructure reforms permeate to the subnational levels of government, IBRD will prepare a State Level Infrastructure Decentralization APL operation—a "wholesaling," financial-intermediary operation which would make funding available for fiscally sound states and municipalities that seek to consolidate that fiscal soundness, develop their institutions, and complete sector reforms and invest in water and sanitation, electricity, transport, and telecommunications.

81. The overall program of IBRD support to the infrastructure sectors will be underpinned by related analytical products, notably an Energy Sector review (fiscal 2004), a report on Low-Income Housing (fiscal 2004), and a policy note on Urban Land Management issues and options (fiscal 2005). IBRD will also develop for federal and subnational authorities an urban poverty "tool kit" (fiscal 2003) that pulls together knowledge developed by various sector groups on urban poverty issues.

82. IBRD's efforts in infrastructure will be synergetic with an expanding IFC participation. The Corporation will seize the opportunity to facilitate private investments in power, water, sanitation, and hydrocarbons, as these sectors become open to private agents—a path-breaking event that, as mentioned, will greatly contribute to unleashing Mexico's growth potential. At the same time, IFC will continue to provide support for private sector projects in transport and logistics.

83. *Financial Sector*. In addition to continuing close monitoring, IBRD will seek to support the broadening of financial sector reforms beyond the commercial banking industry, in a three-pronged strategy. First, it will support policy and institutional reforms in rural finance (including the restructuring of BANRURAL) through a Rural Finance SECAL (fiscal 2003). Second, it will assist in the reorientation and restructuring of the other main public development banks (NAFIN,

BANOBRAS, and BANCOMEXT) toward complementing, rather than competing with, private providers of financial services (Financial Sector SECAL I, fiscal 2004). Third, further strengthening of the legal and institutional infrastructure for capital markets transactions (like information disclosure practices, and collateral and credit registries) will be sought through a Financial Sector SECAL II (fiscal 2005), and through a comprehensive review of impediments to the development of the insurance sector (fiscal 2004). Finally, an operation to support reforms in state-level public-employee pension systems may also be considered in the outer year if the states in question show their readiness to embark on such programs following the reforms implemented for the federal employees' pension regimes (see below IMSS and ISSTE).

84. Those IBRD activities will be mutually reinforcing with the IFC's activities which, in the financial sector, will focus on (a) reaching out to Mexican firms (including SMEs and microenterprises) that lack access to term-financing through local financial intermediaries, and (b) supporting transactions that help develop the domestic financial sector. The latter will include nonbank intermediaries, housing finance institutions, credit enhancement, and local currency facilities, and better corporate governance practices (for example, through private corporate and financial restructurings).

85. *Agriculture and Rural Development.* In spite of many reforms, Mexico's agricultural sector has not yet adjusted and prepared for the forthcoming competition under NAFTA. The WBG aims to help make that adjustment both efficient and, more important, socially sustainable. Thus, it will base its sectoral strategy on a more integrated rural development strategy that builds on on-farm and off-farm opportunities at the regional level while promoting agricultural productivity. First, it will support efforts to improve the living standards of the rural poor—especially the indigenous populations—through the expansion of the Rural Development in Marginal Areas project (fiscal 2004) and the related Carbon Sequestration in Coffee Areas project (fiscal 2003) with financing from the Prototype Carbon Fund, and a new phase of the Community Forestry project. Second, enhanced agricultural competitiveness will be sought through the consolidation of the transfer of the irrigation districts and their modernization (Irrigation and Drainage Modernization, fiscal 2003), and continued support to the restructured *Alianza* program (Agricultural Productivity II, fiscal 2004) with an emphasis on diversification and microenterprise development. Third, the improvement of key factor markets will be (re-) emphasized, notably; (i) rural financial markets (a Savings and Credit TA loan and a Rural Finance SECAL in fiscal 2003 will support, respectively, the strengthening of savings and loan institutions through BANSEFI and SAGARPA, and the restructuring of public development banks like BANRURAL and FIRA); (ii) land markets (a Land Titling LIL for fiscal 2003 will be the vehicle for enhanced access and security, completion of the PROCEDE program, and the sharing of international experience); and (iii) warehousing and inventory financing through sector work (fiscal 2003). Finally, as in other sectors, the policy dialogue with state governments will be deepened, in this case as a means to foster municipal capacity and the provision of basic infrastructure services in rural areas (Municipal Development in Rural Areas fiscal 2003). This four-part strategy described above will be based on the continuing accumulation of analytical knowledge on the sector which, in the coming three years, will explore policy options for the repositioning of the coffee and sugar sectors (fiscal 2002), agricultural competitiveness under NAFTA (fiscal 2003), rural public pension schemes (fiscal 2003), indigenous peoples' access to assets and factor markets (fiscal 2004), warehousing schemes (fiscal 2004), and rural enterprise development (fiscal 2003). Improvements in the sector's policy framework will present

opportunities for firms with enhanced competitiveness in agribusiness, an area in which IFC will continue to focus as a means to reach out to smaller farmers through larger actors.

86. *Middle-Market, Micro-, and Small Enterprises.* IFC will take the lead in direct financial assistance to the Mexican corporate sector, catalyzing access to investment financing for the broad spectrum of Mexican firms. IBRD will focus its support to microbusinesses and small and medium enterprises (MSMEs) on creating a market-friendly environment for their operation (cost of doing business, technology-based development services, access to finance, and the like). The strategy, and its interventions will, however, be demand driven and decentralized—that is, it will allow private agents (firms, financial intermediaries, and other service providers) and subnational governments to decide what kind of assistance they need, with the federal government (and the WBG) assuring appropriate monitoring and evaluation. When required, this will translate into remittance investment schemes, whereby the savings of migrants residing abroad are channeled into (micro)business in their community of origin. The ongoing South-East Regional Development LIL, National Micro- and Small Business Development Project soon to be brought for Board consideration, and a forthcoming report (SME Development, fiscal 2003) will provide the operational framework for IBRD's assistance, and will be well complemented by IFC's funding for financial intermediaries catering for MSME (including microfinancing schemes in poor areas).

(iii) Human Capital Development

87. *Education*. Mexico's education system needs better quality, more uniform access, market sensitivity, and local accountability. The WBG's education sector strategy, and a major part of its overall CAS, will be aligned to serve those needs—the richness of the existing sectoral dialogue and project pipeline provides an excellent platform from which to proceed. The ongoing IBRD efforts in basic education (the sustainability of which will be ensured by the Basic Education APL III in fiscal 2005) will be complemented by new interventions in Technological Training and Certification in fiscal 2003 (to put the opportunities of the new knowledge economy within the reach of Mexican workers competing in global markets), Science Education in fiscal 2004 (to foster critical thinking and group learning in the early stages of education), and Science and Technology II in fiscal 2005 (to continue bringing financing to those that merit higher education but cannot afford it). In parallel, two formal reports will study mechanisms to improve quality and access in secondary (fiscal 2004) and adult education (fiscal 2003) (especially for the poor and the indigenous), and an assessment of constraints to the expansion of the Knowledge Economy will be carried out in fiscal 2003. IBRD efforts will be complemented, on the supply side, by IFC's support for private providers of education, a growing area of activity for the Corporation in Mexico.

88. *Health.* The WBG will align its strategy in the health sector to the three objectives of the government's National Health Program 2001–06—equity, quality, and financial viability. This entails IBRD's support of interventions to deliver health services to people living in underserved rural and urban areas (and specifically the indigenous populations through the Indigenous Health project in fiscal 2005), and to continue developing sustainable institutional capacity at the central and local level (ongoing support for SSA; ISSSTE SECAL and TAL in fiscal 2003; and Health Systems Reform IMSS in fiscal 2004). The reform of these institutions will not be rapid or simple—the issues include separation of financing and delivery, agglomeration of all public financing under a single fund, definition of basic health packages, competition in delivery,

accountability, and regulation and accreditation of providers. IBRD will continue to contribute to the design of those reforms through the above-mentioned projects but, equally important, through formal and informal analytical work. At the same time, technical assistance will be provided for the implementation of insurance mechanisms that could alleviate the formidable financial burden that catastrophic illnesses have on the poor (for example, the Indigenous Health report in fiscal 2003). Fundamentally, as IBRD-supported reforms take root, the health sector will open to private investors, whose entry IFC will seek to facilitate through partnerships that build on the Corporation's experience with health provision in Mexico.

89. *Social Protection.* Mexico can show major recent achievements in its social protection network (for example, its OPORTUNIDADES program), and has allocated the necessary resources to build on them. The WBG will thus focus on contributing ideas to preserve and, where possible augment, the efficiency of that network as the process of enlarging coverage unfolds, especially onto urban areas. There, it will be difficult but important to minimize regressive targeting structures, avoid leakage to the nonpoor, evaluate impact, and coordinate the actions of the three levels of government. The WBG's analytical contribution to efficiency enhancement will also include the design of more adequate mechanisms for "graduation" from program eligibility, countercyclical triggers for social expenditure, closer links between planning and demographic dynamics, and early identification of new groups at risk. Two pieces of analytical work will channel that support (Urban Poverty report, fiscal 2003, and Safety Net Programs, fiscal 2004).

90. *Indigenous Peoples*. The WBG's strategy toward indigenous peoples in Mexico will continue to fulfill its responsibilities under OD 4.20 (currently under revision as OP 4.10); that is, to ensure that Bank-financed operations in Mexico do not cause adverse impacts upon indigenous peoples and that they provide such peoples with culturally appropriate benefits. But the strategy will go beyond safeguards—it will emphasize indigenous people's direct participation in WBG-financed operations, especially those meant to improve their access to basic health, education, and rural development services (for example, Indigenous Health, fiscal 2005). The WBG has supported, in collaboration with a number of Mexican governmental and academic institutions, the preparation of a series of state-level profiles of indigenous peoples, and a major investigation of the situation of indigenous peoples living in urban areas. This analytical work provides a framework for "development with identity," especially in projects located in indigenous regions that mean to protect the local environment (the ongoing Indigenous Community Biodiversity Conservation and Mesoamerican Biological Corridor GEF projects, the Regional Southeast Development LIL, and the forthcoming Community Forestry II in fiscal 2004). A new sector work on indigenous people access to assets and markets will be prepared in fiscal 2004.

91. *Gender*. Over the next three years, the WBG gender strategy for Mexico will continue to focus on bringing gender considerations across the whole of the development spectrum—that is, on "mainstreaming" gender. Priority areas of entry for this mainstreaming will be gender constraints in the labor, family, and domestic violence laws; gender differences in responses to workforce participation and self employment; and male gender issues such as violence (including domestic violence), risky behavior, and substance abuse. Three types of vehicles will deliver that strategy. First, the recently approved Gender Equity LIL will, among other things, support gender-specific financial services for female-headed microbusinesses, access to child care, and the resolution of gender stereotypes in childrearing (especially by fathers), pedagogical methods,

and youth development. Second, analytical work will identify policy options for gender issues, notably through the dissemination of the book, *Gender and the Mexican Economy*, published in 2001, and the soon-to-be-completed "Gender Assessment of Mexico's Legal Framework." Third, a Portfolio Gender Assessment (fiscal 2004) will identify mechanisms to mainstream gender in the WBG's own operations.

(iv) Balancing Growth and Poverty Reduction with Protecting the Environment

92. *Environmental Management*. The government's five-year environmental action plan, with which the WBG will continue to align its strategy for the environment, involves two types of cross-cutting reforms—institutional (especially decentralization of responsibilities to the state and municipal levels and better enforcement), and policy (user charges, fees, taxes, and pricing in different sectors, notably water and energy). The WBG will support both types as it will prepare a programmatic, environmental adjustment operation to address regulatory and policy reforms in sectors like water, forestry, waste, energy, and tourism, that are critical for the protection of natural resources (Environmental Support SAL under discussion for fiscal 2002, and its programmed successor in fiscal 2004). The above financial interventions will be conceptually supported by a growing body of analytical work—Degradation and Poverty (fiscal 2003) and Environment and Growth (fiscal 2004).

93. *Mainstreaming*. In the context of a better policy and institutional framework, the WBG will continue to work with the line agencies leading environmental protection programs in each sector: (i) in water, with CNA, a modernization program will be supported for the consolidation of the irrigation sector (fiscal 2003), and for the strengthening of the water and sanitation sectors (fiscal 2003); (ii) in forestry, with CONAFOR, support will be continued for the expansion of the community-based approach developed under the on-going project for indigenous forest-based *ejidos* (fiscal 2004); and (iii) in air quality, with CAM, through the Mexico City's Transport and Air Quality II (fiscal 2004) in support of the Government's recent Air Quality Plan that sets the stage for a revision of the effectiveness of the transport system, the efficiency of vehicle technology, and the policy and regulatory framework for air quality management.

94. *Global Issues*. The WBG will assist the government in taking advantage of the potential synergies among global, national, and local resource management through the GEF. The National Protected Areas system will be consolidated and expanded (fiscal 2003–04); and a new operation for the conservation of the Gulf of Cortez will be promoted (fiscal 2004). Moreover, support will be sought for testing Climate Friendly Air Quality measures (hybrid technology) in Mexico City (fiscal 2003), and efforts to control the use and environmental impact of Persistent Organic Pollutants (POPs) will be pursued. Through the Prototype Carbon Fund, a follow-up operation to the existing GEF carbon sequestration project in Oaxaca would be put in place.

95. While IBRD interventions focus on strengthening institutions and setting policies for environmental protection, IFC's support for business in sustainable development will help foster environmentally and socially sound practices among private participants—an increasingly important area for maintaining international competitiveness and growth, as mentioned earlier.

(v) Building an Efficient, Accountable, and Transparent Government

96. *Decentralization.* As noted throughout the sectoral strategies, *federalismo*, understood as the devolution of decisionmaking power to states (and their municipalities), is changing the way

policy is made in Mexico across all sectors—and the nature of IBRD's country client. The WBG has therefore accompanied, and will continue to accompany, this decentralization process closely with a four-pronged strategy. First, it will assist on insuring that the process is sustainable, both fiscally and programmatically. The first step in this direction was the FY99 Decentralization Adjustment Loan (DAL), of which the underlying package of federal "rules-of-the-game" has become a model for other countries. Subsequent operations will help fine-tune those rules (for example, through analysis of options for the Reform of the Fiscal Pact in fiscal 2003).

97. Second, the WBG has begun to support individual states that request help in adjusting to the new responsibilities and to the structural reforms and fiscal discipline that those responsibilities imply—as it did with the *Estado de Mexico* SAL in fiscal 2000, and will do with a program of State-Level Adjustment loans and technical assistance that will place special emphasis on poorer states, a parallel implementation-focused Technical Assistance Window for subnationals in fiscal 2004, and a succession of state-level Public Expenditure Reviews and State Economic Memorandums as of fiscal 2003.[16] Third, IBRD will also help states and large municipalities that have reached a sustainable fiscal and financial path, access infrastructure financing in sectors (like water, sanitation, and transport) where they still need know-how to complete legal and regulatory frameworks that are conducive to private participation (the channel for this assistance will be the State Infrastructure Decentralization APL I and II projects, in fiscal 2003 and fiscal 2005, respectively). Fourth, IBRD will continue its institutional development work with poor municipalities in rural areas through the Municipal Development in Rural Areas project. Finally, the World Bank Institute will maintain, and where possible expand, its successful, long-distance learning programs for subnational officials, with special emphasis on public sector management techniques (Box 5).

Box 5. Capacity and Learning Activities of the World Bank Institute (WBI) in Support of the CAS Objectives.

As the learning and capacity-building arm of the World Bank Group, WBI designs and delivers courses and seminars aimed at building the institutional and human capacity of its client governments to fight poverty. It facilitates networks and communities of development practitioners among its clients so they can access, share, and promote innovation and knowledge.

In Mexico, WBI supports the CAS objectives by focussing on capacity building, with special-emphasis areas such as decentralization, finance, governance, sustainable development/environmental management, population and health, and social protection. In support of this strategy:

- During 1999–2001, over 5,000 participants from Mexico took part in WBI activities, at both the national and regional levels and in worldwide events.
- WBI has established a training partnership with the *Instituto Tecnológico y de Estudios Superiors de Monterrey*. This partnership, through which public sector management education was delivered to thousands of national and local government officials in Mexico and Latin America, pioneered the use of distance-learning technology in this field.
- The federal government's internal auditing institution, SECODAM, participated in a WBI worldwide forum on anticorruption strategies, and in ensuing training on participatory government.

16. The criteria to choose states for IBRD adjustment support will follow the government's own priorities as expressed in the letter of development for the *Estado de México* SAL (Report No. P7400ME). These include: i) the state's poverty levels and incidence; ii) impact of the state's finance on the national macroeconomic framework; iii) degree of the state's commitment to a comprehensive reform program; and iv) potential demonstration effect on other states.

In the coming three years, WBI will continue to align its knowledge and capacity-building program with the development priorities identified in this CAS—in particular, decentralization and public finance, governance, education, community empowerment and social protection, sustainable development and environmental management, rural poverty and development, and health and population. In all cases, WBI will continue to work closely with the Mexico Country Department and other relevant operational units to ensure that its interventions are client responsive, demand driven, and integrated in current and future projects. WBI will also seek to establish additional partnerships within the country to ensure long-term sustainability and national-level "ownership" of the various training programs. Distance learning will remain the main communication tool, because it ensures access to wider audiences at all levels of government and throughout the Mexican territory.

98. *Judicial System*. In fiscal 2000, a diagnostic study of *Juicios Ejecutivos Mercantiles* was completed at the request of the Supreme Court of the Federal District. Since the presidential transition of 2000, the government has made judicial reform a priority, and has requested IBRD support. The key for the success of that support will be ownership by the judicial branch itself. Assuming such ownership materializes, the first step in that support, and the initial objective of the sector strategy, will be to design, in partnership with the judiciary, a comprehensive Judicial Reform Agenda in fiscal 2003. "Early wins" and lessons in implementing that agenda will be sought through an Access to Justice LIL, also in fiscal 2003. This will set a solid basis for a second phase of support, and for the deepening of related reforms, through a Judicial Reform Investment loan in fiscal 2005. Mexico is also participating in the WBI-sponsored training program on judicial reform in Latin America.

99. *Anticorruption*. As with judicial reform, the WBG had until the current presidential administration only a limited presence in the anticorruption area— although a successful one, for its support led to the establishment at SECODAM (the federal government's internal auditor) of a path-setting electronic system for public procurement (COMPRANET). Since the publication of the government's Anti-Corruption Program 2001–06 and the ensuing interministerial agreements, the WBG faces a heightened demand for support in the fight against corruption at the various levels and institutions of government. WBG will respond to that demand. First, it will provide on-demand technical assistance for the design of anticorruption strategies to individual federal ministries and their dependent agencies, starting with those the operations of which are most exposed to rent-seeking practices (the first will be *Secretaria de Hacienda y Crédito Pûblico*, and the Tax Administration Office [SAT] it oversees). Second, it will, also on demand, carry out State Financial and Accountability Assessments and State Procurement Assessment Reports each year through fiscal 2005. Third, an Anti-Corruption Investment Loan (fiscal 2004) will support the implementation of necessary institutional reforms, at both the federal and state levels. Fourth, IBRD will continue assisting SECODAM in making the federal government more transparent in areas like standardization of bidding documents, arbitration of procurement disputes, contracting of consulting services, and e-government. Finally, WBI will expand its training programs for federal and subnational employees, whose emphasis on corruption has recently proven instrumental for SECODAM's strategy-setting efforts; Mexico was also chosen as the site for a region-wide course on National Governance and Anti-Corruption (in which more than 2000 public officials have participated).

100. *Civil Society*. The WBG will continue to assist the opening of Mexico's development process to civil society participation. This CAS has been prepared in a consultative manner, with three regional events to gain feedback from a broad range of local actors (see below). Consultations with key civil society actors were held in 2001 to discuss the WBG's own policies for information disclosure and indigenous peoples. And IBRD continues to explore ways to

involve local CSOs in its lending products. In a remarkable example, the Marginal Areas project has transferred decisionmaking on community development priorities, approval of subprojects, contracting of technical assistance, and project supervision to Regional Councils, with civil society and community involvement—mostly through indigenous organizations. Over the next three years, the WBG will expand its support for dialogue between government and civil society on participatory approaches to the design, execution, and evaluation of WBG-financed projects and, more generally, to public policy formulation and accountability. It will also seek suitable mechanisms to help civil society engage in budget planning, execution, and evaluation, and will pilot an information disclosure initiative to bring better access to information for poor communities and their organizations. If requested, the WBG would provide technical assistance on enabling legal frameworks for CSOs.

(g) Exposure Evolution Under the Proposed Strategy

101. As of February 28, 2002, IBRD exposure to Mexico was US$10.9 billion, its third-largest country portfolio, and 9.5 percent of the total IBRD portfolio. Under the scenario outlined in this CAS, with a lending envelope of US$5 billion during fiscal 2003–05 (half of which through faster disbursing adjustment loans), Mexico's IBRD exposure is projected to increase to US$12.1 billion by end-fiscal 2005 and stabilize at that level thereafter. IBRD exposure to Mexico would thus remain well within the IBRD's single borrower exposure guideline of US$13.5 billion throughout the CAS period, leaving a US$1.5 billion "cushion" should additional lending be needed.

102. Exposure projections are sensitive to, among others things, the level of new lending, its rate of disbursement, disbursements from the existing pipeline of US$3 billion in loans already approved, possible cancellations of approved lending and, for longer-term projections, the repayment schedule selected. To ensure that the IBRD's single borrower exposure guideline is not breached in the outer years because of the level of lending committed during this CAS cycle, and that IBRD's assistance program is therefore not impaired in the future, exposure projections have been carried out for a 10-year period (see Figures 1a and 1b). These projections show that keeping the IBRD annual commitments at US$1.6 billion in fiscal 2006 and thereafter—that is, a program similar in size to the one proposed in this CAS for fiscal 2003–05—would lead to a relative peak exposure of only US$12.3 billion in fiscal 2009, well below the guideline and leaving some headroom to assist in case of a crisis.

103. Alternative disbursement assumptions were also employed to test the sensitivity of the exposure projection to a faster disbursement profile of both adjustment and investment lending (see, again, Figures 1a and 1b).[17] Whereas the normal disbursement scenario assumes a three-

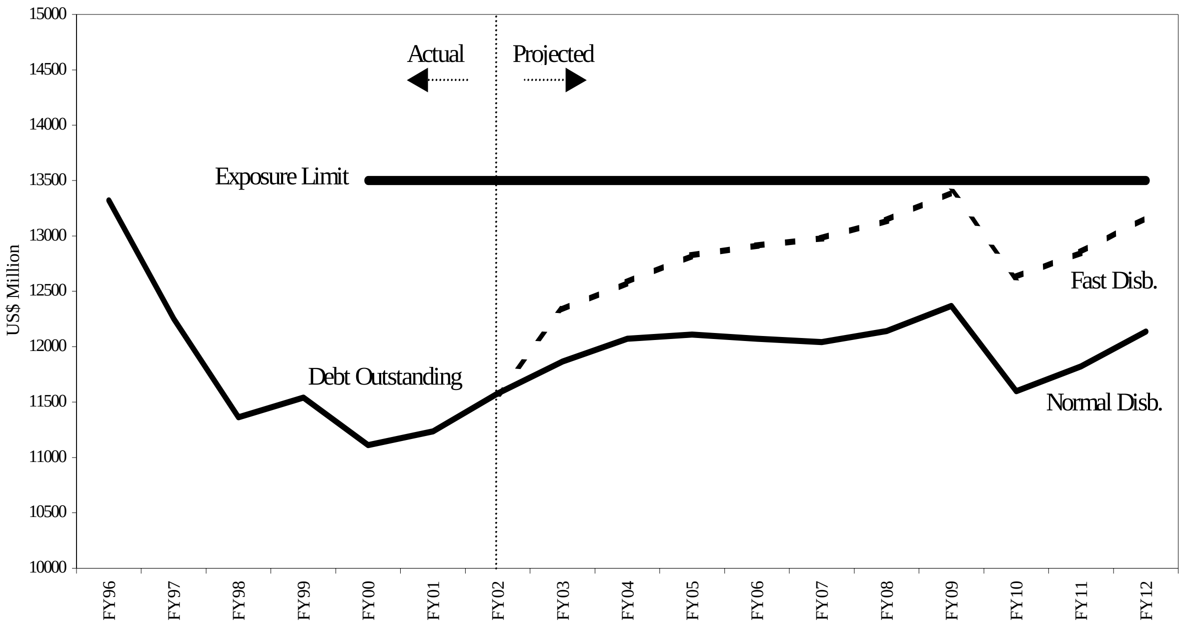
17. In addition to the level of new lending and the disbursement profile (the latter inclusive of the split between faster disbursing adjustment and investment lending), exposure projection scenarios may include variations in future loan cancellations, repayment schedules, and the currency composition of IBRD debt. To err on the cautious side, the projections presented here do not include any future cancellations and take a standard repayment schedule for future lending applicable to Mexico with a five-year grace period and 15-year maturity. In the past CAS, both disbursement ratios and new commitments proved lower than orginally anticipated, which resulted in an exposure lower than expected (for example, the 1999 CAS projected a total IBRD TDO of US$13.3 billion for the year 2001, compared with an actual for that year of US$10.8 billion). The projections do not consider the exchange rate risk stemming from the currency composition as practically all of Mexico's IBRD debt outstanding is denominated in U.S. dollars, and all contracting of IBRD debt has taken place in this currency ever since the single currency loan was initiated in fiscal 1998.

year disbursement profile for adjustment lending (with 65 percent of the loan disbursed within the first year) and an eight-year disbursement profile for investment loans (both based on the actual disbursement profile of IBRD lending to Mexico over the past decade), the fast disbursement scenario assumes an immediate, upon-approval, one-tranche disbursement of all future adjustment operations and a shortened, five-year disbursement profile for investment lending. Such an accelerated disbursement would bring exposure to US$12.8 billion by end-fiscal 2005 and US$13.4 billion by end-fiscal 2009, still within—though exceptionally close to—the exposure limit. Although such a disbursement profile would constitute a major change from past performance (evident in the rapid drop of the undisbursed balance of approved loans), such a fast buildup of exposure could require a cutback in lending past fiscal 2006. Management will continuously monitor the implementation of the lending program, including the disbursements of approved lending and the implications thereof for country exposure.

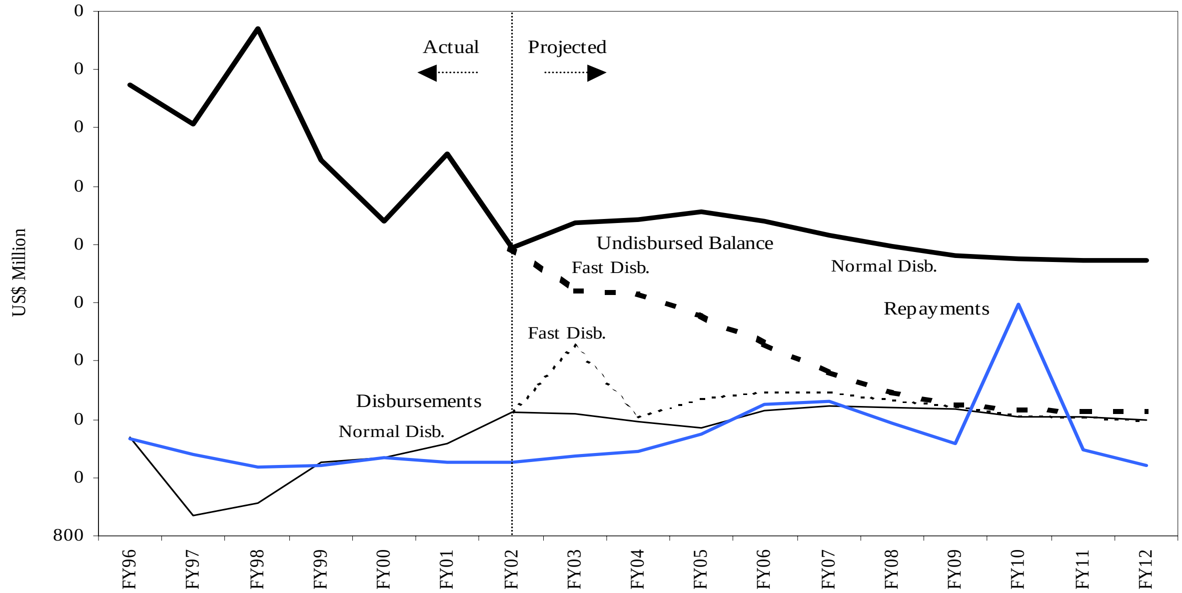
104. Both the proposed IBRD lending program and its sensitivity analysis, assume that policy-based, adjustment lending will be disbursed as per regular practice. The Mexican authorities are aware of IBRD's new and forthcoming product lines (especially, Deferred Draw-Down Options and Guarantees) and may consider employing them in the future if they suit the evolving economic and development conditions of the country. From the point of view of IBRD's Mexico exposure (as opposed to Mexico's debt outstanding and disbursed with IBRD), the choice of delivery tool does not change the time-series or conclusions from Figure 1a and 1b—that is, the proposed program preserves a US$1.5 billion "cushion" vis-à-vis the absolute concentration limit.

Figures 1a and 1b. Mexico IBRD Exposure Scenarios, 1996–2015

(a) Debt Outstanding



(b) Disbursements, Repayments, and Undisbursed Balance



V. THE RISKS IN THE PROPOSED CAS

105. The assistance strategy put forward in this document faces a series of real but manageable risks. First, in the more integrated Mexico of today, the possibility of negative external developments unsettling the country's macroeconomic framework is not negligible—the rebound of the U.S. economy is by no means guaranteed, and contagion from another, post-Argentina emerging market crisis cannot be assumed away. Also, the recent appreciation of the Mexican peso deserves close monitoring, even though much of the currency's strength reflects a significant improvement in market "fundamentals" (higher productivity, a floating exchange rate regime, enhanced independence of the monetary authority, fiscal credibility, a more comfortable public foreign debt position, three investment grades, falling inflation rates, a flight-to-quality by international investors seeking emerging market exposure in their portfolios, and so on). As mentioned earlier, fiscal consolidation remains a challenge. Oil price volatility presents an additional challenge. Mexico's recent macroeconomic record and policy mix (especially its fiscal discipline and flexible exchange rate regime) are solid, have proven resilient during the U.S. recession, and have "market differentiated" Mexico through successive international financial crises (East Asia in 1997, Russia in 1998, Brazil in 1999, and Argentina in 2001).

106. Second, with no single party holding a majority in Congress, and mid-term elections scheduled for 2003, the Mexican government may find it all but impossible to see through pending reforms (energy, labor, judicial, water, and so forth). While this type of political risk is difficult to mitigate, the government has learned the lessons from the recent attempt at fiscal reform (eventually passed but in a partial manner)—future legislative initiatives are likely to be accompanied by more up-front debate, systematic consensus building, and negotiation.

107. Third, as the U.S. economy rebounds, growth in Mexico will likely recover in full force and quickly reach the high rates of the late 1990s. This may put Mexican policymakers in a "comfort zone," that is, under the perception that further structural reforms are either not necessary or not worth the political cost. Growth sustainability could then be compromised. The

likelihood of this complacency is, however, not large, because the current administration continues to show a strong commitment to reform that is compatible with the mandate for change it received in the 2000 elections.

108. Fourth, many of the necessary reforms are cross-ministerial undertakings, fall under the purview of both federal and subnational governments, and are championed by presidential commissioners. Coordination among that many actors will be difficult, even before stakeholders outside the Executive (like Congress) enter the debate. Such coordination problems did occur in the early part of the administration, but a gradual and reassuring improvement is visibly underway (for example, in the design of water sector reform).

109. Fifth, as *federalismo* unfolds and long-entrenched structural problems in the states become immediately binding, the likelihood of a crisis, be it financial or social, at the subnational level will expand. For example, this could take the form of a state or large municipality being fiscally unable to deliver the basic social services for which they are increasingly responsible, or previously marginalized groups bringing their accumulated grievances and pent-up demands to bear all at once, overwhelming the capacity of local governments to respond. This risk is present countrywide, but especially in poorer southern states. It is in part mitigated by the federal government's recent efforts to establish market-driven rules for decentralization, by its ongoing support to states that proactively seek to reform themselves, and by the newly available mechanisms for subnational accountability.

110. Sixth, in the absence of sectoral reforms, Mexico may run into an "infrastructure crisis" during this *sexenio*—power generation might prove unable to keep up with faster growth, northern industrial states might run out of water, or transport-driven air pollution might bring large cities to a halt. This type of crisis, and the resultant political pressures for quick-fix solutions, could permanently damage the country's prospects for long-term growth. The federal government is aware of these dangers and is placing better infrastructure provision (notably, through increased private sector participation) at the forefront of its reform agenda.

111. Finally, as with the previous CAS cycle, IBRD's assistance program to federal entities remains at budgetary risk—the nonadditionality of IBRD funds with respect to sector–ministry budgets will continue to dampen the demand for its participation. As in the past, the decisive factor will be the technical quality of IBRD's contribution. The presence of a particularly strong program of analytical work in the proposed CAS seeks to mitigate that risk.

VI. COORDINATION WITH OTHER PARTNERS AND PARTICIPATION IN THIS CAS

112. The WBG continues to maintain a fluid and productive relationship with the community of Mexico's development partners. That relationship takes many forms, in accordance with the country's needs (Table 4). In some areas, the WBG is the leading agency and acts as a catalyst for the intervention of others (for example, in GEF operations where UNEP and UNDP take part). In other cases, the WBG has developed complementary partnerships (for example, with the IMF to help strengthen the macroeconomic framework) or joint products (for example, IDB's parallel financing of the Decentralization and Rural Development project series). Sometimes the government led institutional specialization. For example, in decentralization, the WBG has focused on setting conducive legal and regulatory frameworks and helping states adjust to them,

while IDB emphasized institutional capacity at the subnational level. And sometimes donor coordination has taken the form of knowledge sharing, like with the OECD. A comprehensive overview of how various stakeholders integrate into a comprehensive framework is shown in Annex Table B11. Among partner activities, two of particular importance for this CAS are further described below—IMF and IDB.

113. Mexico maintains an excellent relationship with the IMF. Following the successful completion in 2000 of a 17-month SDR US$3.103 million Stand-by Arrangement, which the country eventually treated as precautionary and from which it did not withdraw the last installment, the Fund continues providing regular surveillance (Article 4 consultations) and technical assistance (for example, in monetary policy up to the year 2000, and tax administration matters). It also produced, together with IBRD, a Financial Sector Assessment Paper (FSAP) in 2001. In addition, the authorities may explore the possibility of an IMF Contingent Credit Line (CCL), the first of its kind since the facility became available for countries which pursue strong macroeconomic and structural policies and show progress toward adherence to internationally accepted standards in the financial, fiscal, and statistical areas. Apart from the continued pursuance of sound economic policies, the CCL would be based on further progress toward compliance with international standards, including following up on the recommendations made in the FSAP. These IMF efforts are, of course, directly complementary to the first conceptual pillar of the proposed CAS—consolidating the macroeconomic gains of recent years.

114. IDB also has a sizable assistance program in Mexico (with new commitments worth some US$1.2 billion per year, and an accumulated debt of about US$6 billion). Its strategic focus is on social sector modernization and poverty reduction, fiscal decentralization, private sector competitiveness, and international economic integration. The ensuing interventions have reinforced, rather than substituted for, the WBG's assistance—IDB has put emphasis on institutional development (for example, in decentralization) and on supporting ongoing programs (for example, PROGRESA), while the WBG's analytical and financial assistance has favored the design and implementation of new reforms (for example, in state-level adjustment programs). The synergies have sometimes lead to joint or parallel-financing operations (for example, in rural municipality development, and in the proposed ISSSTE project). (For more details on IDB's program in Mexico see Box 6).

Box 6. IDB's Program

During 1999–2000 the IDB had 11 projects in Mexico—one general multisector loan, five in the power sector, and one each for bank restructuring, housing, labor market reform, strengthening subnational finances, and rural water and sanitation. Mexico's outstanding debt with the IDB was US$5.8 billion at the end of 2000, with net disbursements of approximately US$250 million in recent years, usually lower than the interest payments.

IDB's program for the next five years has four main components: (a) social sector modernization and poverty reduction, (b) modernization and decentralization of the state, (c) improvement of private sector competitiveness, and (d) international economic integration. The base-case scenario includes operations in the amount of approximately US$1.2 billion per year on average during 2002–06. Approximately 40 percent of the value of the planned operations corresponds to support for poverty reduction; 35 percent is for improvements in private sector productivity, 20 percent is for modernization of the state, and 5 percent is for international integration. The high-case scenario includes lending of approximately US$1.5 billion per year, with the main difference being greater emphasis on fast-disbursing operations.

To support modernization of the social sector and reduction of extreme poverty, the IDB will put forward operations in several areas: primary education, the labor market, and targeted support to poor groups, particularly women, indigenous peoples, and probably also health. The biggest projects in this area would be for PROGRESA, primary education, labor market reform, restructuring social security for public sector workers (ISSSTE), and sustainable restructuring of small-scale rural producers.

Improving competitiveness of the private sector by lowering barriers to enhanced productivity is the second major area of lending foreseen by the IDB. This includes support for modernization of the financial system; public and private investment in various sectors; improvement of regulatory schemes and incentive systems; and enhancing economic efficiency by helping the private sector play an active role in financing and implementing investments in electricity, water and sanitation, transportation, telecommunications, and education and health infrastructure construction projects.

Modernization of the state, and subnational decentralization and development, while having a smaller volume of lending than the first two areas, is equally important for improving the social and economic climate in Mexico. The IDB would support improvements in government practices and in the regulatory framework, strengthening the civil service and public institutions in states and municipalities, and improving the justice and property rights systems.

Since the integration of Mexico with the rest of North America through NAFTA is proceeding satisfactorily, IDB support in this area would be for the Puebla–Panama Plan, which seeks to expand integration to the south as a way to fight poverty in both Mexico and Central America.

115. The preparation of CASs in Mexico has followed an increasingly participatory approach. Until 1999, CAS documents were confidential and of limited distribution even within the government. In 1999, a consultation process was undertaken with a range of stakeholders (including NGOs, academics, think tanks, unions, businessmen, and politicians) and the final product was made widely available within the administration. The 2001 Progress Report (on the 1999 CAS) was published by the authorities—a first-ever event for Mexico. This gradual opening to civil society in the articulation of the WBG assistance took another step forward in this CAS—a countrywide process of consultation with the full array of stakeholders was put in motion through a series of public events organized in Mexico City, Monterrey, and Oaxaca during March 2002. (For a description of those consultations, see Box 7). Those events were complemented by a large number of individual meetings with leaders of civil organizations, whose feedback will also be sought on a continuing basis during CAS implementation, a practice that proved instrumental in the previous strategy cycle.

Box 7. Mexico CAS Consultation with Civil Society

In the process of preparing this CAS, WBG staff organized three full-day seminars with a broad and diverse selection of members of Mexican civil society, including representatives from trade unions, religious groups, academic institutions, charitable foundations, producer and community-based organizations, business chambers and other non-governmental organizations. The discussions that took place in March 2002 with more than 120 representatives of civil society organizations at three different locations throughout Mexico—Mexico City, Monterrey and Oaxaca—allowed for a better definition of the role that the WBG may have in assisting Mexican society to address the country's main development challenges, as well as an increasing stakeholders' awareness of the WBG's activities and assistance strategy. Despite, at times, different and divergent perspectives on development issues, the general constructive atmosphere in which the consultations took place contributed to an improved understanding of the key problems that Mexico faces and the identification of new issues for future support, such as:

- The importance of evaluation and impact analysis of public policies and programs in order to improve the efficiency of public spending and the design of effective government interventions. Such evaluations should be made public and should be widely discussed, something that would not only improve the quality of future service provision but also give legitimacy to the taxation required to fund those services.
- The need to conceive development as a broader and multifaceted process that, beyond economic growth

and poverty reduction, should aim at the improvement of overall human well-being.

- The role that strengthening domestic-market-oriented suppliers (including through linkages with NAFTA-driven ones) and the enhancement of their competitiveness can play in economic growth, job creation and poverty reduction.
- Developing closer relationships between civil society and government will enhance stakeholder participation and ownership of public policies and programs. In view of the political transition that Mexico is going through, the WBG can play a critical role as an independent analyst and catalyst for dialogue within society and between government and civil organizations.
- The relevance of taking into account regional dimensions in the design and implementation of development policies and public investment programs, especially in a country of the size and with the sharp regional contrasts of Mexico.

The continued, strong engagement of the WBG in Mexico received broad endorsement by Mexican civil society in view of the major development challenges the country faces and, in particular, the contribution the WBG can make in tackling the still-prevailing high levels of poverty and inequality in the country. Many participants expressed their appreciation for the WBG's initiative to reach out to civil society for views on its assistance strategies and strongly encouraged a continuation of such activities with the possibility to include the Mexican government in such discussions. A summary report and detailed minutes of the consultations have been distributed to participants and are available upon request.

VII. CONCLUDING REMARKS

116. The objective of this WBG assistance strategy is to support the government's efforts to consolidate the macroeconomic framework, accelerate growth through enhanced competitiveness, develop the country's human capital, protect the environment, and build an efficient, accountable and transparent government. That strategy is the result of extensive analytical work, lessons of operational experience, and country consultation.

James D. Wolfensohn
President

By:

Shengman Zhang

Peter L. Woicke

Washington, D.C., April 19, 2002

Table 6. Mexico—CAS Matrix FY03–05

COUNTRY DEVELOPMENT OBJECTIVES	GOVERNMENT INSTRUMENTS	WORLD BANK GROUP'S SUPPORT INSTRUMENTS: FINANCIAL	WORLD BANK GROUP'S SUPPORT INSTRUMENTS: NON-FINANCIAL	PROGRESS BENCHMARKS
Consolidating macroeconomic stability	Strengthening federal fiscal anchor by (a) continuing the tax reform, (b) addressing implicit and contingent liabilities, (c) maintaining subnational fiscal discipline; and (d) stabilizing oil revenues	Tax Reform SAL FY02 Tax Reform TAL FY02 Labor Reform SAL FY04 (tbc)	Macro-monitoring (ongoing) Public Expenditure Management FY04 Promoting Trade FY04 International Factor Mobility FY04 Country Economic Memorandum FY05 Economic Shocks and Fiscal Responses FY05 Labor Market Convergence FY05 Public Debt Management FY05	**For country:** Continued sound fiscal and monetary policies including reduced dependency on oil-related revenues, coupled with continuation of tax reform. Preserve satisfactory standing with IMF. Maintain sustainable balance-of-payments current account deficits. **For WBG performance:** Enhanced country awareness and debate around key macro vulnerabilities, notably the need for completing tax reform as evidenced by relevant reform proposals by core interest groups
Accelerating growth through enhanced competitiveness	Ensuring the adequate provision of physical infrastructure	National Urban Upgrading Loan FY03 Off-grid Rural Electrification Loan FY03 States Infrastructure Decentralization APL I FY03 Water & Sanit. Modernization FY03 Highway Finance Loan FY04 Power Sector Reform Loan FY05 States Infrastructure Decentralization APL II FY05 IFC's Operations in Transport, Power, Water, Sanit. & Hydrocarbons	Energy Sector Dialogue FY03 Energy Sector Review FY04 Low Income Housing FY04 Urban Land Management FY05	**For country:** Improved financial performance and efficiency in highways, power, and water utilities; improved access for the poor to basic infrastructure. Increased ownership and involvement of subnational governments in setting key infrastructure development and financing strategies **For WBG performance:** Enhanced catalyst role in progress toward structural reform in key infrastructure subsectors, notably electricity, as evidenced by the quality of the sector dialogue and operations. Expanded support for state-level infrastructure reform.
	Increasing efficiency in the financial sector (broadly defined).	Rural Finance SECAL FY03 Financial Sector SECAL I FY04 Financial Sector SECAL II FY05 IFC's Financial Sector Instruments FY03–05	Fin. Sector Monitoring (ongoing) Insurance Sector Report FY03	**For country:** Strengthened financial sector supervision, better performing development banks, and improved financial infrastructure. **For WBG performance:** WBG technical assistance as a catalyst for reform in the overall incentive structure for the operation of the financial sector, especially in the area of legal and regulatory infrastructure.

Table 6. Mexico—CAS Matrix FY03–05

COUNTRY DEVELOPMENT OBJECTIVES	GOVERNMENT INSTRUMENTS	WORLD BANK GROUP'S SUPPORT INSTRUMENTS		PROGRESS BENCHMARKS
		FINANCIAL	NON-FINANCIAL	
Accelerating growth through enhanced competitiveness *(continued)*	Raising productivity in the agricultural sector	Savings & Loan Sector Development FY02 Irrigation Sector FY03 Land Titling LIL FY03 Rural Finance SECAL FY03 Ag. Productivity II FY04 Rural Develop. Marginal Areas APL III FY04 IFC Operations in Agribusiness FY03-05	Coffee Sector Study FY02 Sugar Sector Restructuring FY02 Ag. Competitiveness FY03 Rural Pension Schemes FY03 Warehousing Schemes FY03 Rural Enterprise Development FY04	**For country:** A consolidated non-bank savings and loan sector, being strengthened through capacity building and enhanced supervision. An improved framework for agricultural productivity and competitiveness and better access to diversification opportunities and TA. A restructured sugar sector in the process of privatizing the government expropriated mills. A revised incentive framework for the rehabilitation and repositioning of the coffee sectors. The operation of more effective warehousing schemes . **For WBG performance:** Contribution to the implementation of key programs as determinants to agricultural competitiveness and productivity, and enhanced understanding of the functioning of factor and goods markets in rural areas through the delivery of key sector work.
	Integrating Middle-Market and Micro- and Small Enterprises in the "new" Mexican economy.	IFC Financial Intermediary Operations for MSME FY03–05 IFC Direct Support for Middle-Market Companies; Corporate Governance Support FY03-05	SME development FY03	**For country:** Improved business environment for MSMEs, including a reduction in the "cost of doing business," and better access to development services and finances. **For WBG performance:** Satisfactory implementation and completion of the ongoing Southeast Regional Development LIL and Urban Micro-Business Loan.

Table 6. Mexico—CAS Matrix FY03–05

Country Development Objectives	Government Instruments	World Bank Group's Support Instruments: Financial	World Bank Group's Support Instruments: Non-Financial	Progress Benchmarks
Human Capital Development	Enhancing the quality of public education	Tech. Training & Certification FY03 Science Education FY04 Basic Ed. APL III FY05 Science and Techn. II FY05 IFC's Operations with Private Education Providers FY03–05	Knowledge-Economy Assessment FY03 Adult Education Study FY03 Secondary Ed. Study FY04	**For country:** Improved quality of education inputs (i.e., increased number of primary education teachers retained in remote rural areas, increased number of primary education students with educational material in rural areas), and enhanced efficiency (i.e., internal efficiency in primary education) **For WBG performance:** Delivery of technical assistance for effective education programs at all levels (basic, secondary, technical, and higher education).
	Increasing the quality of public health services	ISSSTE SECAL FY03 ISSSTE TAL FY03 Health System Reform IMSS FY04 Indigenous Health FY05 IFC's Operations with Private Health Providers FY03–05	Evaluation Basic Healthcare FY03 Indigenous Health FY 04	**For country:** Increased access to basic healthcare for rural (particularly indigenous) and urban underserved populations, and strengthened coordination among public health care institutions at the three levels of government. Arresting the growth of the implicit debt in the public-employee pension system. **For WBG performance:** Consolidating the delivery of a basic health care package for uncovered and underserved rural and peri-urban poor. Successfully assisting in the implementation of the public-employee pension reform.
	Closing gaps in social protection		Urban Poverty FY03 Social Safety Net Evaluation FY04	**For country:** Improve coverage and minimize regressive targeting structures and leakages. **For WBG performance:** Deliver TA to help GOM design better SP programs.

Table 6. Mexico—CAS Matrix FY03–05

COUNTRY DEVELOPMENT OBJECTIVES	GOVERNMENT INSTRUMENTS	WORLD BANK GROUP'S SUPPORT INSTRUMENTS		PROGRESS BENCHMARKS
		FINANCIAL	NON-FINANCIAL	
Human Capital Development (*continued*)	Understanding and attending to the specific needs of the poor and the disadvantaged.	Indigenous Health FY05 Gender LIL (recent approval)	Gender Assessment of Legal Framework FY02 Dissemination of *Gender and the Mexican Economy* FY03 Poverty Assessment FY03 Impact of PROGRESA FY03 Portfolio Gender Assessment FY04 Business Cycle and the Poor FY04 Growth Poverty and Inequality FY04 Indigenous Peoples Access to Assets and Markets FY04	**For country:** Improved access to health services for the indigenous. Identify and begin to correct gender biases in the country's legal framework, as well as in the WBG's own portfolio. **For WBG performance:** Improved understanding of indigenous and gender issues, and related projects being satisfactorily implemented. Expanded analytical work on poverty and inequality leads to better targeted operations.
Balance growth and poverty reduction with protecting the environment.	Establishing an adequate incentive framework for environmental protection and for the decentralization of environmental management. Breaking the vicious circle between degradation and survival.	Environmental SAL FY02 Air Quality II FY04 Community Forestry FY04 Environmental SAL II FY05 IFC's Operations in Environmentally-sound Infrastructure FY03–05 IFC's Operations in Sustainable Development Business Practices FY03-05	Degradation and Poverty FY03 Environment and Growth FY04	**For country:** Better and more decentralized management of water and forestry resources. Improvement of air quality in Mexico City. **For WBG performance:** Effective contribution to environmental policy reforms and to capacity building at the state level. Better understanding of the incentive structure driving environmental degradation and its linkages with poverty and growth.
	Pursuing opportunities for harnessing global benefits to the advantage of local development.	GEF Protected Areas II and III FY03/ FY04 GEF Climate Change-Hybrid Technology FY03 PCF – Carbon Sequestration in Coffee Areas FY03 GEF – Persistent Organic Pollutants FY03 GEF – Gulf of Cortez FY04		**For country:** Expanded protected areas system to new reserves. Contribution to climate change initiatives through better transport technology and carbon sequestration. **For WBG performance:** Catalyst role in Mexico's seizing opportunities to contribute to global-level biodiversity conservation and climate change mitigation.
Building an efficient, accountable and transparent government.	Pursuing Decentralization (*Federalismo*) Along a Sustainable Path	Municipal Development in Rural Areas FY02 EdoMex TAL FY02 State Infrastructure Decentralization APL FY03 State-level Adjustment FY03	State-level CFAA FY03 State-level CPAR FY03 Reform of the Fiscal Pact FY03 State-level PER FY03 State-level CEM FY03 State-level CFAA II FY04 State-level CPAR II FY04	**For country:** Decentralization is proceeding apace, while fiscal discipline at subnational levels is maintained. Improved institutional capacity among states and municipalities.

Table 6. Mexico—CAS Matrix FY03–05

COUNTRY DEVELOPMENT OBJECTIVES	GOVERNMENT INSTRUMENTS	WORLD BANK GROUP'S SUPPORT INSTRUMENTS		PROGRESS BENCHMARKS
		FINANCIAL	NON-FINANCIAL	
Building an efficient, accountable and transparent government *(continued)*	Pursuing Decentralization (*Federalismo*) Along a Sustainable Path *(continued)*	State-level TAL Window FY04 State-level Adjustment II FY04 Municipal Development in Rural Areas II FY05 State Infrastructure Decentralization APL II FY05 State-level Adjustment III FY05	State-level PER II FY04 State-level CFAA III FY05 State-level CPAR III FY05 State-level CEM II FY05 WBI Sub-national Training Programs FY03–05	**For WBG performance:** Catalyst role in improving coordination across levels of government, strengthening the sustainability of decentralization, and facilitating state adjustment. Effective contribution to institutional capacity at the subnational level.
	Fostering a more efficient and more accessible judicial system	Access to Justice LIL FY03 Judicial Reform Loan FY05	Judicial Reform Agenda FY03	**For country:** Dispute resolution mechanisms are faster, more efficient, and more accessible, at both national and subnational level. **For WBG performance:** Instru-mental contribution to putting in motion judicial reform across all levels of government.
	Strengthening anticorruption Mechanisms	Anticorruption Mechanisms Loan FY04	Anticorruption TA Window FY03–05 State-level CFAA FY03–05 State-level CPAR FY03–05 WBI Transparency Training Programs FY03–05	**For country:** Mexico's international ranking of transparency is significantly improved. **For WBG performance:** Lending and nonlending support to transparency enhancements prove effective and sustainable.
	Expanding the role of civil society in government accountability		Civil Society Organization Dialogue and TA FY03–05	**For country:** CSOs participation in public policy formulation and accountability. Enhanced institutional capacity of CSOs. **For WBG performance:** Local CSOs participation in IBRD operations is deepened at all stages of the project cycle. Network of CSO dialogue is expanded.

Table 7. Mexico—World Bank Group Financial Instruments—FY2003–2005

FY03	FY04	FY05
Policy-based		
Rural Finance SECAL ($200 million) ISSSTE SECAL ($500 million) State-level Adjustment ($200 million)	Highway Finance Loan ($200 million) Financial Sector SECAL I ($200 million) Health System Reform IMSS ($200 million) State-level Adjustment II ($200 million)	Power Sector Reform Hybrid Loan ($200 million) Financial Sector SECAL II ($200 million) Environmental SAL II ($200 million) State-level Adjustment III ($200 million)
Standard Investment Projects		
National Urban Upgrading Loan ($50 million) Off-grid Rural Electrification Loan ($5 million) Water & Sanit. Modernization ($200 million) Irrigation Sector ($220 million) Tech. Training & Certification ($150 million) ISSSTE TAL ($15 million)	Ag. Productivity II ($300 million) Science Education ($100 million) Air Quality II ($100 million) Community Forestry ($100 million) State-level TAL Window ($50 million) Anti-corruption Mechanisms Loan ($50 million)	Science and Techn. II ($150 million) Indigenous Health ($50 million) Municipal Development in Rural Areas II ($200 million) Judicial Reform Loan ($30 million)
APLs (new and follow-ups)		
States Infrastructure Decentralization APL I ($250 million)	Rural Develop. Marginal Areas APL III ($100 million)	States Infrastructure Decentralization APL II ($200 million) Basic Ed. APL III ($170 million)
LIL		
Access to Justice LIL ($5 million) Land Titling LIL ($5 million)		

continued

Table 7. Mexico—World Bank Group Financial Instruments—FY2003–2005 (continued)

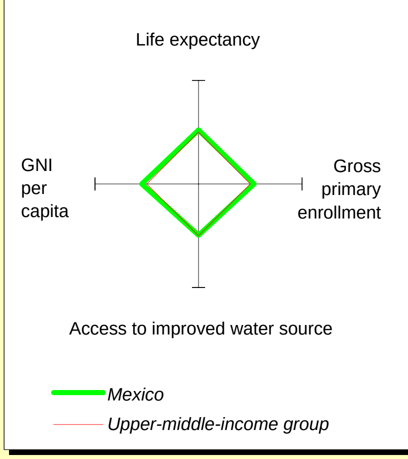
<table>
<tr><th>FY03</th><th>FY04</th><th>FY05</th></tr>
<tr><td colspan="3">GEF/MP</td></tr>
<tr><td>GEF Protected Areas II
GEF Climate Change-Hybrid Technology
GEF Persistent Organic Pollutants
PCF – Carbon Sequestration in Coffee Areas</td><td>GEF Protected Areas III
GEF Gulf of Cortez</td><td></td></tr>
<tr><td colspan="3">IDF/Grants</td></tr>
<tr><td>Municipal Development-Capacity Building</td><td></td><td></td></tr>
<tr><td colspan="3">IFC[a/]</td></tr>
<tr><td>IFC’s Operations in Transport, Power, Water, Sanit. & Hydrocarbons
IFC’s Financial Sector Projects
IFC Financial Intermediary Operations for MSME
IFC’s Operations with Private Education Providers
IFC’s Operations with Private Health Providers
IFC’s Operations in Sustainable Development Business Practices FY03-05
IFC Operations in Agribusiness
IFC Direct Support for Middle-Market Companies; Corporate Governance Support</td><td>IFC’s Operations in Transport, Power, Water, Sanit. & Hydrocarbons
IFC’s Financial Sector Projects
IFC Financial Intermediary Operations for MSME
IFC’s Operations with Private Education Providers
IFC’s Operations with Private Health Providers
IFC’s Operations in Sustainable Development Business Practices FY03-05
IFC Operations in Agribusiness
IFC Direct Support for Middle-Market Companies; Corporate Governance Support</td><td>IFC’s Operations in Transport, Power, Water, Sanit. & Hydrocarbons
IFC’s Financial Sector Projects
IFC Financial Intermediary Operations for MSME
IFC’s Operations with Private Education Providers
IFC’s Operations with Private Health Providers
IFC’s Operations in Sustainable Development Business Practices FY03-05
IFC Operations in Agribusiness
IFC Direct Support for Middle-Market Companies; Corporate Governance Support</td></tr>
<tr><td>Note:
IBRD overall projected lending commitment in FY03 is $1,800 million, of which $900 million in adjustment lending</td><td>IBRD overall projected lending commitment in FY04 is $1,600 million, of which $800 million in adjustment lending</td><td>IBRD overall projected lending commitment in FY05 $1,600 million, of which $800 million in adjustment lending</td></tr>
</table>

a. All IFC instruments are indicative, and subject to the Mexican private sector's demand for IFC assistance.

Mexico at a glance

POVERTY and SOCIAL	Mexico	Latin America & Carib.	Upper-middle-income
2000			
Population, mid-year *(millions)*	98.0	516	647
GNI per capita *(Atlas method, US$)*	5,080	3,680	4,620
GNI *(Atlas method, US$ 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

Development diamond*

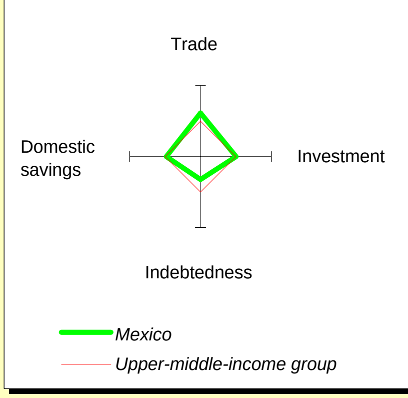


KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1980	1990	1999	2000
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	26.1
Present value of debt/exports	..	..	102.6	77.8

	1980-90	1990-00	1999	2000	2002-04
(average annual growth)					
GDP	1.1	3.1	3.8	6.9	3.3
GDP per capita	-1.0	1.4	2.3	5.4	1.9
Exports of goods and services	7.0	14.6	12.4	16.0	7.2

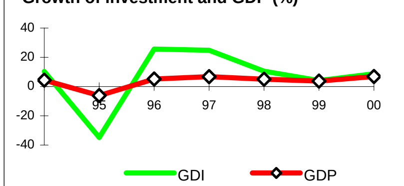
Economic ratios*



STRUCTURE of the ECONOMY

	1980	1990	1999	2000
(% 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

Growth of investment and GDP (%)

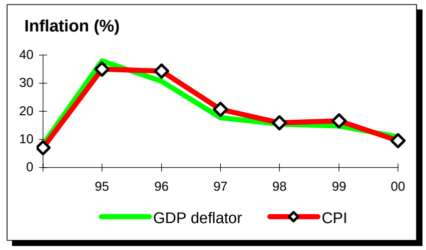


	1980-90	1990-00	1999	2000
(average annual growth)				
Agriculture	0.8	1.8	2.0	2.1
Industry	1.1	3.8	4.2	6.6
Manufacturing	1.5	4.4	4.2	7.1
Services	1.4	2.9	3.7	7.4
Private consumption	1.4	2.4	4.3	9.5

Mexico

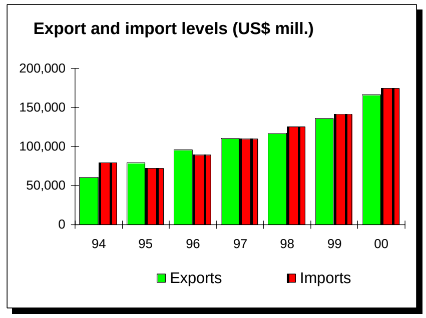
PRICES and GOVERNMENT FINANCE

	1980	1990	1999	2000
Domestic prices				
(% change)				
Consumer prices	..	26.7	16.6	9.5
Implicit GDP deflator	33.4	28.1	14.9	10.9
Government finance				
(% of GDP, includes current grants)				
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



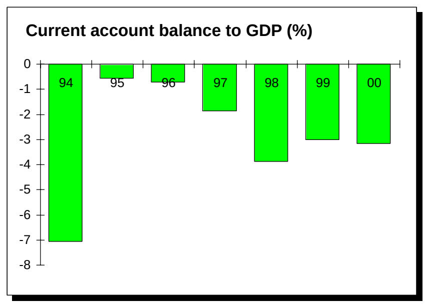
TRADE

	1980	1990	1999	2000
(US$ millions)				
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
Food	2,448	5,099	12,175	16,691
Fuel and energy	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



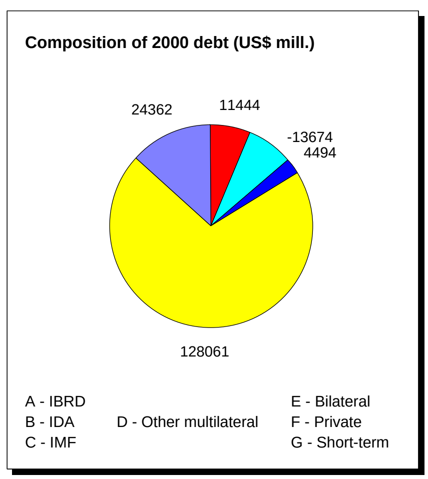
BALANCE of PAYMENTS

	1980	1990	1999	2000
(US$ millions)				
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
(US$ millions)				
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



CAS Annex B2 — Mexico
Selected Indicators* of Bank Portfolio Performance and Management
As of March 14, 2002

Indicator	1999	2000	2001	2002[a]
Portfolio Assessment				
Number of Projects Under Implementation [a]	24	26	28	28
Average Implementation Period (years) [b]	3.4	3.3	3.1	3.4
Percent of Problem Projects by Number [a, c]	12.5	11.5	10.7	7.1
Percent of Problem Projects by Amount [a, c]	10.1	13.3	12.6	3.7
Percent of Projects at Risk by Number [a, d]	12.5	11.5	10.7	7.1
Percent of Projects at Risk by Amount [a, d]	10.1	13.3	12.6	3.7
Disbursement Ratio (%) [e]	20.2	22.9	25.7	9.6
Portfolio Management				
CPPR during the year (yes/no)	No	No	No	--
Supervision Resources (total US$000)	1,866.6	2,386.6	2,144.5	--
Average Supervision (US$000/project)	77.8	91.8	76.6	--

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	118	22
Proj Eval by OED by Amt (US$ millions)	22,279.9	4,113.1
% of OED Projects Rated U or HU by Number	28.4	10.0
% of OED Projects Rated U or HU by Amt	0	0

a. As shown in the Annual Report on Portfolio Performance. For current FY data as of March 14, 2002.
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio,

Mexico—Country Assistance Strategy
Annex B3. Bank Group Program Summary, FY2002–05
Proposed IBRD Lending Program, FY2002–05

FY	Project	Amount (US$ millions)	Strategic Rewards	Implementation Risks
2002				
	Tax Reform SAL	200	H*	L
	Tax Administration TAL	30	H	M
	Savings & Loan Sector Development	43	H	M
	Environmental SAL	200	M	M
	Municipal Development in Rural Areas	400	M	M
	EdoMex TAL	27	H	M
	Urban Microbusiness	8	M	M
	Landing Titling LIL	5	M	M
	Total FY02	905		
2003				
	Rural Finance SECAL	200	M	M
	ISSSTE SECAL	500	H	H
	State-level Adjustment	200	H	M
	National Urban Upgrading Loan	50	M	M
	Off-grid Rural Electrification Loan	5	M	L
	Water & Sanitation Modernization	200	M	M
	Irrigation Sector	220	M	L
	Technical Training & Certification	150	M	L
	ISSSTE TAL	15	H	M
	State Infrastructure Decent. APL I	250	H	H
	Access to Justice LIL	5	H	H
	Land Titling LIL	5	M	M
	GEF Protected Areas II		M	M
	GEF Climate Change-Hybrid Technology		M	M
	PCF Carbon Sequestration in Coffee Areas		M	M
	Total FY03	1,800		
2004				
	Highway Finance Loan	200	H	M
	Finance Sector SECAL	200	H	L
	Health System Reform IMSS	200	H	M
	State-level Adjustment II	200	H	M
	Agricultural Productivity II	300	M	L
	Science Education	100	M	L
	Air Quality II	100	M	L
	Community Forestry	100	M	L
	State-level TAL Window	50	H	M
	Anti-corruption Mechanisms Loan	50	H	H
	Rural Develop. Marginal Areas APL III	100	M	M
	GEF Protected Areas III		M	M
	Total FY04	1,600		
2005				
	Power Sector Reform Hybrid Loan	200	M	M
	Financial Sector SECAL II	200	M	L
	Environmental SAL II	200	M	L
	State-level Adjustment III	200	H	M
	Science and Technology II	150	M	L
	Indigenous Health	50	M	L
	Municipal Development in Rural Areas II	200	M	L
	Judicial Reform Loan	30	H	M
	States Infrastructure Decent. APL II	200	H	M
	Basic Education APL III	170	M	L
	Total FY05	1,600		
	TOTAL	5,905		

* H = High, M = Moderate, L = Low.

CAS Annex B3 (IFC & MIGA) — Mexico
IFC and MIGA Program, FY 1999-2001

	1999	2000	2001
IFC approvals (US$m)[1]	121	210	232
Sector (%)[1]			
Agribusiness	0	0	3
Chemicals	0	21	4
Financial Services	44	1	92
Infrastructure	1	46	0
Manufacturing & Services	55	14	1
Social Services	0	17	0
Total	**100**	**100**	**100**
Investment instrument (%)[1]			
Loans	73	86	93
Equity	18	9	5
Quasi-Equity	9	0	1
Other	0	5	0
Total	**100**	**100**	**100**
MIGA guarantees (US$m)	0	0	0

[1] Approvals for IFC's own account; approvals including syndications amounted to US$131m (1999), US$401m (2000), and US$332m (2001).

Mexico—CAS FY03–05
Annex B4. Summary of Nonlending Services

Consolidating Macroeconomic Stability

Macro-monitoring (ongoing)	158
Reform of the Fiscal Pact FY03	41
Public Expenditure Management FY04	81
Promoting Trade FY04	81
International Factor Mobility FY04	158
Country Economic Memorandum FY05	158
Economic Shocks and Fiscal Responses FY05	81
Labor Market Convergence FY05	158
Public Debt Management FY05	41

Accelerating Growth Through Enhanced Competitiveness

Financial Sector Monitoring (ongoing)	81
Coffee Sector Study FY02	81
Sugar Sector Restructuring FY02	81
Insurance Sector Report FY03	41
Agricultural Competitiveness FY03	158
Rural Pension Schemes FY03	41
Warehousing Schemes FY03	41
Energy Sector Dialogue FY03	41
SME Development FY03	81
Energy Sector Review FY04	41
Low-Income Housing FY04	81
Rural Enterprise Development FY04	81
Urban Land Management FY05	

Human Capital Development

Gender Assessment of Legal Framework FY02	41
Dissemination of *Gender & the Mexican Econ.* FY03	10
Poverty Assessment 03	158
Impact of PROGRESA FY03	41
Knowledge-Economy Assessment FY03	
Evaluation Basic Healthcare FY03	
Adult Education Study FY03	81
Secondary Education Study FY04	41
Indigenous Health FY 04	81
Urban Poverty FY03	81
Social Safety Net Evaluation FY04	81
Portfolio Gender Assessment FY04	41
Business Cycle and the Poor FY04	81
Growth Poverty and Inequality FY04	81
Indigenous People Access to Assets and Markets FY04	

Balance Growth and Poverty Reduction with Protecting the Environment

Degradation and Poverty FY03	81
Environment and Growth FY04	81

Building an Efficient, Accountable, and Transparent Government

State-level CFAA FY03	90
State-level CPAR FY03	90
State-level PER FY03	81
State-level CEM FY03	81
Judicial Reform Agenda FY03	81
State-level CFAA II FY04	90
Anticorruption TA Window FY03–05	158
State-level CFAA FY03–05	90
State-level CPAR FY03–05	90
WBI Transparency Training Programs FY03–05	—
Civil Society Organization Dialogue and TA FY03–05	158

CAS Annex B5 — Mexico
Poverty and Social Development Indicators

	Latest single year	Same region/income group	
	1995-2000	**Latin America & Caribbean**	**Upper-middle Income**
POPULATION			
Total population, mid-year (millions)	97.4	508.2	571.5
Growth rate (% annual average for period)	1.3	1.6	1.4
Urban population (% of population)	74.7	74.9	75.4
Total fertility rate (births per woman)	2.4	2.6	2.4
POVERTY (unadjusted figure-all poor)			
(% of population)			
National headcount index	45.73	..	..
Urban headcount index	36.33	..	..
Rural headcount index	73.29	..	..
INCOME			
GNI per capita (US$)	5,080	3,800	4,870
Consumer price index (1995 = 100)	219	140	131
Food price index (1995=100)	227	..	..
INCOME/CONSUMPTION DISTRIBUTION			
Share of income or consumption			
Gini index	51.9	..	..
Lowest decile	4.0	..	..
Highest decile	56.7	..	..
SOCIAL INDICATORS			
Public expenditure			
Health (percent of GDP)	2.3	3.3	3.3
Education (percent of GDP)	4.9	3.6	5.0
Social Security (percent of GDP)	2.9	7.4	7.9
Net primary school enrollment rate			
(% of age group)			
Total	101	91	94
Male	101	..	..
Female	102	..	..
Access to an improved water source			
(% of population)			
Total	86	85	87
Urban	63	93	94
Rural	94	62	68
Immunization rate			
(% under 12 months)			
Measles	96	90	90
DPT	96	87	88
BCG	99	..	..
Child malnutrition *(percent under 5 years)*	8	9	..
Life expectancy at birth *(years)*			
Total	75	70	69
Male	73	67	66
Female	78	73	73
Mortality			
Infant (per thousand live births)	29	30	27
Under 5 (per thousand live births)	36	38	34
Adult (ages 15-59)			
Male (per 1,000 population)	166	207	233
Female (per 1,000 population)	104	122	143
Maternal (per 100,000 live births)	55	..	..
Births attended by skilled health staff (%)	92	..	..

Source: 2000 Census INEGI, and 2001 World Development Indicators.

CAS Annex B6 — Mexico
Key Economic Indicators

Indicator	Actual 1997	Actual 1998	Actual 1999	Actual 2000	Estimated 2001	Projected 2002	Projected 2003	Projected 2004
National accounts (as % GDP at current market prices)								
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	5.5	5.2	4.7	4.2	4.4	4.5	4.5	4.4
Industry[a]	28.6	28.6	28.8	27.9	27.0	27.7	28.0	28.2
Services[a]	65.9	66.2	66.5	67.8	68.6	67.8	67.5	67.3
Total Consumption	74.2	77.8	78.1	78.7	81.3	81.5	81.1	80.6
Gross Domestic Investment	25.9	24.3	23.5	23.1	20.9	21.4	21.9	22.4
Government Investment	3.1	2.8	2.9	2.9	2.9	3.7	4.0	4.2
Private Investment (includes increase in stocks)	22.8	21.5	20.6	20.2	18.0	17.7	18.0	18.2
Exports (GNFS)[b]	30.4	30.7	30.9	31.1	27.8	27.8	28.4	28.9
Imports (GNFS)[b]	30.4	32.8	32.4	32.8	30.0	30.7	31.4	31.8
Gross Domestic Savings	25.8	22.2	21.9	21.3	18.7	18.5	18.9	19.4
Gross National Savings[c]	23.9	20.5	20.5	20.0	18.0	17.9	18.0	18.4
Memorandum items								
Gross Domestic Product (US$ million at current prices)	400,868	421,010	479,448	579,925	615,855	641,345	683,663	730,146
Gross National Product per Capita (US$, Atlas method)	3,710	4,000	4,440	5,080	5,520	5,940	6,330	6,660
Real Annual Growth Rates (%, calculated from 1993 prices)								
GDP at market prices	6.8	5.0	3.8	6.9	-0.3	1.5	4.1	4.5
Gross Domestic Income	7.7	4.2	4.6	8.3	-1.3	1.1	4.2	4.6
Real Annual per Capita Growth Rates (%, calculated from 1993 prices)								
GDP at market prices	5.2	3.6	2.3	5.4	-2.4	0.1	2.7	3.1
Total Consumption	4.4	3.5	2.8	7.2	-0.4	0.0	2.3	2.4
Private Consumption	4.9	4.0	2.8	7.9	-0.6	-0.7	2.2	2.3

CAS Annex B6 — Mexico
Key Economic Indicators (continued)

Indicator	Actual				Estimated	Projected		
	1997	1998	1999	2000	2001	2002	2003	2004
Balance of Payments (US$ m)								
Exports (GNFS)[b]	121,701	128,982	148,083	180,167	171,207	178,342	193,965	210,732
Merchandise FOB	110,431	117,460	136,391	166,455	158,547	164,946	179,699	195,423
Imports (GNFS)[b]	121,608	137,801	155,465	190,494	184,494	196,789	214,652	232,327
Merchandise FOB	109,808	125,373	141,975	174,458	168,276	179,898	196,647	213,097
Resource balance	94	-8,818	-7,382	-10,326	-13,287	-18,447	-20,688	-21,595
Net current transfers (including official current transfers)	5,247	6,012	6,313	6,994	9,338	10,009	10,727	11,499
Current account balance (after official capital grants)	-7,448	-16,090	-14,375	-17,737	-17,457	-22,701	-26,544	-29,037
Net private foreign direct investment	12,830	11,602	11,915	14,190	21,022	13,600	14,400	15,800
Portfolio investment	3,800	-451	3,901	401	1,092	1,146	1,204	1,264
Long-term loans (net)	356	12,420	11,479	4,416	113	9,353	11,889	11,301
Official	-4,567	-805	-1,703	-524	2	760	526	262
Private	4,922	13,225	13,182	4,940	112	8,592	11,363	11,039
Other capital (net, including errors and omissions)	4,395	-4,281	-8,643	5,850	2,645	61	74	87
Net use of IMF resources	-3,439	-1,063	-3,682	-4,299	0	0	0	0
Change in gross reserves	-10,494	-2,137	-594	-2,822	-7,330	-1,459	-1,023	585
Memorandum items								
Resource balance (% of GDP at current market prices)	0.0	-2.1	-1.5	-1.8	-2.2	-2.9	-3.0	-3.0
Current account balance (% of GDP at current market prices)	-1.9	-3.8	-3.0	-3.1	-2.8	-3.5	-3.9	-4.0
Annual growth rates (%)								
Merchandise exports	15.0	6.4	16.1	22.0	-4.8	4.0	8.9	8.8
Merchandise imports	22.7	14.2	13.2	22.9	-3.5	6.9	9.3	8.4

(Continued)

CAS Annex B7 — Mexico
Key Exposure Indicators

Indicator	Actual				Estimated	Projected		
	1997	1998	1999	2000	2001	2002	2003	2004
Total debt outstanding and disbursed (TDO) (US$m)[a]	148,697	161,404	167,626	164,686	165,099	174,513	186,476	197,865
Net disbursements (US$m)[a]	-3,083	11,357	7,797	117	413	9,413	11,961	11,387
Total debt service (TDS) (US$m)[a]	43,480	27,990	39,760	63,497	42,410	42,062	51,062	61,214
Debt and debt service indicators (%)								
TDO/XGS[b]	117.5	119.9	108.9	88.2	91.7	92.9	91.3	89.2
TDO/GDP	37.1	38.3	35.0	28.4	26.8	27.2	27.3	27.1
TDS/XGS[b]	34.4	20.8	25.8	34.0	23.5	22.4	25.0	27.6
IBRD exposure indicators (%)								
IBRD DS/public DS	6.5	10.6	10.1	7.4	15.8	17.4	16.5	13.2
Preferred creditor/ public DS (%)[c]	20.8	22.2	38.6	29.3	21.2	24.1	23.8	19.2
IBRD DS/XGS[b]	1.7	1.5	1.4	1.2	1.3	1.3	1.1	1.0
IBRD TDO (US$m)[d]	11,906	12,108	11,353	11,444	10,883	11,709	11,723	11,973
Present value of guarantees (US$m)	550	595	326	0	0	0	0	0
Share of IBRD portfolio (%)	11.0	10.2	9.3	9.4	9.0	9.2	9.3	9.6
IFC (US$m)[e]								
Loans	402	263	366	455	519	…	…	…
Equity and quasi-equity[f]	165	154	170	209	214	…	…	…

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.
b. "XGS" denotes exports of goods and services, including workers' remittances.
c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank of International Settlements.
d. Includes present value of guarantees.
e. IFC's own account exposure (excluding guarantees and risk management products).
f. Includes equity and quasi-equity types of both loan and equity instruments.

CAS Annex B8 — Mexico

Status of Bank Group Operations in Mexico Operations Portfolio

As of March 14, 2002

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions				Diference between expected and actual disbursements a/		Last PSR Supervision Rating b/	
				IBRD	IDA	Cancel.	Undisb.	Orig	Frm Rev'd	Dev Obj	Imp Prog
Number of Closed Projects: 157											
Active Projects											
MX-PE-7648	1993	BANOBRAS	MEDIUM CITIES TRANSP	200.0	0.0	63.0	55.8	118.8	95.8	S	S
MX-PE-7710	1994	BANOBRAS	N. BORDER I ENVIRONM	368.0	0.0	313.4	23.6	337.0	62.3	S	S
MX-PE-7701	1994	NAFIN	ON-FARM & MINOR IRRI	200.0	0.0	30.0	11.9	41.9	11.9	S	S
MX-PE-34490	1995	NAFIN	TECHNICAL EDUC/TRAINING	265.0	0.0	69.7	51.3	120.9	90.9	S	U
MX-PE-7689	1996	NAFIN	BASIC HEALTH II	310.0	0.0	0.0	29.6	29.6	29.6	HS	HS
MX-PE-7713	1996	NAFIN	WATER RESOURCES MANA	186.5	0.0	0.0	120.4	101.2	41.9	S	S
MX-PE-7700	1997	NAFIN	COMMUNITY FORESTRY	15.0	0.0	0.0	6.1	5.1	0.0	S	S
MX-PE-44531	1998	NAFIN	KNOWLEDGE & INNOV.	300.0	0.0	0.0	195.4	67.0	0.0	S	S
MX-PE-7720	1998	BANOBRAS	HEALTH SYSTEM REFORM - SAL	700.0	0.0	0.0	150.0	150.0	0.0	S	S
MX-PE-55061	1998	BANOBRAS	HEALTH SYSTEM REFORM TA	25.0	0.0	0.0	1.3	1.3	0.0	S	HS
MX-PE-49895	1998	BANOBRAS	HIGHER ED. FINANCING	180.2	0.0	0.0	144.3	72.1	0.0	S	S
MX-PE-7711	1998	NAFIN	RURAL DEV. MARG.AREA	47.0	0.0	0.0	30.2	22.5	0.0	S	S
MX-PE-48505	1999	NAFIN	AGRICULTURAL PRODUCT	444.5	0.0	0.0	155.6	52.5	-28.1	S	S
MX-PE-7610	1999	BANOBRAS	FOVI RESTRUCTURING	505.1	0.0	0.0	312.0	308.7	0.0	S	S
MX-PE-66938	2000	NAFIN	GENDER (LIL)	3.1	0.0	0.0	3.1	1.4	0.0	U	U
MX-PE-57530	2000	NAFIN	RURAL DEV.MARG.AR II	55.0	0.0	0.0	42.7	5.4	0.0	S	S
MX-PE-64887	2001	BANOBRAS	DISASTER MANAGEMENT	404.1	0.0	0.0	395.7	45.0	0.0	S	S
MX-PE-65779	2001	BANOBRAS	FEDERAL HIGHWAY MAINTENANCE PROJ	218.0	0.0	0.0	206.9	-11.1	0.0	S	S
MX-PE-70479	2001	BANOBRAS	EDO DE MEXICO SAL	505.1	0.0	0.0	200.0	-304.6	0.0	S	S
MX-PE-71323	2001	NAFIN	BANK RESTRUCTURING FACILITY II	505.1	0.0	0.0	350.0	-51.7	0.0	S	S
MX-PE-66321	2001	NAFIN	BASIC HEALTH CARE PROJ. III	350.0	0.0	0.0	350.0	0.0	0.0	S	S
MX-PE-60577	2002	NAFIN	SOUTHEAST REGIONAL DEVELOPMENT	5.0	0.0	0.0	5.0	0.0	0.0	S	S
Total				5,791.4	0.0	476.1	2,840.8	1,113.0	304.3		

	Active Projects	Closed Projects	Total
Total Disbursed (IBRD and IDA):	2,474.6	24,541.7	27,016.3
of which has been repaid:	84.4	18,435.3	18,519.7
Total now held by IBRD and IDA:	5,230.9	6,121.9	11,352.9
Amount sold :	0.0	92.3	92.3
of which has been repaid:	0.0	92.3	92.3
Total Undisbursed :	2,840.7	15.5	2,856.3

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): se proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

CAS Annex B9 (IFC) — Mexico
Statement of IFC's Held and Disbursed Portfolio
As of February 28, 2002
(In US Dollars Millions)

		Held				Disbursed			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1998	CIMA Mexico	0.00	4.80	0.00	0.00	0.00	4.80	0.00	0.00
1998	CIMA Puebla	6.75	0.00	0.00	0.00	3.25	0.00	0.00	0.00
1994/01	CTAPV	2.88	0.00	1.69	0.00	2.88	0.00	1.69	0.00
2000	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
1997/01	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	16.23	0.00	10.00	54.57	16.23	0.00	10.00	54.57
1993	GIDESA	2.50	0.00	0.00	0.00	2.50	0.00	0.00	0.00
1994/96/00	GIRSA	57.00	0.00	5.71	70.00	57.00	0.00	5.71	70.00
1993	GOTM	0.33	0.00	0.00	0.00	0.33	0.00	0.00	0.00
1997/98	Gen. Hipotecaria	0.00	3.29	0.00	0.00	0.00	3.29	0.00	0.00
2001	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
1989	Grupo FEMSA	0.00	5.26	0.00	0.00	0.00	5.26	0.00	0.00
1997	Grupo Minsa	12.00	10.00	0.00	18.00	12.00	10.00	0.00	18.00
1992/93/95/96/99	Grupo Posadas	34.65	5.00	15.00	5.00	34.65	5.00	15.00	5.00
1998	Grupo Sanfandila	8.09	0.00	0.00	3.61	6.76	0.00	0.00	2.95
1994/96/98/00	Heller Financial	0.00	3.12	0.00	0.00	0.00	3.12	0.00	0.00
2000	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
1994	Interceramic	5.00	0.00	4.00	0.00	5.00	0.00	4.00	0.00
2000/01	InverCap	0.00	1.07	0.00	0.00	0.00	1.06	0.00	0.00
1998	Merida III	29.59	0.00	0.00	72.15	29.59	0.00	0.00	72.15
1995/96/99	Mexplus Puertos	0.00	4.46	0.00	0.00	0.00	4.46	0.00	0.00
1996/99/00/01	NEMAK	0.00	0.00	9.04	0.00	0.00	0.00	9.03	0.00
2000/01	Pan American	0.00	9.00	0.00	0.00	0.00	9.00	0.00	0.00
2002	Puertas Finas	13.00	0.00	0.00	0.00	0.00	0.00	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
2001	Su Casita	0.00	10.62	0.00	0.00	0.00	10.62	0.00	0.00
1999	Sudamerica	0.00	15.00	0.00	0.00	0.00	15.00	0.00	0.00
1997	TMA	2.58	0.00	2.60	8.95	2.58	0.00	2.60	8.95
1992	Toluca Toll Road	4.83	0.00	0.00	0.00	4.83	0.00	0.00	0.00
1991/92	Vitro	0.00	10.17	0.00	0.00	0.00	10.17	0.00	0.00
1998	ZN Mxc Eqty Fund	0.00	15.30	0.00	0.00	0.00	14.77	0.00	0.00
2002	ZN Mexico II	0.00	10.00	0.00	0.00	0.00	0.90	0.00	0.00
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
1990/92/96/99	BANAMEX	75.71	0.00	0.00	5.49	75.71	0.00	0.00	5.49
2001	BBVA-Bancomer	86.47	0.00	0.00	0.00	86.47	0.00	0.00	0.00
1995/99	Baring MexFnd	0.00	11.82	0.00	0.00	0.00	11.24	0.00	0.00
Total Portfolio:		564.60	156.14	51.26	435.42	514.93	142.28	51.25	422.00

Approvals Pending Commitment

		Loan	Equity	Quasi	Partic
1998	Cima Hermosillo	7.00	0.00	0.00	0.00
1999	BANAMEX LRF II	50.00	0.00	0.00	0.00
2002	Coppel	30.00	0.00	0.00	0.00
2000	Educacion	3.20	0.00	0.00	0.00
2001	BBVA-Bancomer CL	100.00	0.00	0.00	0.00
2001	Su Casita	0.00	0.00	2.40	0.00
2001	GFNorte-CL	100.00	0.00	0.00	100.00
2001	La Colorada	4.30	0.00	6.00	18.30
2001	Greenmanor	7.00	0.00	0.00	0.00
2001	PanAme-La Colora	0.00	1.20	0.00	0.00
Total Pending Commitment:		301.50	1.20	8.40	118.30