Office of Evaluation and Oversight, OVE
Inter-American Development Bank

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Country Program Evaluation (CPE): Mexico (1990 – 2000)

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Acronyms and Abbreviations

BANOBRAS	Banco Nacional de Obras y Servicios Públicos, S.N.C.
BANXICO	Banco de México
CAC	Central American Countries
CAMEL	Capital Asset Quality Management Earnings and Liquidity Evaluation System
CFE	Comisión Federal de Electricidad
CIMO	Calidad Integral y Modernización
CNA	Comisión Nacional del Agua
CNBV	Comisión Nacional Bancaria y de Valores
COFETEL	Comisión Federal de Telecomunicaciones
CONASUPO	Compañía Nacional de Subsistencias Populares
CP	Country Paper
CPE	Country Program Evaluation
EFF	Expanded Fund Facility
ESW	Economic Sector Work
EXIMBANK	Export -Import Bank
FDI	Foreign Direct Investment
FIRA	Fideicomisos Instituidos en Relación con la Agricultura
FOBAPROA	Fondo Bancario de Protección al Ahorro
FONHAPO	Fondo Nacional de Habitaciones Populares
FOVI	Fomento a la Vivienda
FOVISSTE	Fondo de la Vivienda del Instituto del Seguro Social al Servicio de los Trabajadores
GATT	General Agreement on Tariffs and Trade
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
INFONAVIT	Instituto del Fondo Nacional de la Vivienda de los Trabajadores
IPAB	Instituto de Protección al Ahorro Bancario
IPPS	Independent Power Producers
LFC	Luz y Fuerza del Centro
MDB	Multilateral Development Banks
MIF	Multilateral Investment Fund
MTE	Mid -Term Evaluation
NAFIN	Nacional Financiera
NAFTA	North American Free Trade Agreement
OECF	Overseas Economic Cooperation Fund of Japan
PBL	Policy Based Loans
PCR	Project Completion Report
PIDIREGAS	Proyectos Infraestructura Productiva de Largo Plazo Impacto Diferido en el Registro

PPMR	Project Performance Monitoring Report
PRI	Partido Revolucionario Institucional
PRI-IDB	Private Sector Department
PROBECAT	Programa de becas de capacitación para los trabajadores
PROCAMPO	Programa de Apoyos Directos al Campo
PROCEDE	Programa de Certificación de Derechos Ejidales y Titulación de Solares Urbanos
PROGRESA	Programa de Educación Salud y Alimentación
PRONASOL	Programa Nacional de Solidaridad
PROSSE	Programa de Servicios Esenciales
RES	Research Department
SCT	Secretaría de Comunicaciones y Transportes
SECODAM	Secretaría de la Contraloría y Desarrollo Administrativo
SEP	Secretaría de Educación Pública
SHCP	Secretaría de Hacienda y Crédito Público
SMP	Small Medium Project
SME	Small Medium Enterprises
SNG	Sub-National Governments
SOFOLES	Sociedad Financiera de Objeto Limitado
STPS	Secretaría del Trabajo y Previsión Social
TELMEX	Teléfonos de México

Note: Throughout this document, more information is provided on the corresponding organizations, departments, ministries, institutions, projects and documents, by clicking on the corresponding words in blue in the electronic version of this document.

Executive Summary

This report presents the Office of Evaluation and Oversight's evaluation of the Bank's program with Mexico from 1990 to 2000. This evaluation is based on the standard evaluative criteria adopted by the Evaluation Cooperation Group of the MDBs: relevance, efficiency of delivery-implementation, focus, and effectiveness. The purpose of the exercise is to improve the development effectiveness of the Bank's program. From the evaluation are drawn out recommendations as inputs to the discussion of how to improve the Bank's performance in the country.

Before summarising the findings respecting each criterion, this report briefly presents three points that need to be kept in mind in the reading of the evaluation's findings.

First, the Bank's program in the country has to be placed in the context of a government with a solid institutional basis and a tight budgetary process. These two features imply that Mexico is firmly in the driver's seat in its relation with the Bank, but also means that Bank lending does not provide any additional budgetary authority to any executing unit or agency. In such an environment, any "additionality" for the Bank must be found in qualitative rather than quantitative terms.

Second, an evaluation of the Bank's program has to take into consideration that given the size of the public sector's financial resources, the financial weight of Bank intervention has been at best modest. Therefore disentangling and assessing the development impact of the Bank's intervention is difficult. However, the problem of attribution is reduced to the extent that the program's individual projects clearly set out their results framework and the extent that the Bank collected information regarding progress towards realising those expected results.

Third, the evaluation of the Bank's program has to take note of the macro-structural features of the country as these provide the context within which the Bank's program was conceived and modified. The country and regional context in which the Bank was operating changed dramatically during the period under review. During the nineties the country went through one complete cycle: a consumption led boom up to 1993, a crisis in 1995, and an investment led recovery from 1996 to 2000. Despite substantial policy reforms from the mid-eighties onwards, the country neither reverted the decline in total factor productivity that began in the early eighties nor returned to the high average growth rate of the 1960's-70's. Nonetheless growth improved with respect to the eighties. Economic growth combined with fiscal prudency led to an increasing infrastructure gap, which the private sector did not fill. Further, economic growth benefited mainly the upper income households with the poorest seeing declines in household real per capita income. These trends were compounded by a macroeconomic crisis in the mid 1990s, and together they produced a pattern of stubbornly high levels of poverty which left a legacy of inequality of opportunities and capabilities. The rural extreme poor were particularly hard hit due to the reforms in that sector despite a gamut of mitigating poverty programs. These programs begin to be effective by 1998 when rural poverty as well as overall poverty begins to fall. The Mexican economy has become increasingly integrated with that of the United States, implying, alongside the benefits, an increased sensitivity to macroeconomic fluctuations in the North. Integration with the USA economy may have partly contributed to an increased regional divergence within the country. Concurrently the nineties were characterised by a radical transformation of the decentralisation framework.

Relevance

Assessing relevance involves determining whether the program and the strategies therewith were consistent with the country's priorities and the Bank's mandates. It also involves determining whether the Bank's programming priorities addressed the country's needs. In addressing relevance it is necessary to uncover the program's intent –in terms of issues to be tackled and aggregate lending - and to judge the adequacy of the Bank's diagnosis of the country's development challenges. To summarise OVE's reading of the IDB-Mexico programming documents –covering 1990-2000- it is found that:

- Analysis and the diagnosis of the country's problems are few. The low number reflects the dearth of Bank resources allocated to economic and social work.
- The "priorities" outlined in the country papers are so broad and inclusive that no projects would be incompatible with them.
- No indication is given to the Bank's comparative advantage relative to other multilateral lenders.
- The Bank has not adequately anticipated its lending envelope hence its programmed projects. Many lending operations envisioned by the Bank were not realised.

A case can be made that the Bank's program overall was relevant in the dimensions of country ownership of the program and consistency with Bank mandates, and some individual projects received high marks for relevance. Amongst them can be mentioned: ME-0208, Strengthening States and Municipalities; ME-0051, The Municipal Development Program; ME-0118, Modernisation of the Labour Market; ME-0185 Food and Agriculture Sector Loan and the Financing Program for Southeast of Mexico Further, the Bank responded expeditiously to the country's 1995 crisis. It approved projects valued at $1,570 million thereby contributing to the "announcement effect" of the international rescue package. Net cash flow became strongly positive, thus the Bank also provided needy foreign exchange.

Focus

The Bank's program with Mexico cannot be said to be tightly focused. Country papers and other programming documents do not provide an ex-ante framework to focus Bank operations, and no *ex post* focus is evident from an inspection of the individual approved projects. A review of the projects collectively finds:

- Projects were scattered through several different sectors and had numerous stated objectives.
- No identifiable theme or focus related the multi-sector interventions.

The lack of apparent focus, combined with the clear ownership of the program by the country suggests that the Bank's program responded in general to project selection by the government. But neither a multi-sector intervention nor responding to the priorities of the government *necessarily* precludes focus. The 1993 Country Programming Paper, in fact, suggested "sustainable growth with equity" as an organising theme, but a review of subsequent operations finds no evidence of a systematic bias toward the poor:

- Using the Bank's official social–equity enhancing project classification, 26% of the number of projects and 35% of the total value of approvals between 1994-2000 were pro-poor biased.
- There were six operations directed at promoting capabilities and opportunities of the poor.
- In the financial sector none of the five operations had any direct pro-poor bias. However, it could be argued that the benefits of the projects, namely the financial deepening effect on economic growth, hence on poverty, should be considered.
- In the water sector, of the six operations, two (ME-0150, and ME-0138) had a pro-poor bias. However, by concentrating more of the Bank's water projects on unsatisfied rural demand, currently 34% of the population, more progress in increasing coverage could have been achieved.
- In agriculture the two sector loans, although mainly supporting the dismantling of the agricultural support system, had important conditionality requirements to mitigate the reform's negative

effects on the poor. In this the Bank made a significant contribution in re-designing a major poverty program, namely PROCAMPO.

- In two decentralisation projects, one of them (ME-0051) can be said to have a pro-poor bias. It essentially financed an existing government program, PRONASOL.
- In the electricity sector all nine projects, including seven PRI projects, were directed mainly at increasing power generation, which was realised. None were directed at providing service to the poor. Targeted differently, non-PRI operations could have gone towards meeting the unsatisfied demand of five million Mexican inhabitants.

In sum, the Bank's program did not have a marked pro-poor tilt. Such a tilt could constitute a valuable focus for the Mexican program and a viable niche for the Bank. The recently approved Labour Market and PROCAMPO operations and the proposed PROGRESA operation suggest that the country and the Bank are moving in this direction.

Implementation

Our evaluation of implementation of the program relying on the Bank's aggregate approval and disbursement performance data –during 1990-2000- strikes the following chords:

- The Bank had a low approval rate relative to the approval rate of the World Bank.
- The aggregate disbursement performance profile is just about the Bank's average. Further, disbursement performance was lower in 2000 (which was an election year) compared to 1990. Strong domestic institutions, plus the almost exclusive use of two public financial agents (BANOBRAS and NAFIN), should result in systematically better project performance in Mexico than elsewhere. OVE could not find any systematic pattern by sector or by agency, but did so by instrument. Multi-phase projects did systematically better in disbursement efficiency, even better than policy based loans.
- The approval rate and the disbursement profile, together with the maturity of the debt stock, implied an annual net financial flow that approximated zero in normal times but changed to significantly positive during the economic crisis of 1995-6.

These patterns, combined with the findings of interviews suggest two hypotheses:

- Although Mexico's borrowing from the Bank takes into account both financial and non-financial considerations, at the financial level , the Bank's loan's interest cost margin relative to alternative financing is tending towards zero as the country reaps the benefit of a reduced margin over LIBOR due to its investment grade classification. The Bank's effective interest cost margin is smaller once discounted by the risks associated with nature of Bank approvals and disbursements. It must be noted however, the attractiveness of the longer maturity profile of Bank loans vs. other debt issuance. From a broad viewpoint, amongst the non-financial considerations of Bank involvement could be –as asserted by the World Bank's OED for their program- value added in the following ways: by "providing direct technical assistance and useful policy advice; providing an objective, outsider's perspective on problems; communicating the lessons from international experience; using the Bank's " convening power" to bring about more productive dialogues among Mexican stakeholders; inducing greater coordination among units of government which normally do not communicate well with each other; insisting on technical norms for resource allocations that might otherwise be subject to excessive discretionality; and injecting a greater measure of discipline in project execution." These considerations are not necessarily internalised at the level of line Ministries.

- From the line Ministries' view point, given that the budgetary process implies no additional fiscal resources, the net value of the Bank's loans, can be defined as the value of knowledge transfer minus the value of the extra work involved in dealing with an international institution. The extra work associated with Bank financed relative to budgetary financed operations was emphasised (eleven out of eleven interviewees) while knowledge transfer was not (one out of eleven).

The Bank has made an effort to reduce the costs to Mexico of working with the Bank, particularly in the second half of the nineties. The Bank has:

- Increased its use of policy-based loans, multi-credit loans, and similarly functioning investment instruments (like ME-0208, Strengthening States and Municipalities, and ME-0118, Modernisation of the Labour Market). These innovative designed investment loans disbursed faster than Bank-wide policy based loans.
- Made loans execution procedures flexible by using *ex post* rather than *ex-ante* monitoring control (again like the two projects mentioned previously).
- Tacked operations increasingly onto existing budget items rather than Bank's conventionally designed "projects" (again like the two loans mentioned previously).

Still key tasks remain in order to obtain better delivery. One task is to realise the full potential of the institutional framework involving the trinity of SHCP, the financial agents, and the Bank – and between all three and the executing agencies. Another task is to take actions to obtain a positive net value on Bank loans from the ministries' point of view. This involves not only reducing the administrative burden placed on them, but also increasing knowledge transfer. This is a particularly difficult task given that the government can draw upon many more highly qualified personnel and world-wide experiences than the Bank can offer. Knowledge transfer is accomplished mainly through two mechanisms: diagnosis and dialogue; and as embodied in individual projects. With the Bank's limited resources relative to that of the country, the solution to the problematic of knowledge transfer could be to define a focus for the Bank interventions.

Efficiency and Effectiveness

Effectiveness (the developmental impact of the IDB's interventions), and efficiency (approval to cost ratio) of the program are difficult to gauge, because:

- Most operations approved in the nineties are still active.
- The Bank's monitoring and evaluation system does not customarily collect information on progress made- neither towards the outputs nor towards the outcomes of ongoing projects.
- Very few projects defined their development objective.
- Instruments designed to give feedback and information on project performance, have a low implementation record: 66% of the anticipated project completion reports, 20%, mid-term evaluations and 0%, of ex-post evaluations have been realised.
- Indicators of effectiveness at the sector level are available and can be used in ascertaining performance, but changes in them could not be attributed confidently to Bank interventions. Such sector-level indicators tend to be overshadowed by macroeconomic-sector effects, compared to which the effects of Bank programs are minor.
- The Bank, unlike the World Bank, does not collect and publish data on lending to administrative cost ratios or any other indicators of efficiency at the country program level.

Given the above difficulties, no general evaluative statement can be judiciously drawn about the development impact of individual projects nor the impact of the overall program. To gauge the overall effectiveness of the Bank's program, then, an option is to use the counterfactual, the "without- the- Bank-intervention scenario". It is difficult to marshal convincing arguments that "the- with- Bank-intervention" is significantly different from "the- without -Bank –intervention scenario". Specifically, it is rarely clear that Bank's projects fostered directional changes of policy, or changes in the structure of the economy and its institutions either at the macroeconomic or sectoral level, that would not have been realised in the absence of the Bank. At the individual project level it is also difficult to sustain that the activities financed by the Bank would not have been realised in the absence of the Bank.

Nonetheless, the evaluation found a number of innovative and successful projects, although there is no discernible pattern in their distribution between sectors or themes. Already mentioned previously are: ME-0208, Strengthening States and Municipalities; ME-0051, The Municipal Development Program; ME-0118, Modernisation of the Labour Market; and ME-0185 Food and Agriculture Sector Loan. Also should be highlighted the Financing Program for Southeast of Mexico which targets low-income indigenous population and women in poor areas through bottom up project selection.

Conclusions and Recommendations

Our evaluation of the Bank's Mexico program, despite some positive experiences, identifies shortcomings in each of the evaluative dimensions; and these findings should have implications for subsequent programming cycles. Five core recommendations are offered for consideration in subsequent programming cycles:

Improve knowledge transfer. To improve the Bank's program in the country, and to address the ex-ante perception of value, the Bank needs to enhance its stand-alone economic and sector work as well as to increase the provision of technical assistance in general. These actions will contribute towards counteracting the additional administrative burden imposed on executing line ministries and agencies, as well as compensating for the Bank's relatively limited range of lending instruments and reflect a greater emphasis on continuous dialogue between the Bank and the Country. However, with a limit on the Bank's potential budget, the solution to the problematic of knowledge transfer could be to define a limited set of priorities for the Bank.

Define priorities. To produce demonstrable results the Bank needs to set – jointly with the country – a limited range of areas of action in which it can construct measurable goals whose achievement can be effectively monitored. Such a focus would facilitate the Bank in marshalling its resources efficiently and effectively to provide technical services in addition to financial services.

Specify results and introduce accountability. If a focus will make demonstrable results possible, transparency and accountability will make such results likely. Mexico's new administration presents an opportunity for the Bank to transform its programming exercise into a results-oriented agreement with the country. In recent years, the Mexican government has stressed repeatedly the triad of transparency-accountability-results. The Bank should respond by making country programming documents negotiated performance agreements with the government, concerning the development challenges that the Bank and the country will jointly take on.

Re-emphasize completeness of project design and progress data. Accountability would be aided by completeness of the designs of individual projects in terms of *ex ante* evaluability and by collecting information of progress towards goals set. Projects should include comprehensive statements of their objectives (in terms both of outputs and developmental outcomes), define the objectives' indicators, and state the relevant baselines and milestones. While such guidelines are not new, our review of the Bank's Mexico projects indicates that they require renewed emphasis.

Introduce a pro-poor tilt to all Bank operations. In whatever areas are chosen for action, the Bank could consider introducing a demonstrable pro-poor tilt to the subsequent interventions. Such a tilt could be in any of the sectors that the Bank and the country agree upon as long as they demonstratively improve the capabilities and opportunities of the poor. Such a tilt would be compatible with the Bank's eighth replenishment and its new Institutional Strategy. Indeed some projects already identify poverty reduction among their objectives; the key word, however, is *demonstrable*.

1. Background

1.1 This report presents the findings of an evaluation of the Bank's Mexico country program for 1990 to 2000. The purpose of the exercise is to improve the development effectiveness of the Banks program. From the evaluation are drawn out recommendations as inputs to the discussion of how to improve the Bank's program in the country. The evaluation is based on the following conventional evaluative criteria: relevance, efficiency of delivery-implementation, focus, and the effectiveness-impact of the program. The methodology used is mainly documental evidence, both produced by the Bank and other sources, complemented with selective interviews.[1] Neither an in-depth field inquiry nor a fresh impact analysis was carried out of individual projects. Moreover, not all of the Bank's non-financial products were updated. Conditional upon these caveats, our evaluation of the Bank's Mexico program, despite some positive experiences, identifies shortcomings in each of the evaluative dimensions.

1.2 The structure of the document is as follows: Chapter 1 briefly reviews key developments of the Mexican economy, thus provides the context within which the Bank's program was conceived, modified and implemented. Chapter 2 has the objective of determining relevance and focus intent through an analysis of programming documents and non-financial products. Chapter 3 has the objective of evaluating the efficiency of delivery through an examination of aggregate approval and disbursement patterns, and the sector-instrument loan mix. Chapter 4 has the objective of determining the development impact of the Bank program by reviewing selected individual projects. The Chapter also complements the previous chapters by returning to the evaluative dimensions of relevance and, through an inductive exercise, on focus but at the sector- project level. Our central findings and conclusions are presented in the executive summary accompanying this report.

A. Background

1.3 Mexico is a paradox. On the one hand it has one of the highest per capita incomes in the Region, behind only Chile, Argentina and Venezuela.[2] It is held up as an example of the virtues of pro-market structural reform and north-south trade integration. Its major social and demographic indicators have improved significantly and it is an investment grade borrower.

1.4 On the other hand, Mexicans complainabout the high level of poverty, low wages and lack of opportunities. .[3] The majority of the citizens complain of the unequal opportunities to move out of poverty citing not only a bad economic situation of the household but also of the country (see Chart 1.1).

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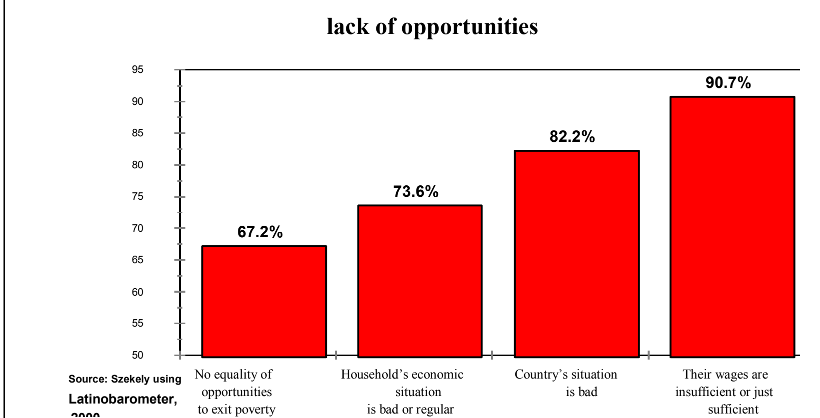
[1] These included Government officials from SHCP, NAFIN, BANOBRAS, BANCOMEXT and selected executing entities (CNA, FIDE, *Secretaría del Trabajo* and CNBV); staff of the Bank, particularly project team leaders and staff in the local office, and staff of the World Bank. Interviews are a useful means of obtaining information and interpretations of data to complement documented evidence. Where possible assertions made in interviews are checked by further interviews with other staff. However, a limit is that many interviewees do not wish to be quoted. This is particularly true for IDB staff.

[2] GDP per capita, purchasing power adjusted, in 1998 was: Chile $9,089; Argentina $7,299; Venezuela $6,527; and Mexico $6,345. By the second quarter of 2001, in nominal dollar terms, Mexico's GDP was larger than that of Brazil. Using the international poverty line it was the ninth in terms of poverty ordering in 1998.

[3] See Latinbarometro 2000.

1.5 Underlying these negative opinions, and partly accounting for the paradox, is the legacy of the interaction of two factors. First, the country has witnessed macroeconomic instability and generally low economic growth during the last two decades. Second, its development has been uneven, in that stagnation and growth alike have been characterised by strong inequalities of capacities and of opportunities.[4] Thus while average socio-demographic figures have improved, their variances have also risen.

Chart 1.1. Public Opinion



67% percent of Mexicans complain of the lack of opportunities to exit poverty. They attribute the lack of opportunities to their household circumstance (74%), the country's situation (82%) or low wages (90%)

A.1. Macroeconomic Developments

1.6 Regarding macroeconomic conditions, six points can be emphasised. Each has ramifications, to a greater or lesser extent, for Bank programming, sector-instrument mix of projects, and portfolio performance; Chart 1.2 illustrates some of the points. First, over the period in study, Mexican macroeconomic variables had high structural volatility with a marked political cycle, notwithstanding the political hegemony of the PRI.[5] Second, despite substantial policy reforms from the mid-eighties onwards, the country neither reverted the decline in total factor productivity that began in the early eighties nor returned to the high average growth rate of the 1960's-70's.[6] Third, the Mexican economy has become increasingly integrated with that of the United States, implying, alongside the benefits, an increased sensitivity to macroeconomic downturns in the North. Fourth, the nineties were characterised by a radical transformation of decentralisation policy. Fifth, the level of poverty and extreme poverty remained stubbornly high. Finally, during the nineties the economy went through one complete cycle: consumption led boom from 1990 to 1993, crisis in 1995 and investment led recovery from 1996 to 2000.

1.7 The six points need to be kept in mind in a reading of the following broad view of the Mexican economy in the 1990's. The early nineties were characterised by euphoria as economic growth increased and inflation fell. The factors taken as success however, undermined the economy's fundamentals. Domestic reforms and positive external shocks, together with the initiation of

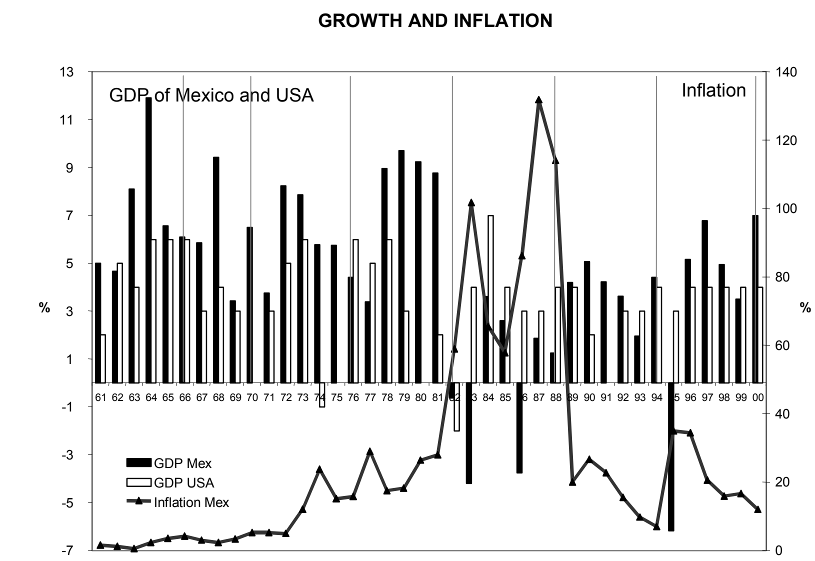
[4] This is one of the central themes of *Primer Informe de Gobierno*, Fox 2001, www.presidencia.gob.mx.
[5] Economic crises coincide with presidential elections since 1970 and were only avoided in the year 2000. See Selected Issues, IMF, 2000. For a discussion of the country's structural volatility see "Structural Volatility in Mexico: a policy report", WP/RES/IDB no.420, by R. Caballero.
[6] See "Mexico: Enhancing Factor Productivity Growth". World Bank 1998

NAFTA negotiations in 1990, contributed to a surge of capital inflows.[7] Concurrently there was an appreciation of the peso (the real value of the peso increased by more than 40 percent between 1988 and 1993) in the midst of radical trade liberalisation.[8]

[7] Gross flows increased tenfold from $3.5 billion in 1989 to $33.3 billion in 1993 (from negligible net flows. Large capital inflows followed the country's financial liberalisation and the lifting of restrictions on foreign investment in the domestic bond and stock markets (in 1989-90)). To the latter has to be added the regulatory changes in the United States Securities Exchange Commission Changes – regulation S and rule 144A – which simulated portfolio investment in Mexico and other emerging economies through issues of ADRs in New York market and the development of country funds in US financial markets (see R. French-Davis, "*Reforming the Reforms in Latin America: macroeconomics, Trade, Finance*, 2000, chap. 5). Further, the debt relief agreement (Brady Plan in 1989), the use of privatisation proceeds to reduce domestic and foreign public debt, and the reduction in international interest rates implied that conventional indicators used to evaluate country risk fell to below the levels of those in the mid-seventies.

[8] "A once for all unit increase in the ratio of quarterly capital inflow to quarterly (annualised) GDP causes a long-run appreciation of the peso of about 12 percent" see "Real Exchange Response to Capital Flows in Mexico: an empirical analysis" by M. Dabos and Huan-Croce, IMF, WP/00/108, 2000.

Chart 1.2. Evolution of the Main Macroeconomic Variables



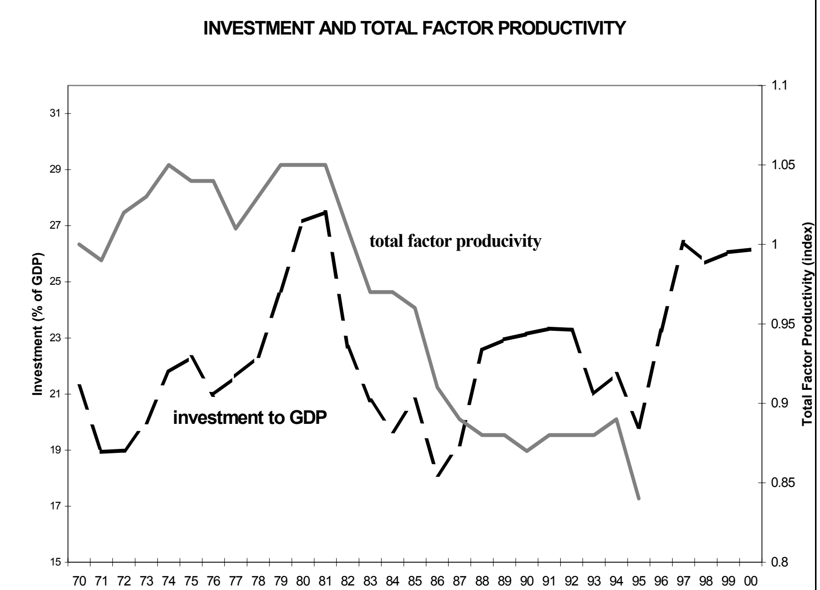
Source: INEGI (www.inegi.gob.mx)

After two decades (60s and 70s) of high growth and low inflation Mexico growth rate falls and inflation shoots up during the eighties.

In the nineties inflation falls and growth recovers from the eighties "lost decade" but not back to the levels of the sixties and seventies.

Each major crisis is generally more severe than the previous one.

Mexico's GDP growth is increasingly collinear with that of the USA except for the crisis of 1995.

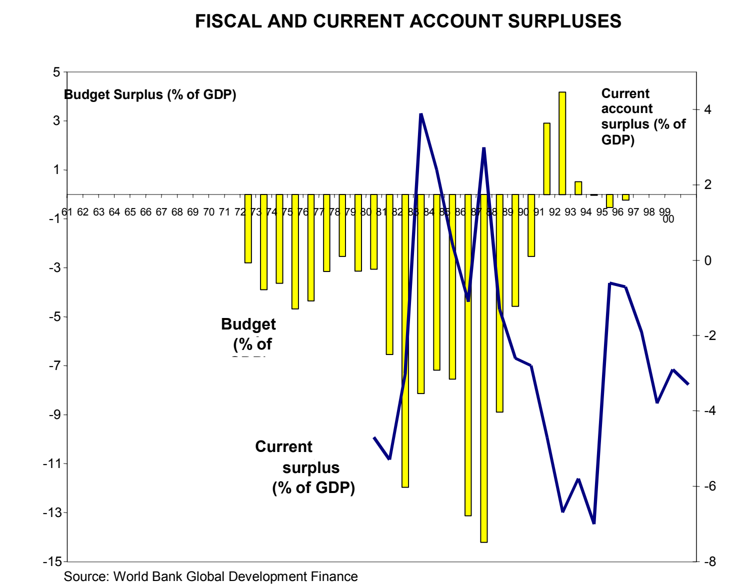


Source: IMF and INEGI and World Bank, 2000.

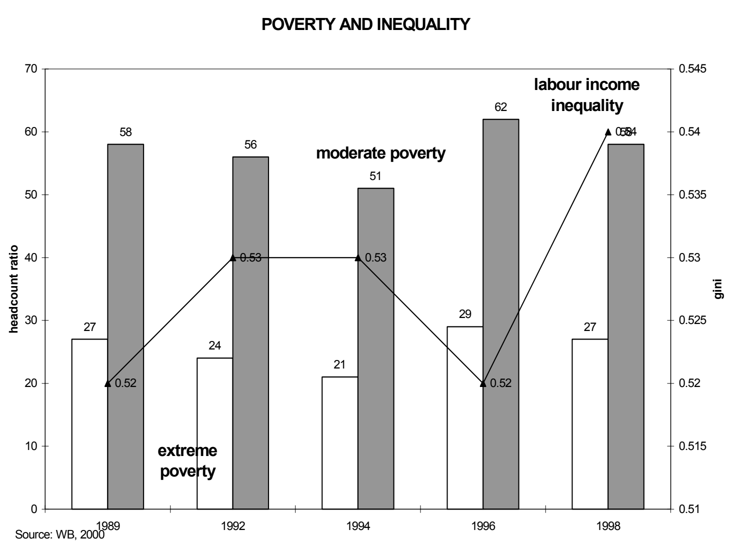
Investment falls drastically during the early eighties, it partially recovers from the mid-eighties until 1993. From 1996 onwards investment recovers to the highs of the late seventies.

Total factor productivity begins to fall in the early eighties. The fall has yet to be arrested and reversed.

Chart 1.2. continued



The fiscal deficits of the eighties were sharply reversed in the late eighties reaching surpluses by the early nineties and balance thereafter.
The current account deficit of the balance of payments increased significantly from the late eighties reaching by mid-nineties a higher value than the deficits of the eighties. The deficit continued increasing despite fiscal adjustment of late eighties to early nineties reflecting the effect of an increasing saving-investment gap of the private sector. The narrowing of the deficit during the crisis of 1995-6 was reverted from 1997 onwards.



Extreme poverty and poverty began to fall in the early nineties. Both peak in 1996 reflecting the crisis of 1995, and thereafter begin to fall.

Labour income inequality, which had risen during the early nineties, fell back by 1996 to the level of 1989. Thereafter it has risen above the levels of the late nineties.

1.8 The ensuing macroeconomic imbalances were reinforced by the commercial bank's intermediation of capital inflows. Inflows, with semi-fixed exchange rate should have led to a decline in interest rates. They did not. Partly this was due to an expansion of consumer and non-tradable sector demand. Not only did credit to the private sector increase by 50% p.a. (25% in real terms) but its composition changed. The stock of credit to the tradable sector fell from 55% of total stock to 20% with a corresponding increase to the non-tradable sector. This was a rational reaction of the banks to the relative deterioration of the tradable sector. However, by facilitating the expansion of the profitable non-tradable goods the banks contributed to the deterioration of the tradable sector and set the stage for the tradable sector's contagion to the economy and back to the banking sector. The previous factors also contributed to a widening –unsustainable- current account deficit, which showed no signs of reversal as growth decelerated in 1992-93, following the slow down in the United States economy.

1.9 There were corresponding unfavourable developments in the labour market, a rapid and unprecedented contraction of manufacturing employment and the expansion of underemployment in commerce and agriculture. First, the reduction in manufacturing employment was the result of a high growth in productivity (6% p.a.) in the face of slow rate of output growth (4.2% p.a.). Second, wage inequality in the labour market increased (GINI coefficient of wages increased from 0.46 in 1989 to 0.49 in 1992 to 0.53 in 1994.)[9] The worsening of wage inequality in turn was the single major factor behind the worsening of income distribution.[10] These trends in turn are related to trade liberalisation and appreciation of the exchange rate, which intensified competition from imports and thus accelerated the rate of technology adoption and reduced the demand for low skilled workers in manufacturing.

1.10 In 1994, an election year, additional processes came into play leading to capital flight. The central bank (BANXICO) decided to sterilise the effects of reserve losses on the money supply, which contributed towards maintaining low interest rates. In part, this decision responded to the increased vulnerability of the banking sector, where non-performing loans were increasing, and because the authorities considered the slow down in capital inflows to be temporary and reversible. The decision temporarily accomplished its objectives: domestic interest began to fall in July, and there were no more dramatic drops in reserves from April to November. The change in administration in December, however, abruptly modified the perceived costs of devaluing. The announcement of a new exchange rate band ceiling in December 20 sent the peso to the 4-peso ceiling and about $5 billion left the country in two days. BANXICO withdrew from the market and the peso devalued to 7.55 pesos per dollar by March. [11] The exchange rate crisis quickly degenerated into a debt crisis as the country was unable to rollover its debt.[12] The exchange rate slide was not halted by the first rescue package of $18 billion but by a second package of about $50 billion, which was equivalent to total debt payments coming due in 1995.[13, 14]

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[9] See N. Lustig and M. Szekely "Economic Trends, Poverty and Inequality In Mexico", IDB, Mimeographed, 1988.

[10] See J. Ros and N. Lustig " Trade and Financial Liberalisation with Volatile Capital Inflows: Macroeconomic Consequences and Social Impacts in Mexico During the Nineties", IDB, Mimeographed, 1999.

[11] In addition to the real disequilibrium interpretation (Ross, 2001, IMF 2000) there have been equilibrium speculative interpretations. Sachs, Tornell, and Valsco ("The Mexican Peso Crisis: sudden Death or Death Foretold" Journal of International Economics 41, 1996) apply a variant of second generation models a la Obstfeld 1986, while Calvo and Mendoza ("Mexico's Balance of Payments Crisis: a Chronicle of a Death Foretold", Journal of International Economics, 41, 1996) emphasis banking problems and the effect of moral hazard on lending and investment.

[12] Cole and Kehoe ("A Self-Fulfilling Model of Mexico's 1994-5 Debt Crisis", Journal of International Economics, 41, 1996) calculate a crisis or vulnerability debt zone for which the government will be willing to service the old debt provided that it can roll it over, but will default if it cannot sell new debt. In this zone there are multiple equilibria, and the size of the zone depends positively related to the maturity of debt. A short maturity structure, the interval is large and includes low levels of debt, as was the Mexican case prior to the 1994 crisis.

[13] For a detailed –blow by blow- account of the rescue package, and a comparison with the one in 1982, see Nora Lustig "Mexico in Crisis, The US to the Rescue: the financial assistance packages of 1982 and 1995" Journal of International Law and Foreign Affairs, No.1 1997

1.11 Policy response consisted of a sharp real devaluation, significant fiscal retrenchment (mainly on the expenditure side) and monetary tightening. Economic growth collapsed in 1995, average real wages fell by 20% (between 1994 and 1996) and a domestic banking sector crisis erupted. Poverty rose. However, unlike the previous crisis of 1982 and in contrast to the recent Asian countries' crisis, the economy quickly rebounded to a growth rate of 5% in 1996 and open unemployment fell to about 3%, and the current account deficit began to narrow.

1.12 Further, it could be argued that the economy emerged stronger than it was prior to the crisis as the crisis, and the policy response to it, may have altered the long-term macroeconomic outlook. First, it eliminated the unsustainable combination of trade and exchange rate policies. The legacy of a more open economy and greater integration with the United States economy is that the devaluation led to a huge increase in exports (both in-bond and non-oil).[15] This contrasts with the experience in 1983 when non in-bond exports fell despite a nominal devaluation of 466%. Second, the real devaluation reversed the factors underlying the profit squeeze in the tradable sector and the fall in private savings rate. The increasing profitability of the tradable sector contributed to the observed increase in direct foreign investment, (which now represent about 20% of private investment and 60% of total foreign investment including portfolio inflows). Indeed the post-crisis period's recovery has been investment led.[16] Third, the changed structure of inflows in turn reduced the country's vulnerability and contagion effect from the volatile international capital markets. For example, Mexico was the least affected in the Region by contagion from the international capital market turmoil derived from the Russian and Brazilian crisis.[17] Most countries of the region experienced a recession: Mexico in contrast grew at 3.7%. However, the increased interaction with the United States economy raises concerns regarding whether Mexico's post crisis success is primarily due to a sounder structure or due to the fast growth-low interest rate combination in the United States economy. This is a concern as the United States economy slows down and consequently, as does the Mexican economy.

A. 2. Development Imbalances: *"un país de desigualdades"*[18]

1.13 The negative perceptions mentioned previously that are widely held in Mexico are not without a basis. The nineties can be characterised as a period of growth but with increasing inequality and poverty. Chart 1.3 shows for 96-98, the extent to which the benefits of economic growth have been tilted in favour of the rich and how labour income inequality has increased over time and that the increase is the largest in fourteen countries of the Region. The richest income decile had an increase in income per capita by 7% while the poorest decile had a decline of 11%.

1.14 Underlying the pattern of poverty and inequality of incomes, in addition to the impact of macroeconomic fluctuations, is inequality of opportunities and capacities. Inequality of capacities are found in education (i.e. the potential to generate income in the labour market), health (i.e. physical and mental capacity to work), in investing (i.e. capital and other assets) in

---

[14] The Bank, approved in 1995, 4 operations, valued at $1.8 billion, of which two were fast disbursing, valued at $1.25 billion (policy based loan of $750 million, ME-0188, and a work-alike investment loan of $500 million, ME-0187). Both disbursed almost 100% within 24 months.

[15] The rise in export growth was not due to the accounting effect of the real exchange rate but because the rate of growth of the volume of non-oil exports accelerated.

[16] During the post crisis fixed investment contributed 2.27 percent to the GDP growth of about 5.13. See *"Mexico after five years after the Crisis*", D. Lederman et al WB, April 2000, who did a GDP demand component decomposition.

[17] The Bank, in response to the contagion effects of international turmoil, introduced, for 1998-99 a new lending instrument, Emergency Loans. Mexico was not a recipient of this instrument.

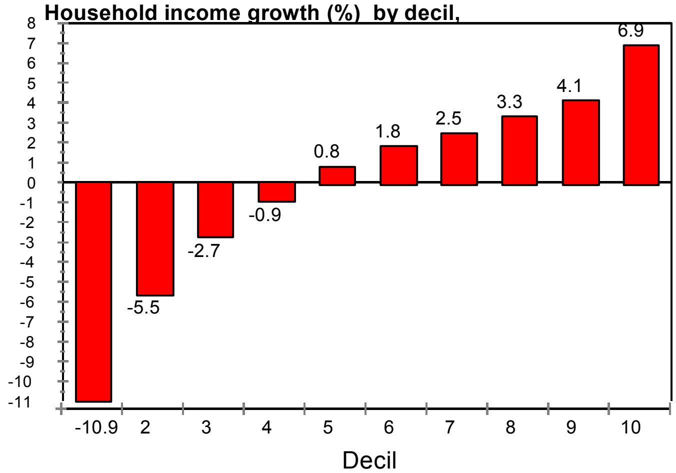
[18] P. 26 of Fox. "*Primer informe de gobierno*" www.presidencia.gob.mx

entrepreneurial activity, and in access to basic infrastructure (which is necessary for minimum subsistence). Inequality in opportunities can be found in the labour market (opportunities to use human capital) and in investment (i.e. opportunities to use physical and human capital productively).[19]

[19] For a formal theoretical discussion see J. Roemer's *Equality of Opportunity*, 1998, and for the Mexican case, from which this section draws upon see M. Szekely's "*Hacia Una Estrategia de Desarrollo Social En México*", IDB, 2000, which was presented to the incoming administration in 2000.

Chart 1.3. Unequal Gains From Economic Growth

Distribution of the benefits of growth
(1996-98)

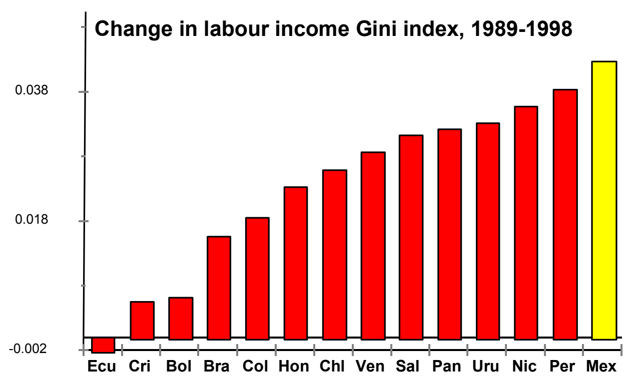


Source: M. Szekely: using ENIGH

The post crisis economic growth (1996-98) has benefited the top five deciles, with the richest decile having the largest increase in income.

The four poorest deciles income has fallen, with the lowest decile having the largest fall.

Increase in labour income inequality

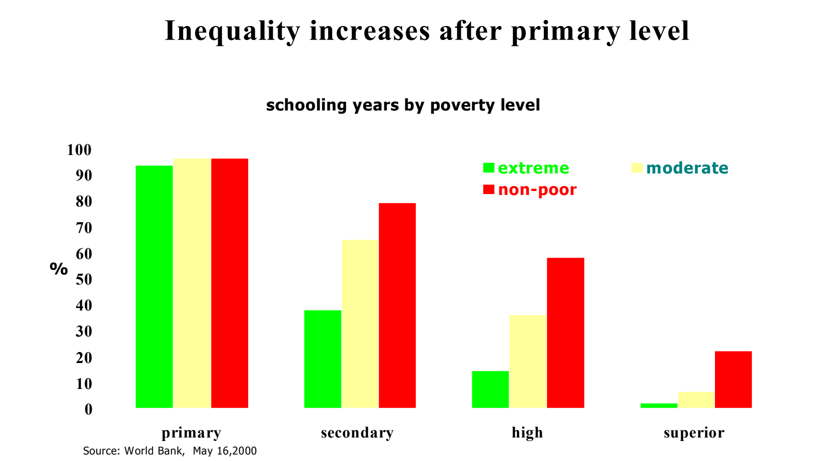


Source: M. Szekely: Household Surveys

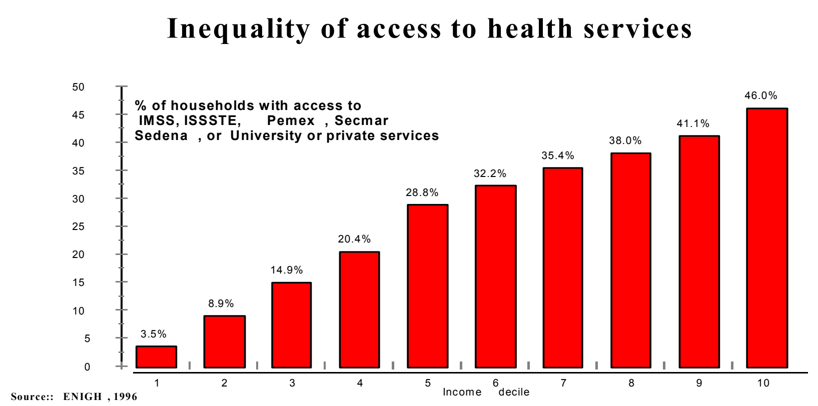
Labour inequality has generally risen in the Region. Of the fourteen countries of the Region Mexico has had the largest increase in labour income inequality.

1.15 Although average education levels have risen, education is badly distributed between households. In fact the poorest income decile's average schooling years is about the same as the much poorer Central American countries. The disparity in education levels between the extremely poor and non-poor household's increases after the primary level (see Chart 1.4). A similar picture is obtained regarding access to health services: the poor have little access. This situation partly reflects that Mexico's health expenditure is below the level implied by its GDP per capita. The poor also have a low capacity in investing capital and other assets in entrepreneurial activity partly due to reduced access to formal credit.

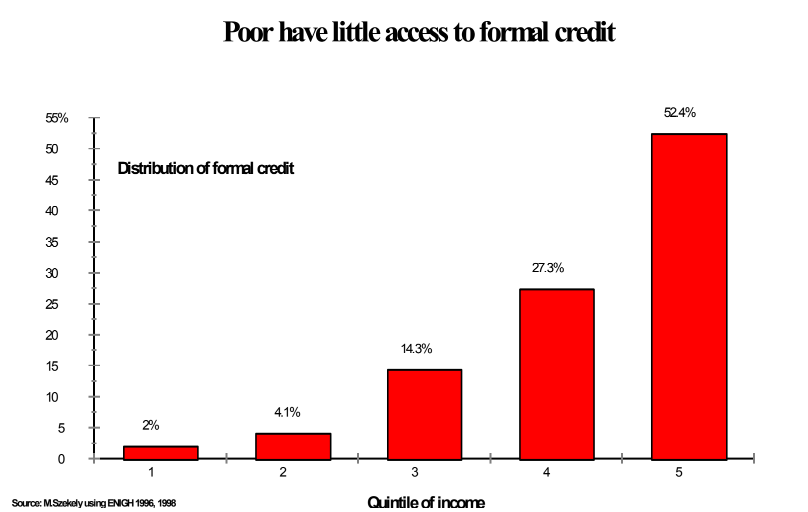
Chart 1.4. Inequality in Education, and Access to Health and Credit



The problem does not appear to be primary education but secondary and higher education. The disparity between the extreme poor, the poor and non-poor grows after primary education.



The rich have a greater access to health services. Only four percent of the very poor –lowest decile- do so.



The lowest quintiles have little to no access to credit.

1.16 Finally, inequality has an unmistakable spatial dimension. Regional disparities are obviously a legacy of the past, but recent trends may be feeding them. During the later part of the import substitution period state GDP growth rates were converging, but with trade liberalisation (Mexico's accession to the GATT in 1986 and the NAFTA in 1994) the pattern reverted to increasing divergence (see Table 1.1). There are notable exceptions: several states, particularly the Northern ones, have been converging to the Federal District (D.F) as export-oriented investments are undertaken within them. In the entire population, though, what stands out is increasing divergence between roughly the North (and D.F.) and the South.[20]

Table 1.1 Regional convergence - divergence of GDP growth *

	β- convergence to the mean	α-convergence, decline in dispersion
Late Import Substitution Period (1970-1985)	-0.0328	0.415
NAFTA (1994- 1998)	0.0089	0.44

* Excluding oil states Campeche and Tabasco. Source: "*Trade liberalisation and its impact on regional disparities*" by Javier Sanchez and Rodriguez, LSE, unprocessed

[20] See Miguel Messmacher Linartas: "*Desigualdad Regional en México. El efecto del TLCAN y otras reformas estructurales*" Documento de Trabajo No. 2000-4, Banco de México, Dec. 2000.

2. *Programming*

2.1 The central objective of this chapter is to determine relevance and focus intent through an examination of programming documents and other non-financial products. To evaluate the response to Mexico's needs in the Bank's country program, a first step is to lay open the Bank's diagnostic and intent. Intent can be gleaned from the country programming exercise. The programming exercise seeks to establish the Bank's own viewpoint on a country and its problems, from which can be extracted priorities for Bank action in the country. These actions should be the basis for a dialogue with the country, a dialogue that locates Bank actions within the context of other development assistance activities in order to foster co-operation with other agencies and realise synergies for the benefit of the borrower. Finally, the programming process should anticipate the actual program of the Bank, a program which integrates the full range of Bank instruments, and establishes a broad results framework against which to evaluate the success of the program.[21]

2.2 To discern the Bank's programming intent throughout the 1990's, though, one must recall that during the decade: Board directives and basic guidelines changed from IDB-7 to IDB-8. The Bank's reorganisation in the mid-nineties changed the Bank's programming in both its institutional basis and its documentation. With that in mind, three programming cycles are analysed: 1993-1995, 1995-1996, and 1999. Documentary evidence of intent, and changes in intent, will be gathered from three country papers (those of 1993, 1995, and 1999)[22]; a number of Programming Mission Reports (PMRs); and Portfolio Reviews (PRs) and other non-financial products. However, an informed evaluation of intent is not only hindered by the absence of documents that were lost in the reorganisation but also because programming practice is littered in no longer available memorandums or because programming intent had remained only as a verbal agreement.

2.3 Further, the available documents do not tell the whole story of programming in Mexico. The documents are common to all country programs, but programming in Mexico is *sui generis.* Mexico has an outstanding institutional capacity to conceptualise and execute major policies and programs. It has been unquestionably in the driver's seat in determining its policies and its relation with the Bank. The relation with the Bank, as with other multilaterals, is essentially through the *Dirección de Organismos Financieros Internacionales* of the Credit and Treasury Secretariat (SHCP), with authorised direct dialogue with other actors. On the one hand this allows better co-ordination but on the other hand may reduce the fluidity of dialogue with different stakeholders.

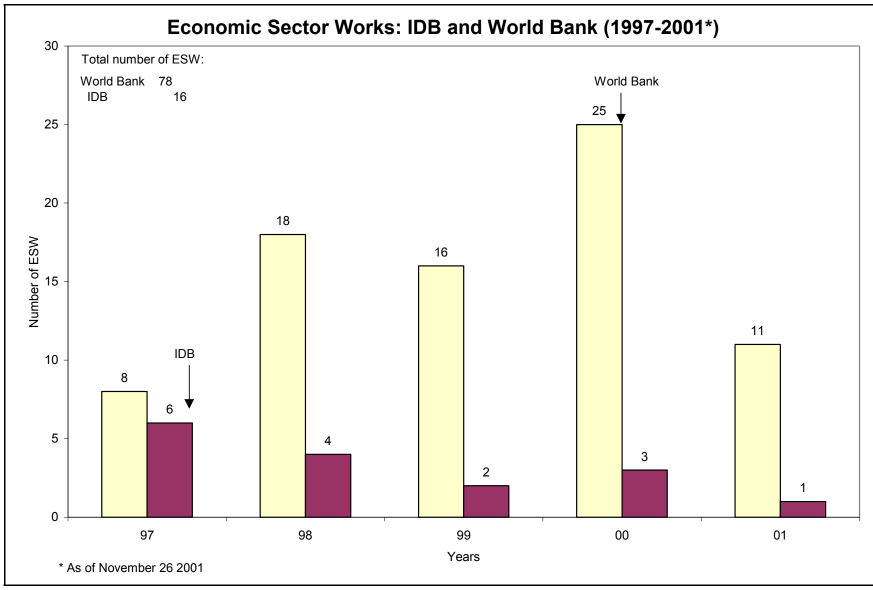
2.4 Keeping in mind the above caveats we evaluate programming using the following evaluative dimensions: analysis; guidance on priorities; degree of integration of range of instruments and services offered by the IDB family; location within other multilateral actors; anticipation of subsequent lending program, and the results framework.

2.5 Analysis forms the basis from which the Bank can develop its side of the dialogue with the country. Programming documents in general describe prevailing conditions, they do not provide sufficient insight on the roots of these conditions, nor do they offer specific guidance about how

[21] These dimensions of programming can be distilled from Bank mandates and policies, however they represent the current normative status hence do not take into consideration the changes imposed on programming throughout the nineties.
[22] Both the 1993 and 1999 CPs were one year before the presidential elections.

the Bank might effectively respond to the problems described. In part this maybe due to a shortfall in economic and sector work, (ESW). Chart 2.1 shows the number of ESW of the IDB and the World Bank.[23] An extreme, but illustrative example is the differential role played by the World Bank and IDB regarding policy notes for the incoming government of President Fox. The World Bank spent US$ 3 million or so and eventually published the notes in a book form. The IDB's seven notes have yet to see the light of the day. The example is illustrative of two points. First, the shortfall can partly be attributed to a lack of sufficient budget allocated to ESW [24].

Chart 2.1. Economic Sector Work



The Bank has very few economic and sector work publicly available.

Source: IDB and WB Webpages.

2.6 Second, what ESW is done gets lost in the system due to the combined impact of a lack of a comprehensive archive system and the absence of a culture-incentives in transforming diagnostic work into working papers and other dissemination instruments. This is lamentable given the potential high pay-off from such activity.[25] But too much can be made of this. Indeed, the World Bank asserts that: "the Bank's [World Bank] policy advice and technical assistance have seldom been a dominant factor in Mexico's policy, dialogue and decision making."[26] The same can be said of the IDB. Further, the World Bank points out, "there is little evidence that over the decade major formal reports had been influential. … this may have reflected the reticence of Mexican officials to attribute influence to other parties… and by the former government's reticence about

[23] Note these numbers are from the web pages of the IDB and World Bank. In the case of the World Bank the number is of studies completed, and which are available in the same web page. In the case of the IDB the annual numbers are studies that were programmed that year, they are not available in the same web page, nor is information provided of which of the studies were terminated. The IDB web page provides contacts –mainly names of authors- that can be approached to find out if the study was completed and if so obtain a copy. However a case can be made that the IDB numbers severely understates actual ESW done, either independently or as part of project preparation. The point however, is they have not seen the light of day as they are inaccessible.
[24] OVE was unable to obtain the budget allocated by the Bank.
[25] A recent study argues that one-dollar of ESW yields between 12 and 15 dollars of development impact. See Deininger, Squire and Basu 1998.
[26] See p. 13 of "Country Assistance Strategy Progress Report of the World Bank Group for the United States of Mexico", May 2001. No. 22147-ME.

their dissemination,….[27] Thus the Bank's relative lack of attention could reflect an optimal reaction, given budget constraints, and the implicit decision to follow the World Bank.

2.7 The second key objective of programming documents is to provide guidance to the Bank in establishing priority areas of activity with the country. Each of the relevant documents contains a section dealing with "Bank strategy". Table 2.1 summarises the CPs priorities. The themes defined, as "priorities" are, however, so broad that virtually no actions can be excluded from consideration. In fact the Mexican government reaction to the 1995 CP states: "*El documento es bastante descriptivo y carece del elemento propositivo que contribuya a fomentar un dialogo mas constructivo sobre diversas alternativas para la definición de políticas adecuadas de desarrollo*."[28] However, non-focus of the program is not necessarily limited to the Mexican case but may reflect an endemic feature of current Bank-wide programming practice. Programming is subject to a double squeeze. From top-down is the pressure for documents to articulate and include the Bank's different mandates. From down-up programming has to accommodate theme and project wish list from different entities within the Bank. These pressures occur without a trade-off framework, which would hold if a budget constraint (either of costs or of a multi-year lending envelope) were imposed on the programming exercise.

Table 2.1. Articulated Strategic Priority Areas for Bank Activity

The 1993 Mexico Country Programming Paper – The objectives were to: 1) help the government to improve the social situation in a setting of sustainable growth with equity; and 2) Help consolidating economic reforms, expanding and modernizing production.
The 1995 Mexico Country Paper – The Bank's strategy accordingly consisted of a short-term and a long-term component. The short-term objective was to support the government's efforts to restore macroeconomic stability. In the medium and long term, the goals were to: a) support the efforts of the government to restore and maintain growth; b) install the necessary infrastructure for efficient development of the private sector; c) improve agricultural productivity and; d) Raise the skills level of the worker force.
The 1999 Mexico Country Paper – The objectives were to: 1) strengthen the process of structural change related to decentralization, in order to achieve greater social development, reduce poverty, and promote more harmonious regional development that is socially equitable and geographically balanced; 2) promote private-sector participation in the country's economic growth and; 3) undertake a number of studies and analyses under the strategy to support dialogue with the authorities and to prepare an agenda with the new administration.

2.8 The third key objective of programming is to provide an inclusive description of the full range of Bank operational products. Recent documents not only define the lending program but also mention technical co-operation activities, small projects, the MIF and the IIC. However, absent is their complete integration into the Bank's strategy.

2.9 The fourth key objective of programming documents is to locate the Bank's program within the universe of development finance actors. Location has improved but the documents provide no strategic assessment of the different competencies, nor indicate any potential synergy (positive or negative) between IDB efforts and those of other actors.[29]

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[27] Mexico Country Assistance Evaluation, OED, WB, June 2001. Such an exercise cannot be done for IDB projects as they generally do not specify expected economic rates of return.

[28] From p.1 of "Comentarios al borrador preliminar del documento de país, Mexico. Preparado por el Banco Interamericano de Desarrollo", Memorándum, from M. Pineda, SHCP, to J Sanchez, COF/MEX, June 29 1995.

[29] According to the World Bank: "In some area – such as education, roads, water, decentralization, gender, and financial sector reform-both banks are working with detailed coordination and divisions of labor. In some areas-tourism development, gas pipelines and large electric projects- the IDB is active but not WBG. In other areas-health, alternative electric generation, and air quality-the WBG has been active but not the IDB in recent years." Report No 22147-ME, World Bank, May 2001.

Table 2.2 Programming Anticipation Rate *

93 CPP	Anticipated and done				Anticipated but not done		Not anticipated but done			
	PR Num	Name	Approval	Amt Appr (mill)	Programs	Amt	PR Num	Name	Approval	Amt Appr (mill)
EDUCATION	ME0170	PROG EDUCACION PRIMARIA	07-Dec-94	$ 393	EDUC VOCACIONAL TECNICA					
	ME0041	PROG CIENCIA Y TECNOLOGIA	16-Dec-93	$ 175	CAPACITACION LABORAL					
WATER & SANIT	ME0056	AGUA POT Y ALCANT GUAD	09-Mar-94	$ 169	APOYO SECRETARIA DE SALUD					
SOC INVESTMENT					PREDERUR-GOLFO		ME0051	PROG DES MUNICIPAL	23-Nov-94	$ 500
					DEC Y DES REGIONAL RURAL					
					INV EN RIEGO Y DRENAJE					
PROD & OTHERS					APOYO PEQ EMPRESAS		ME0127	PROG DES TURISTICO	10-Nov-93	$ 150
					APOYO EMPRESAS EXPORT					
					PROY PILOTO MICROEMPRESA					
					PROG AMB CDS FRONTERIZAS					
					AMPL Y MOD CARRET FED					
					MOD PUERTOS					
95 CP	**Anticipated and done**				**Anticipated but not done**		**Not anticipated but done**			
	PR Num	Name	Approval	Amt Appr (mill)	Programs	Amt	PR Num	Name	Approval	Amt Appr (mill)
MACRO STABILITY	ME0126	CORP STRENGTH FINAN INST	13-Dec-95	$ 500			ME0059	PROG APOYO CNBV	03-Dec-97	$ 8
	ME0188	RESTRUCTURING FINANC SYS	21-Jun-95	$ 750						
	ME0227	CORP STRENGTH FINANCIAL II	14-Jun-00	$ 250						
	ME0197	DOMESTIC SAVINGS DEV	30-Oct-96	$ 300						
SOC INVESTMENT	ME0187	ESSENTIAL SOC SERVICES	21-Jun-95	$ 500	CHIAPAS RURAL DEVEL PROG	$ 100				
	ME0186	LABOR TRAINING	18-Dec-96	$ 250	HEALTH PROGRAM	$ 300				
	ME0185	RURAL PROD CONVERS	30-Oct-96	$ 400	NUTRITION PROGRAM	$ 200				
	ME0208	MUNICIPAL DEVELOPMENT II	20-Oct-99	$ 800	STREET CHILDREN	$ 15				
					HOUSING PROGRAM	$ 400				
ENERGY	ME0204	POWER SECT DEV & ENERGY	10-Dec-97	$ 23	NATURAL GAS	$ 400				
WATER & SANIT	ME0150	NATL WATER SUPPLY & SANIT	16-Dec-98	$ 310	IRRIGATION & DRAINAGE II	$ 200				
	ME0179	SANITATION IN VALLE DE MEX	04-Dec-96	$ 365						
EDUCATION	ME0052	RURAL EDUCATION PROGRAM	03-Dec-97	$ 171						
PROD & OTHERS					RURAL ROADS	$ 200				
					PRIVATE INFRASTRUCTURE FIN	$ 100				
					AGRICULTURAL PRODUCTIVITY	$ 150				
					FEDERAL HIGHWAYS	$ 250				
					TRANSPORT CORRIDORS PROG	$ 100				
99 CP	**Anticipated and done**				**Anticipated but not done**		**Not anticipated but done**			
	PR Num	Name	Approval	Amt Appr (mill)	Programs	Amt	PR Num	Name	Approval	Amt Appr (mill)
MACRO STABILITY	ME0117	CORP CONSOLIDATION FIN INST II	21-Jun-00	$ 300						
SOC INVESTMENT	ME0118	LABOR MARKETS II	12-Jul-00	$ 200	SOCIAL SPENDING PROT PROG	$ 500				
	ME0137	LOW-COST HOUSING PROGRAM	13-Dec-00	$ 505	OCCUPATION SAFETY&HEALTH	$ 200				
	ME0213	PROCAMPO SUPPORT PROG	08-Aug-01	$ 500	HEALTH SECTOR IMPROV PROG	$ 200				
					PERINATAL CARE CENTER PROG	$ 100				
					FAMILY ASSISTANCE REF PROG	$ 400				
					SOCIAL SERVICES REF IN THE DF	$ 200				
ENERGY					ELECTR TRANS & DIST PROG	$ 450				
WATER & SANIT					WATER SUPPLY & MGMT MZVM	$ 690				
					RURAL WATER & SANITATION II	$ 300				
PROD & OTHERS					ROAD REHABILITATION PROG	$ 500				
					PRIV FINANCING GRAIN STOCKS	$ 200				
* excluding PRI projects, TCs, MIF and SMP			Total Amt:	$ 6,861	Total Amt:	$ 6,155			Total Amt:	$ 658

MEMORANDUM

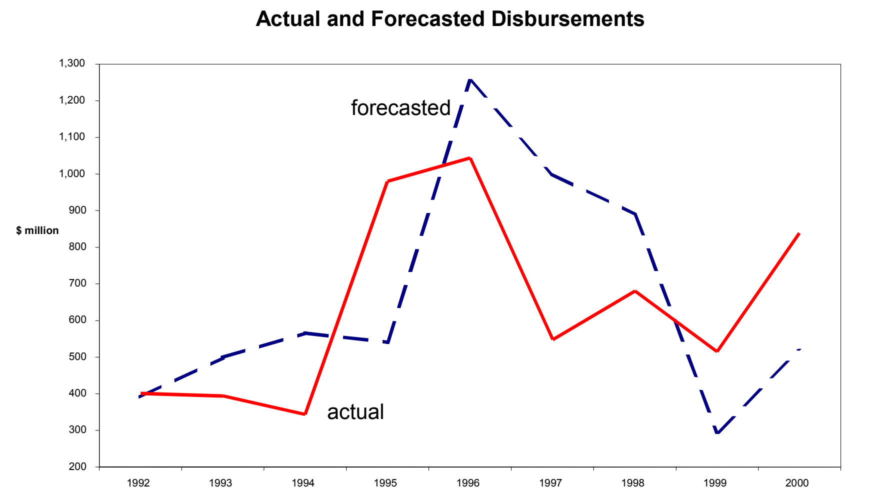
	1995 CP		1999CP /+	
	%, Project #	%, $ value	%, Project #	%, $ value
Anticipated and done	50	66	27	29
Anticipated not done	50	34	73	71
Actual as % of proposed $ lending envelope	54	66	27	29

/+ Presented as a transitional strategy; data up to 2000 end, except for ME-0213 included in the first column.

Note: CP-93 could not be compared, as data on project's approval amounts was not available.

2.10 The fifth key objective of programming is to formally anticipate the subsequent lending program (see Table 2.2). The Table has three columns: projects that were in the country document that were approved; projects mentioned in the country document that were not approved; projects absent from the country document but were approved. First, the data in the table shows that the project anticipation rate has fallen. Second, the information also shows that the "not anticipated but done" project category is practically empty, embodying the restrictions imposed by the country's budgetary process, and the economic situation prevailing in the second part of the nineties.[30] Further, the memorandum to the Table shows a fall in both the aggregate lending anticipation rates (i.e. the category of "anticipated and done" as a percent of the proposed lending envelope), and the country document's indicative lending envelope with respect to actual lending. Thus programming intent's realisation in terms of approvals has fallen.[31] Disbursement intent realisation also has fallen (Chart 2.2 shows actual and forecasted disbursements) as the forecast error is large and has increased.

Chart 2.2. Actual and Forecasted Disbursement



Disbursement forecast error (the difference between forecast and actual disbursements) is high and increased during the second half of the nineties.

Source: OVE using LMS Warehouse and annual prediction by COFIME.

2.11 A country program evaluation is hindered by the absence in programming documents of a results framework and an adequate progress report on a given program cycle. There is no statement about what either the Bank or the country thinks will be the outcomes (the development impact) of proposed actions. This makes it almost impossible to evaluate the effectiveness of the Bank's program, as intent cannot be discerned. The country documents are not a statement of a negotiated agreement with the government concerning the development challenges which the

[30] There is a trade-off between anticipation and flexibility to respond to unforeseen events. Clearly the programming intent –as embodied in CP of 1993-was blown off course due to the unforeseen crisis of 1995. But an economic crisis has occurred every *sexenio* end since the seventies (and only avoided in the year 2000), thus a glaring omission is a scenario of such an eventuality in the CPs. But then also absent, given their impact on the Mexican economy, hence on the Bank's actual and proposed portfolio, is the expected evolution of the international price of oil and the United States economy

[31] Note however, that the 1999 country document was presented as a "transitional strategy" and very little time has passed, however, 2001 is the closure of that programming cycle as the Bank is preparing a new country document programmed for 2001 end.

Bank should (should not) take on, and what results are to be expected within what timeframe.[32] The Dialogue Table introduced in recent country documents falls far short of such a results framework. An agreement would have benchmarking, which helps determine how severe the problem is, and to establish reasonable expectations for its improvement. Such an approach would be in tune with developments in Mexico. The country's new performance evaluation system (SED, introduced in 1997) encompasses the use of performance indicators, through performance contracts between budgetary entities (SHCP and SECODAM) and spending entities with the aim to evaluate the effectiveness and social impact of public spending hence with their programmatic objectives.[33]

2.12 Furthermore, a country program evaluation is also hampered by the absence of a system producing progress reports on its country program. This is partly due to the fact that Programming Missions Reports were not conceived, nor are practised as annual progress exercises of the rolling three-four year country document cycle and due to the absence of a formal progress report.[34] Recent country documents do have a section assessing the previous strategy, and very recently the first project of a country presented to the Board is accompanied by a country document up-date. However, a casual comparison of the former with the WB's programming progress reports indicates their shortcomings.

[32] Such an "agreement" is not found in the current guidelines of Country Papers. For an exhortation that it should be, see, *Nota Metodológica de las Estrategias del País*" OVE, October 2001.

[33] See OECD Economic Surveys, Mexico, July 2000.

[34] Such a system exists in the WB, in the Mexican case see: Country Assistance Strategy Progress Report of the World Bank Group for the United States of Mexico, May 2001. No. 22147-ME, and of May 13, 1994, No. 13008-ME.

3. The Bank's Portfolio

3.1 The objective of this chapter is to evaluate the efficiency of delivery through an inspection of aggregate approval and disbursement patterns. During the 90-99 period, the IDB's program in Mexico covered loans valued at US$ 9.5 billion (38 projects), granted technical assistance operations (TCs) valued at US$ 56.5 million (numbering 94), and generated 57 non-financial products.[35] This represents a small proportion of the Bank's total approvals (4%) and total value amount (14%). In fact, the Bank's approvals in Mexico average only four loan operations per year.[36] From Mexico's perspective both approvals and disbursements are marginal in terms of any aggregate or sectoral metric.[37]

3.2 In this chapter we cut the portfolio in four ways. First, we analyse the aggregate financial flows tackling two puzzles: given that IDB is a relatively cheaper source of financing than private sources, why Mexico did not borrow more from it and why did it borrow only about half as much as it did from the World Bank? Second we desegregate the Bank's portfolio by sector, instrument, and "synergy" – that is, co-operation with other MDBs and bilateral actors. Third, we examine portfolio performance. The puzzle here is that the portfolio's performance is more or less the Bank's average, not systematically better, notwithstanding the solid administrative and technical capacity of the Mexican government and the involvement in project execution of the Mexican development banks NAFIN and BANOBRAS, and a pro-active local office. What's more, performance is worse in 2000 than in the early nineties. Fourth, we look at the Bank's self-evaluations – mid-term and *ex-post* – of which there are few.

A. Financial Flows

3.3 Chart 3.1 shows annual approvals and cash flows for both the IDB and World Bank.[38] The following facts emerge. First, approvals have a strong cyclical pattern: falling during the early nineties (when there were strong capital inflows and a reduction of public debt); rising during 1995-96 (in the wake of the economic crisis); falling once again to a minimum in 1998; and rising steadily thereafter. Second, net financial flows (disbursements minus repayments of principal and interest) have hovered from zero to slightly negative except during the crisis period, 1995-6, when they turned significantly positive. Third, the approval pattern is similar to the World Bank's, although (with the exception of the years 1995-96 and 2000) the IDB's annual approvals are between one third to one half the value of the World Bank's. However, from 1998 onwards the WB's annual approvals systematically fall while those of the Bank systematically rise.[39] Finally, in contrast to the IDB, World Bank's annual net financial flow has been increasingly negative. The differential net financial flow pattern reflects the debt service of WB's much

[35] Unless stated otherwise this section uses gross approvals. For net approvals – that is, net of cancellations – the figure is $8.9 billion. Annex 1, available in the OVE web page, includes information on cancellations at the project level.

[36] Yearly approvals were three if policy based loans are excluded and two and a half if both policy based loans and PRI-IDB operations are excluded.

[37] If "money talks" then insignificant financial flows suggest little power of negotiation for the Bank in its relation with Mexico.

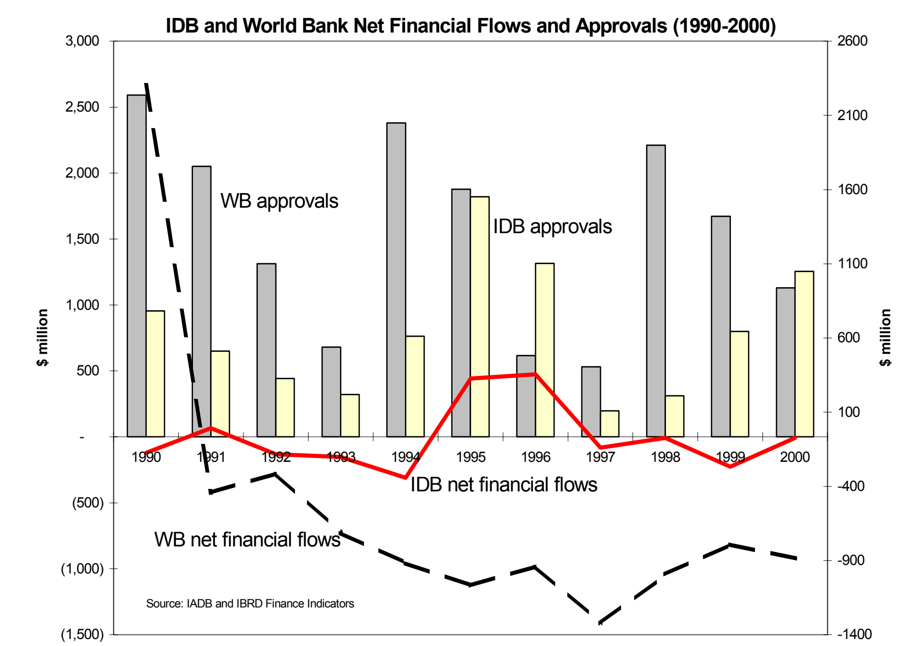
[38] Throughout this report comparisons are made between IDB and World Bank as the latter provides an obvious benchmark. However, a note of caution is necessary, in that there may be important differences budget and human resources allocated to their Mexico country program. Note that the bank's Time Recording System (TRS) does not provide men hours weighted by wages.

[39] These trends continued into 2001 when IDB approved $1.1 billion and the World Bank approved $860 million.

higher, mainly policy based loans, lending during the eighties relative to the IDB combined with exposure ceilings on WB's lending.

3.4 Throughout the nineties the IDB's loans were much better, from country's perspective and in pure financial terms, than conventional market debt issues. The margin is being reduced, however, since the country's debt gained investment grade ratings.[40] Given that Mexico's avowed debt strategy involves "lowering finance costs of public debt and achieving a smooth longer maturity profile thereby reducing Mexico's vulnerability to external shocks,"[41] a question arises: Why does Mexico not borrow more from the IDB for a given gross borrowing requirement?

Chart 3.1. Approvals and Net Financial Flows



IDB approvals are between a third and a half of WB approvals.

IDB net financial flows are marginally negative-close to zero, except for 1995-6 when they were positive.

The answer lies in the interaction of demand, supply and institutional factors. The following hypotheses were developed, by OVE, from interviews held with staff from SHCP, NAFIN, BANOBRAS, and selected executing entities[42]:.

a) From the demand side there are four complementary explanations, in addition to the fact that IDB loans are uncertain in timing of approvals and disbursement compared to the issuance of bonds:

1. SHCP seems to have a de facto policy of zero net financial flows from each lender. Borrowing patterns from the debt crisis of the early 1980s, when Mexico borrowed heavily from the World Bank are thus maintained. As Mexico services the debt they

[40] The comparison of costs is based on spreads of Mexican debt instruments- non-enhanced bond issues- derived from a subset of EMBI plus (produced by J.P. Morgan) which includes only debt issued by Mexican entities
[41] See Letter of Intent, June 15 1999, IMF.
[42] Including CNA, FIDE, Secretaría del Trabajo, BANSEFI, and CNBV amongst others.

borrow anew from the World Bank to keep net financial flows from that lender as near zero as the World Bank's exposure limits allow. Insofar as World Bank and IDB financing are substitutes, and insofar as there is an upper limit to what Mexico wants to borrow from MDBs, the IDB was crowded out.

2. IDB financing seems not to bring the Ministries any "gain," because they receive the same budget outlays from SCHP regardless of how the latter finances the outlays; IDB financing does however bring them "pain," because they must accept additional procedures and constraints upon their expenditures. [43] In return for the pain they receive the IDB's technical assistance – but *given* the capabilities of the Ministries relative to those of the IDB, they often do not want it.[44] "No gain but pain" suggests an optimal policy of maintaining, in normal times, open lines of communication and commerce that can be used intensively in times of emergency, when alternative financing is limited. Given that strategy, Mexican government uses IDB financing for programs where it places greater emphasis on continuity so the programs will be exempt from the vagaries of fiscal retrenchment. It is puzzling, then, to find that in fact the volatility of public primary expenditure related to IDB financing is an additional two-thirds more than the volatility of total primary expenditure: 40% compared to 24, and that disbursements are pro-cyclical, as shown in Table 3.1.

Table 3.1. Volatility of Primary Expenditure (%) \+

	Total primary Expenditure	IDB disbursements of investment projects	IDB disbursements of investment projects (excluding non-traditional) loans *
Volatility \+	24	40	37
Pro-cyclical \^	N/R	0.56	0.56

* ME- 0187, ME-0186, ME-0208, ME-0118; \+ Coefficient of variation; \^ Coefficient relating primary expenditure to IDB disbursements (from a regression with a dummy for 1995) with a positive coefficient indicating pro-cyclical pattern. These figures are obviously just indicative given the small sample.

3. It is argued that IDB has a smaller menu of lending instruments compared to the World Bank, and that the World Bank's local office has greater authorisation to make procurement and other decisions than the IDB's office. Bottlenecks and resistances, both bureaucratic and personal, are thus less tractable for IDB projects than for those of the World Bank.[45]

4. Where a project needs greater technical input than line Ministries can provide, they and SHCP alike seem to prefer the World Bank to the IDB. The IDB, according to

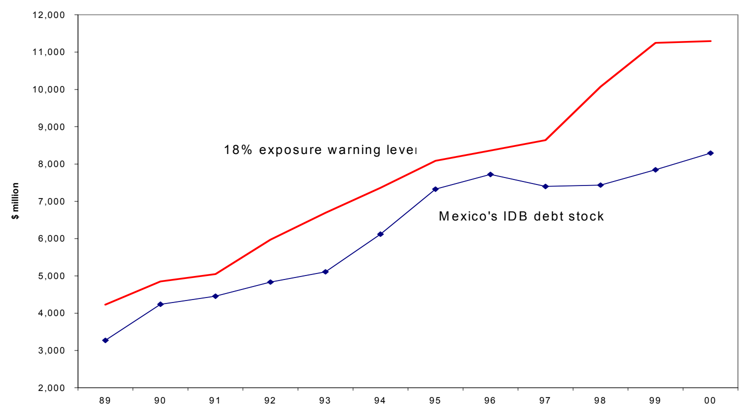
[43] "Pain" from the perspective of an individual Ministry is not necessarily developmentally nor financially imprudent, nor is it confined to the IDB. The same perception holds true for the World Bank. Many of the additional administrative burdens created by working with international financial institutions come from their policies in areas such as procurement, environmental safeguards, and stakeholder consultation which have a strong developmental rationale, but nonetheless are clearly seen as additional "hassles" over and above those associated with resources received from SCHP.

[44] A clear exception was the Bank's Labour Modernisation project, where the technical assistance, flexibility in design, overcome the pain factor. Interview with Ruth G Ornelas, STPS.22 June 2001.

[45] Note that while the World Bank office was established in 1996, there does not appear to be a break in the IDB's approvals-disbursements pattern during the nineties. However, the essential point is that with its establishment, combined with its greater flexibility in procurement than the rigid one in the IDB, the latter has now lost whatever margin it had over the World Bank.

government officials who were interviewed, appears to have less analytical capacity, hence develops and pushes for less innovative programs.

Chart 3.2. IDB's Mexico Debt Stock and Exposure Warning Level



Mexico's IDB debt stock was lower than the indicative exposure levels.

Source: IDB Annual Reports, IMF Article IV, various years.

b) From the supply side an explanation for the relatively smaller level of the IDB's Mexico program could be:

1. that approvals for Mexico are in the region of the Bank's informal debt exposure warning levels.[46] Chart 3.2 shows that Mexico's debt stock was lower than the informal exposure warning level of 18%.

2. that the IDB is not active in promoting its agenda: it is frequently said, in the inevitable comparisons with the World Bank, that the IDB is excessively cautious.

3.5 These are hypotheses about perceptions ex-ante, not judgements about results ex-post. Bank-funded projects may produce positive results, although measurable and verifiable data on results as we demonstrate in Chapter 4 are not widely available. Ex-ante, however, line Ministries do not gain additional financial resources from Bank projects, and thus may tend to prefer funding a given project with domestic budgetary resources rather than international funds. This raises the issue of ownership. On the surface it would appear that, since the Bank's program is developed jointly with and vetted by SHCP, thus the program fully reflects the country's priorities.

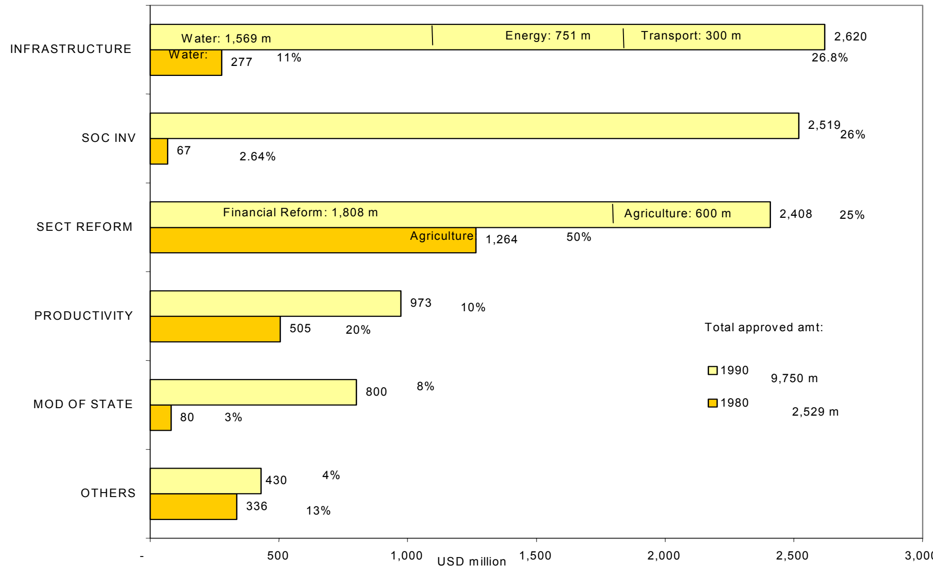
B. Patterns within the Portfolio: Instruments, Sectors, and Synergies

3.6 Loans over the period can be defined in a number of ways: by sectoral composition, by type of lending instrument, the IDB-family (IDB-MIF-IIC), and by whether or not it is co-financed with other multi or bi-laterals.

[46] The Bank does not have mandated country level debt exposure limits. The Board never approved the proposal for such limits as proposed in GN-1835 of 1994. Nonetheless, country document guidelines exhort-recommend that country documents should include key debt to the Bank exposure ratios: loans to any one country, less than 18%; debt service to the Bank to total debt service, less than 30%; debt service to the Bank as a percent off exports of goods and services, upper limit of 8%. The chart shows only the 18% exposure ratio as it is the binding criterion of the different exposure ratios, as the others are far below the ceilings.

3.7 The sectoral composition of Bank approvals in the eighties and nineties appears in Chart 3.3.[47] Total approvals in the nineties were 3.8 times greater than in the preceding decade, and the Bank entered into new fields: the financial sector, modernisation of the state (mainly at sub-national level), and energy (mainly in the private sector). The sector with the largest increase was social investment. *Ex post* sectoral priorities, as reflected by the proportion of total approvals that went to each sector, were: infrastructure (27%) social (26%); sector reform (25%); productivity (10%); modernisation of the state (8%); and others (4%).

Chart 3.3. Total approvals by sector in the 1980s and 1990s



Source: OVE using LMS Warehouse.

3.8 Alternatively, the mix of instruments is relevant, to have an indication of the extent of full use of the Bank's instruments. In the case of Mexico, a frequent theme of conversations with government officials, is their preference for sector loans or private (PRI-IDB) loans, rather than Bank's traditional investment loans. There were 7 PBLs in the nineties representing a quarter of total approvals; they were approved in three sub-periods, 1990-1, 1995-96, and 2000, and were concentrated in the financial and agricultural sectors. There were 7 private sector operations[48], all in the energy sector. Although they represented only 4% (excluding "B" loans)[49] of total amount approved in Mexico, they represented 13% of PRI-IDB projects (19% of total amount value approved). If, to the PBLs and private sector loans, instruments are added that work in terms of disbursement- similarly (e.g. global credit, multi-phase, hybrid, and non-conventionally designed investment loans), approvals represented almost 50% of the total.[50]

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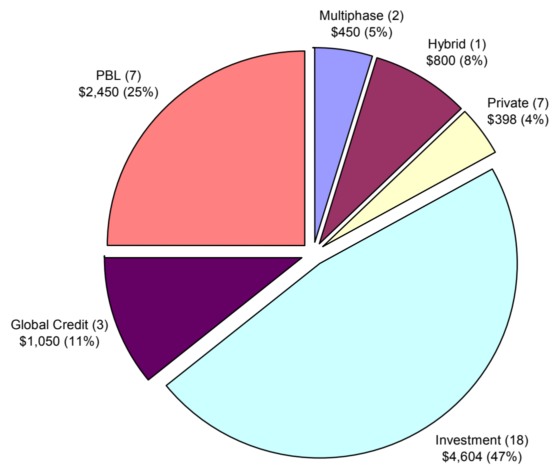
[47] This document does not use the official Bank sector classifications, which consist of 20 separate categories. See Annex 1 for the classification used in this document.

[48] PRI-IDB operations started in 1995.

[49] A "B" loan is a non-recourse loan extended by a commercial or other institutional lender for a Bank-financed private sector operation through a participation agreement with the Bank. In this co-financing arrangement, the "B" loan is combined with an "A" loan directly funded by the Bank, which serves as the lender of record for the total amount of the loan. Is is also referred to as a Syndicated Loan or Participation Loan.

[50] Policy based loans disburse against policy actions, do not require counterpart funds, nor is their size determined by the cost of the actions implied by the loan. Investment loans require counterpart funds, disburse against counterpart expenditure, and their size, for a given IDB-local expenditure ratio, is determined by the expenditure cost of the actions being supported by the loan. However, policy based loans are expected to disburse faster then investment loans.

Chart 3.4. Gross Approvals by Instrument



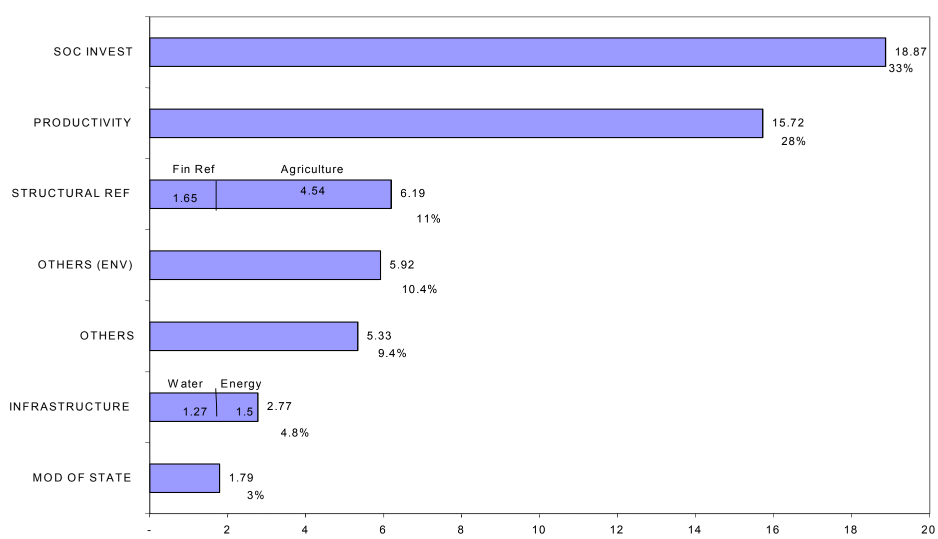
Investment projects were less than fifty percent of total approvals.

Policy based loans plus work-alike investment projects were forty eight percent of total approvals.

Source: OVE using LMS Warehouse.

3.9 The other members of the Bank family are MIF, SMP, TCs and IIC operations.. Total approvals of MIF, SMP, and TC[51] are summarised in Chart 3.5. TCs in the social investment and productivity sectors represented around 61% of total TC approvals.

Chart 3.5. Total Approvals of MIF, SMP and TC by Sector (1990-2000)



Source: OVE using LMS Warehouse.

[51] Does not include regional or co-financed TCs.

3.10 The IIC had 15 operations for the total of $114.8 million including $6.3 million in equity. The total was distributed between corporations (28%), financial intermediaries (21%), and private equity funds (51%), for objectives, at this level of aggregation, that appear unconnected with the Bank's program.

3.11 Finally we turn to review the synergy between MDBs and bilateral actors. IDB and World Bank collaboration in non-policy based operations has been modest.[52] This reflects mainly the Government's policy preference to have the two MDBs working in different areas, in both the sectoral and geographic dimensions. A common compliant by Government officials was that differing procedures between the two entities aggravated implementation by the executing agencies and increased their administrative burdens. Co-financed adjustment operations occurred in the early nineties when the Bank PBL authorisation was only jointly with the World Bank (1990-92) and again in the crisis of 1995-6.[53] Co-financing also occurred with EXIMBANK of Japan and OECF.[54] During the nineties the country had three programs with the IMF, an Extended Fund Facility covering the period 1989.5 to 1993.5, and two stand-by programs from Feb. 1995 to Feb. 1997 and Aug. 1999 to Nov. 2000. Co-financed or parallel loans with the World Bank raise the question of attribution. The answer is predictable. "In most cases, the [World Bank] has had the lead in these operations. IDB financing provided important additional financial support and sometimes gave specific attention to certain aspects of the operations…"[55]

C. Execution Performance

3.12 The Bank's portfolio execution performance is just about the Bank's average. This contrasts with *a priori* expectations that projects in Mexico should be systematically better than the Bank's average. The SHCP plays a dominant role in project selection. Therefore presumably if SHCP gives the projects priority in budget allocations, "lack of counterpart funds" reason for slow disbursement should be absent.

3.13 Further there is an almost exclusive use of financial agents (two development Banks: NAFIN and Banobras), who actively participate in project negotiations and ensure that Bank procedures are followed. Their role should reduce the learning curve of executing entities and facilitate disbursements given their working knowledge of Bank procedures.[56] Around 92% of the loans are administered through the two national development banks (of the total amount approved in the nineties, NAFIN administered 50% of the resources, Banobras 42%, private sector 5% and others 3%).[57]

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[52] There were four co-financed investment projects: Transmission and Distribution 1990, and Water Supply and Sanitation 1992 and Irrigation in 1992, and Social Services in 1995. This list however, understates the symbiotic relation between the two entities, for example some operations finance the same country program-budget item (primary education) but concentrate on different geographical zones, or one Bank leaves and the other Bank enters into essentially the same budget item (Labour Modernisation).

[53] The first group consisted of: Road and Transport and Telecommunication Loan, and an Agriculture Sector Loan. The second set included: Financial Sector Adjustment Loan and a Contractual Savings Loan.

[54] With the former, in 1995, there was co-financing for the corporate consolidation of NAFIN. With the latter the IDB co-financed, in 1996, Mexico Valley Sanitation Program.

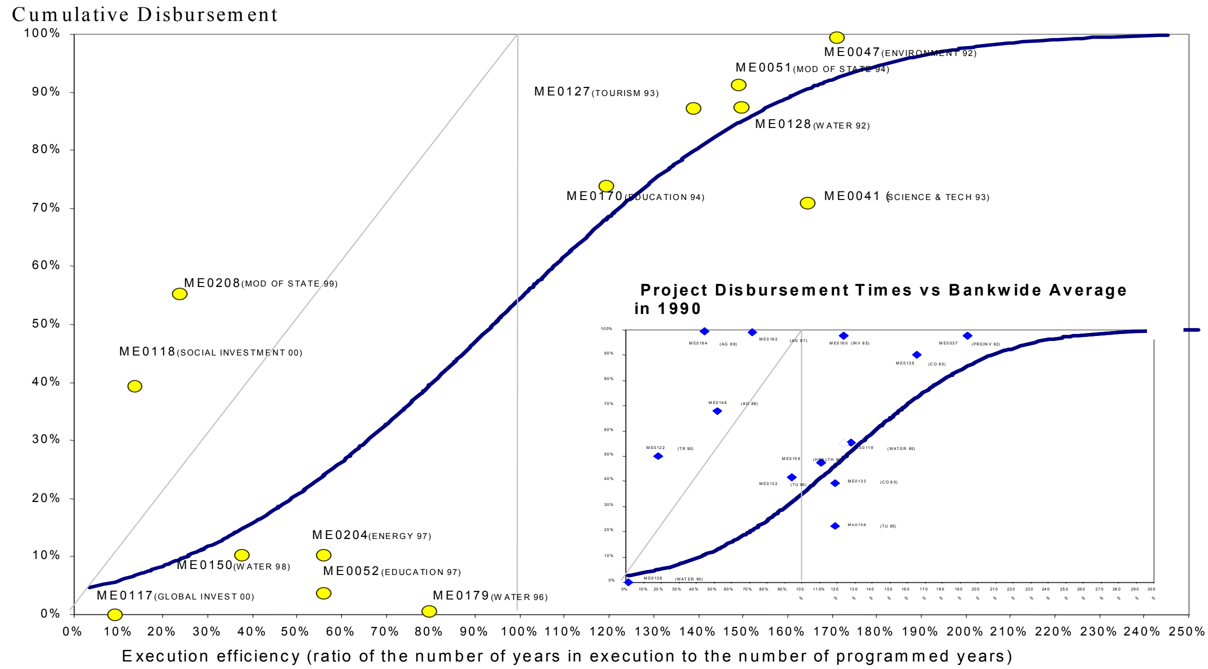
[55] See footnote 16 of "Mexico: Country Assistance Evaluation," Nov. 2000, Draft, OED.

[56] The financial agents represent considerable advantages to SHCP in its supervisory role and in terms of transferring regulatory costs to them. However, their potential role in terms of execution could be strengthened to avoid them becoming "just a post office of documents."

[57] Both development banks have been the targets of institutional strengthening by the IDB with financing built into scattered projects.

3.14 Chart 3.6 compares the percentage of funds disbursed for a project with the percentage of anticipated execution time elapsed. The tipped "S" curve shows the Bank's average pattern: projects are slow to get started, then disburse more quickly before another slowdown in disbursements late in a project's life. One would expect projects in Mexico to lie above average performance. But to the contrary, projects in Mexico are slower to get off the ground and disburse faster as they approach completion. Furthermore, execution performance, compared to the Bank's average, is worse in 2000 than in the early nineties (see the insert to Chart 3.6): in 2000, 54% of active projects were in the north-west region compared to 77% in 1990.

Chart 3.6. Disbursement profile and
Project Disbursement Time versus Bank-wide Average in 2000*



*: The chart excludes policy-based, PRI, SMPs, TCs, MIF and IIC operations.
Source: OVE using LMS warehouse.

3.15 The impression of an average performing portfolio is confirmed in Table 3.2 and Chart 3.7 that shows a summary of portfolio performance based on the Bank's PPMR's[58] and the PAIS[59] monitoring system managed by ROS[60]. Projects in Mexico, according to the Bank's monitoring system, are only marginally more likely than the Bank average to be rated "probable" in their likelihood of achieving their development objectives, and "satisfactory" in terms of implementation progress. Another benchmark is the World Bank's ratings (see Chart 3.7) for its projects in Mexico. The proportion of World Bank projects achieving development objectives is slightly higher than that of the IDB: 96% compared to 86% respectively.

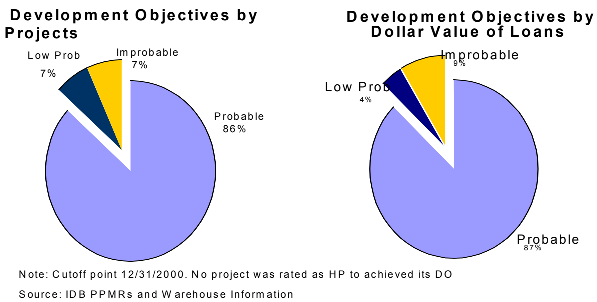
Table 3.2. Development and Implementation Indicators of Projects in Execution

	Probability of achieving development objective					Implementation progress ratings				
	HP	P	LP	I	Total # of projects	HS	S	U	VU	Total # of projects
Mexico	0	88%	6%	6%	16	0%	87%	13%	0	16
Bank	13%	75%	10%	2%	497	4%	72%	23%	1%	497

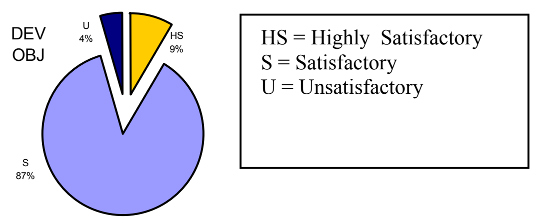
HP: Highly Probable; P: Probable; LP: Low Probable; I: Improbable; HS: Highly Satisfactory; S: Satisfactory; U: Unsatisfactory; VU: Very Unsatisfactory. Data as of 21 of November 2001.

58 Project Performance Monitoring Report: Project monitoring system (for more information see CP-1283.
59 Project Alert Identification System. For more information see: http://portal.iadb.org/pais/
60 Regional Operations Support Office

**Chart 3.7. Project Development Performance:
IDB and World Bank**



World Bank's Development Objectives ratings for projects in Mexico[61]



3.16 Looking at the history of active individual loans within the Bank's 2001's risk-problem classification, twenty-five percent of the current portfolio is categorised to be at risk with problems. Two of the four loans have been in the problematic category for the last three years (see Table 3.3). Multiyear repetition of risky or problematic status, is disconcerting, because this classification should serve as a warning signal and catalyst for remedial action.[62] In a country program evaluation like the present one, repetition of such status is a flag calling for detailed analysis.[63]

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[61] The World Bank has a similar system to rank its projects. Following the FY94 Annual Review of Portfolio Performance, a letter based system was introduced (HS = highly satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory) to classify implementation progress and development objectives. Source: Mexico's Country Assistance Strategy, May 2001. However, the practice may differ between the two Banks, since the data may not be strictly comparable.

[62] However, RE2 argues " That the label does not mean that there is any significant danger that the projects' development objectives will not achieved" OVE Report: Country Program Evaluation: Mexico 190-2000, Draft Comments, undated.

[63] The Bank's monitoring system does not contain information regarding execution performance of neither PRI-IDB operations nor MIF nor IIC operations.

Table 3.3. Projects currently classified as being "at risk" or in "problems by ROS" (as of November 21st 2001) \+

	Project Name	Amt Appr	Sector	1996	1997	1998	1999	2000	2001
ME0041	SCIENCE AND TECHNOLOGY PROGRAM	173	CT	Normal	Normal	Normal	At risk	At risk	At risk
ME0170	ELEMENTARY EDUCATION PROGRAM.	393	ED	Normal	At risk	Normal	Normal	At risk	At risk
ME0179	SANITATION FOR THE VALLEY OF MEXICO	365	OS	Normal	Normal	**Problem**	**Problem**	**Problem**	**Problem**
ME0052	DISTANCE EDUCATION PROGRAM	171	ED		Normal	Normal	At risk	**Problem**	**Problem**
Total number of projects in execution during the year:				8	10	11	12	16	16
Percentage of projects classified as "risk" or with "problems":				13%	30%	36%	58%	25%	25%

1 For a detail analysis of project execution and risk classification see the "1999 Annual Report on Projects in Execution", ROS/PMP, April 2000.

Or http://portal.iadb.org/pais/

3.17 At the other extreme there are two investment loans (faster than average) that disbursed like PBLs. Table 3.4 compares a number of non-PBLs' cumulative disbursement with respect to both the Mexican PBL average, and the average of Bank-wide PBL disbursements. These operations share a number of common features. They finance existing budget line items or they are global credit operations; they also have *ex post* rather than *ex ante* monitoring control. In addition most were of recent approval, reflecting the Bank's response to the Mexican budgetary system. Here a question, to be taken up again in the next chapter, arises about the projects' value beyond merely additional financing.

Table 3.4. Selected non-PBLs disbursement profiles \+

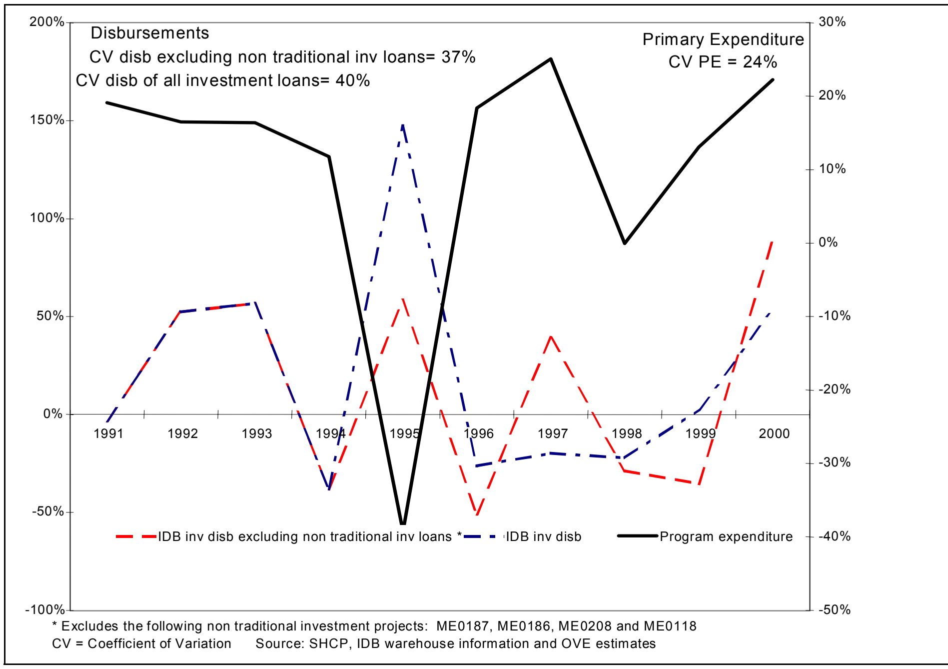
Project title and number	Instrument *	Cumulative disbursement faster than:	
		Bank-wide PBLs	Mexican PBLs
Social Services, ME-0187	PESP	Yes	yes
Labour Modernisation, ME-186 (first phase)	PESP	Yes	yes
States and Municipalities, ME-0208, (PBL component)	PHIB	Yes	yes
SME global credit, ME-0152	PGCR	yes	yes
Corporate Strengthening, ME-0126 (global credit component, 72% of total)	PGCR	yes	yes

\+ Using a 95% cumulative disbursement criterion. *Where: PESP is an investment project, PHIB is a hybrid, and PGCR is a global credit programs.

3.18 According to many Bank documents, most projects suffered from the lack of federal resources and consequent budget adjustments in the wake of the 1994 crisis. During the second half of the decade, too, public primary expenditure was vulnerable to external shocks, particularly following the 1995 crisis and the 1998-drop in international oil prices.[64] Corroborating this claim is the profile of disbursements, which were, except in 1995, pro-cyclical (see Chart 3.8). Another variable affecting disbursements and cancellations is the exchange rate: a devaluation reduces, *ceteris paribus*, the dollar-valued disbursements in projects with high local content, possibly leading to partial cancellations. The volatility of macro-variables thus contributed to a large forecast error of disbursements.

[64] Oil-related activities currently contribute one third of total public revenues

Chart 3.8. Rate of Growth of Primary Expenditure and IDB Investment Disbursements



Investment projects' disbursement has a higher volatility than the country's primary expenditure.

Investment project disbursement is, with the exception of 1995 pro-cyclical.

Source: OVE using LMS Warehouse and IMF, Article IV, documents, various years.

D. Bank's Project Evaluations

3.19 Critical to Country Program Evaluations is the data contained in the Bank's project monitoring and evaluations system.[65] The main instrument is the Project Completion Report (PCR), necessary for all projects other than MIF, TC funds and PRI-IDB operations. In addition the Bank has two other evaluation instruments: mid-term evaluations[66] and *ex-post* evaluations. Of the projects approved during the nineties only three operations proposed to have both.

3.20 Thirty-eight loans were approved during the nineties. Twenty-four investment projects, seven policy-based loans (plus a hybrid)and seven PRI-IDB loans. One project was fully cancelled. Fourteen projects are closed.

3.21 A total of 10 projects (38% of the total) approved in the last decade had an *ex-post* evaluation clause (see Table 3.5). To date, though, no ex-post evaluations have been carried out. The lack of *ex-post* evaluations limits severely any project-by-project analysis of the projects' objectives and results. Similarly, seven projects proposed to have MTEs but only 1 of the 7 has been completed. Fourteen projects are fully disbursed with 12 PCRs due. Presently

- 8 projects have an approved PCR,
- two were done but not approved,
- two were waived,

[65] See "Oversight Review of the IDB's Project Performance Monitoring Review, the Mid-Term evaluations, and Project Completion Report" OVE, April 2001

[66] Mid-term evaluations started to appear in loan operations of the Bank in 1993. For a more detail analysis regarding MTEs and PCRs, see "Oversight Review of the IDB's Project Performance Monitoring Review, the mid-term Evaluation and the Project Completion Report" RE-247

- one has been in preparation for two and a half years, and
- one is pending.

3.22 The paucity of project evaluations limits lessons learned. For a CPE, too, the paucity of PCRs is problematic. And where they do exist, the following is indicative of their quality: the current practice is to transfer the evaluative judgement made in the last PPMR to the PCR. This means there is no final assessment by management of the project.

Table 3.5. Status of project evaluations *

	Total Number	Number Due	Done or Approved
PCRs	30 \\^	12	8
Mid-Term	7\\+	5	1
Ex-post	10	5	0

* The seven PRI-IDB projects are exempt from this monitoring- evaluation cycle. PRI's internal system consists of a semi-annual portfolio review, the results of which are neither broadly disseminated nor available through the Intranet. \\^ This number excludes MIF, TC Funds, PRI-IDB projects and ME-0056, \\+ ME-0056, one of the seven projects that proposed a mid-term review was cancelled.

4. Development Impact

4.1 The chapter has the central objective of determining the outcome-development impact of the Bank's intervention through an evaluation of the Bank's country assistance program at the project level.[67] In addition, two other dimensions of evaluation are touched upon, the relevance at the sector-theme level and the focus derived from an inductive exercise. Each thematic-sector section attempts to include the following items: a summary of the key issues and performance of the sector or theme; the issues that were tackled by Bank interventions (approved projects) and which intents remained frustrated (non-approved projects); a determination of the pro-poor bias of project design; and the realisation, or progress towards, the projects' outputs, milestones and outcomes and development impact of Bank interventions.[68]

4.2 A note of methodological caution is pertinent. First, this evaluation does not cover all the development issues identified by the country programs nor all the sectors of the economy in which the Bank had projects. Second, given the size of public sector's financial resources the Bank's financial contribution even at the sub-sector level has been at best modest. Therefore disentangling and assessing the Bank's development impact is difficult.

4.3 In addition, hampering an evaluation is the dearth of self-evaluations by the Bank, and the bias of the evaluation-motoring system towards administrative-disbursement indicators. The latter is partly due to the frequent absence in project documents of a comprehensive definition of baselines, output and outcome indicators. Further, progress data is rarely collected for projects still active. This is a binding limit for an evaluation exercise given that the Bank's intervention at the sub-sector level is marginal. In addition, data at sub-sector level thus will not pick-up the Bank's contribution, reducing the scope for an evaluation of the development impact of the Bank's intervention and augmenting the problem of attribution.

4.4 Before presenting an evaluation of individual projects we briefly present three dimensions that can be induced from an evaluation of individual projects: evaluability completeness; availability of progress data; and themes:

- The first dimension is the evaluability completeness of project design in terms of their specification of indicators of objectives, baselines, outputs, and outcomes for each objective specified in the project.

- Completeness of project design is derived from a project results framework matrix where the vertical dimension specifies the goals and specific objectives and where the horizontal dimension includes objective indicator, baseline, milestones, output and outcome. Annex II includes the result framework matrixes used to calculate the completeness index. Completeness is defined as the ratio of the sum of the cells with an entry to the sum of total cells of the matrix. The completeness index varies from 0 to hundred (complete). The lower

[67] Not all projects are reviewed. This report evaluates 71% of the universe of approved projects between 1990-2000 excluding PRI-IDB. This report excludes the following closed projects: environment (ME-0047), tourism (ME-0127), export promotion (ME-0112), science and technology (ME-0041), and private pension reform (ME-0112).
[68] For each project evaluated this report used the following documental evidence depending upon the loan instrument: Loan Proposal, PPMRs, tranche release documents, PCRs, and mid-term and ex post evaluations, plus memorandums pertaining to the project. This documental methodology was only possible using the archive system in the local office, as the archive system in headquarters is incomplete. Project level information was summarised into a Table, which was sent to team members and the official responsible in the local office with the request for comments on errors of fact, omission, or interpretation.

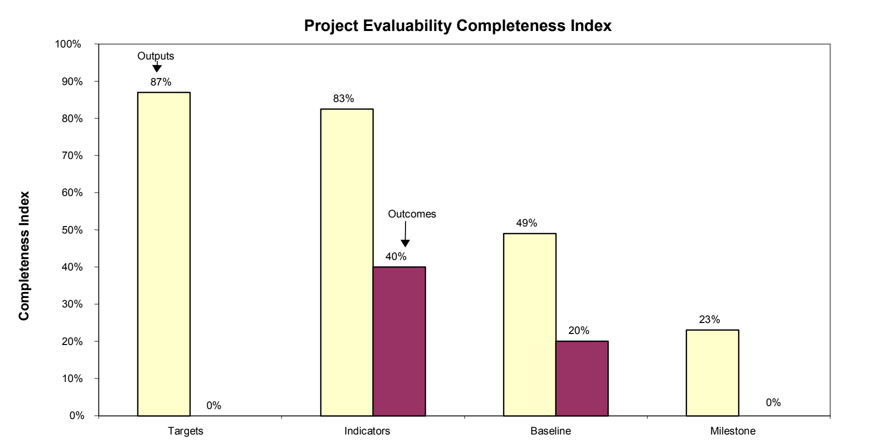
the index the less susceptible is the project's intent, thus greater the limits imposed on an evaluability of the project.

4.5 Chart 4.1 summarises the completeness index for the randomly selected sample (one third of non PRI-IDB and PBL operations) of projects. With regard to outcomes (development objectives) the project design completeness index reveals the following about projects design:

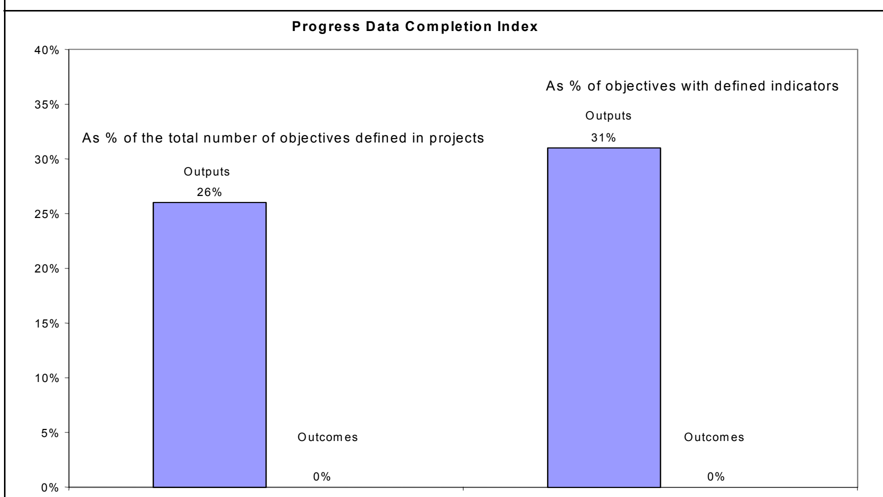
a) although about 40% had defined the objective(s) indicator only a fifth had baselines (the gravity of the problem) and none had defined their development targets or milestones. [69]

b) with regard to outputs the story is better: over eighty percent had defined the indicators, fifty percent gave baselines, twenty three percent included milestones, and the majority, eighty-seven percent defined their targets.

Chart 4.1. Projects Evaluability Design Completeness Index



Lack of complete project design makes it almost impossible to evaluate the development impact of projects, given that they do not provide outcome baselines or outcome targets. Even for outputs there is not a hundred percent specification.



There is little (none) information regarding progress on output (outcome) indicators.

Source: OVE, Annex II.

[69] A note of caution is necessary, in this evaluation projects' development objective have not been taken at face value. For example if the project's development objective was " to finance the 1990-1992 investment program…" (ME-0116) the project is assumed to have zero development objective specification. Thus there is an element of value judgement involved. However, outputs have been taken at face value.

4.6 The second dimension is the completeness of progress data on the realisation of projects declared objectives. The objective of this exercise is to reveal the evaluability of the Bank's program in the country. The methodological exercise uses information bottom-up; i.e. information at the project level aggregated to a total and thematic level. The exercise does not measure how "good" the project is, but measures only the degree that it can be evaluated. This index is calculated from the project's results framework matrix, using the last column, as the percentage of cells with entry to potential cells defined by the column containing information on progress data with the rows containing the project objectives.[70] The index shows the progress made towards the declared objectives. Chart 4.1 shows the low percentage of progress data differentiating between development outcomes and outputs. The values of both the previous and this dimension severely limit a judicious evaluation and accentuate the problem of attribution.

4.7 The third dimension is the natural theme or themes interconnecting the individual projects. The evaluation could not find, through an inductive exercise, such a theme (s). Thus individual projects are forced into four categories: the structural reforms in which the Bank was involved (agriculture and banking sector); infrastructure and private sector development (transport and communications; electricity and water); capabilities and opportunities (education, labour market, social expenditure); and decentralisation.

A. Structural Reform

4.8 For a country deeply engaged in structural reform, the Bank was relatively absent. The Bank supported structural change in three areas: agricultural sector, the financial sector, private sector pension reform and transport and communications. We evaluate the interventions in agriculture and financial sector.[71]

A.1 Agriculture

4.9 There were four key sectoral issues over the nineties. First, the sector was characterised by low GDP growth and productivity. Second, the gamut of instruments of state intervention was not only inconsistent with the pro-private sector development model being adopted but also incompatible with fiscal austerity. Third, property rights of a significant proportion of land – communal and *ejido*- were absent. Fourth, rural poverty and extreme poverty were high.

4.10 The Government initiated a series of reforms that consisted of four pillars. The first pillar consisted of the reduction-removal of price controls and financial and input subsidies combined with the dismantling of the state apparatus through the rationalisation and divestiture of market and processing public entities. The second pillar consisted of the liberalisation of international trade in the context of GATT and NAFTA.[72] The third pillar consisted of a constitutional reform for land and property rights –particularly in *ejidos*- followed by a land-titling program. The fourth pillar consisted of the introduction of a number of programs to compensate the negative impact of the reforms on rural poverty.

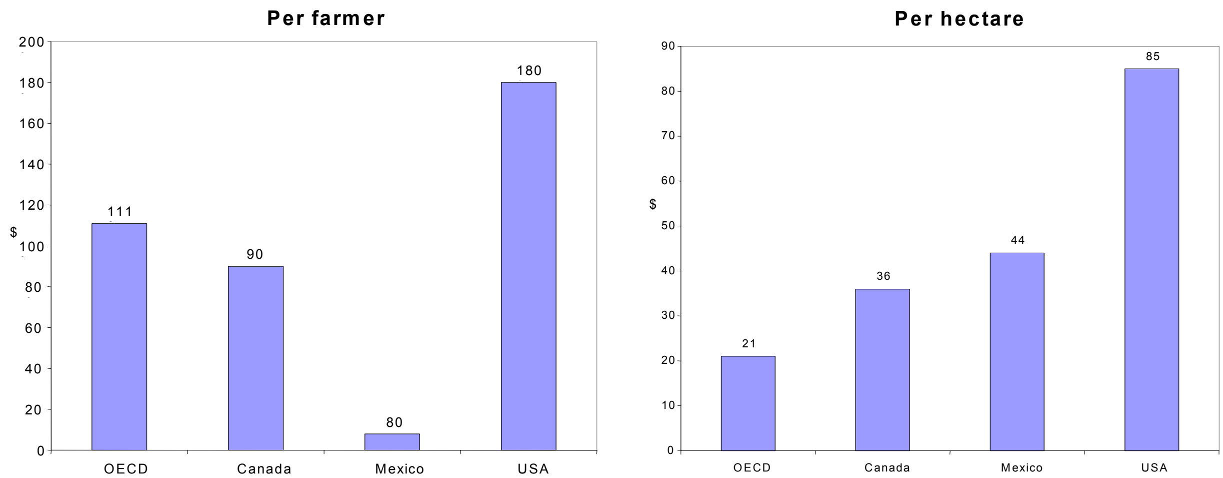
[70] For more information see: OVE Country Program Evaluation: Technical Notes available at http://ove/
[71] This report does not evaluate project ME-0197, Contractual Saving Development, approved in 1996, which was essentially a private pension reform, done jointly with the WB. The WB's $400 million loan was followed by another $400 million loan in 1998. For an evaluation by the WB of the joint project see: Implementation Completion Report, No. 17771, May 1998, WB.
[72] NAFTA's agricultural provisions have a schedule of implementation that stretches up to 2008 will become effective in 2005. The more recent trade agreement with the European Union excludes the agriculture sector.

4.11 The Bank supported this policy transformation through two policy-based loans (ME-0038 and ME-0185 approved in 1991 and 1996 respectively).[73] Both loans were completely in tune with the government's policy of dismantling interventions (the first pillar) and both had conditionalities to mitigate the negative effects on the poor (the fourth pillar). Both loans' objectives had more than one of the following objective set: increasing –growth-productivity-efficiency and reducing poverty. Both loans are fully disbursed, but only ME-0185 has a PCR.

[73] In addition there were eight small projects (US$ 3.5 million) and eleven TCs (valued at US$4.1 million). This report does not evaluate them nor ME-0033, a US$200 million Irrigation and Drainage.

4.12 The projects' outputs in ME-0085, the tranche conditions, were attained. However, according to the World Bank's PCR there was backsliding in policy that "… almost led to cancellation of the 2nd tranch altogether…" [74] No such brinkmanship is found in Bank's documents of the project ME-0038 done jointly with the World Bank, indeed the project's PCR was waived. Nonetheless, reform policies, have led to a private sector driven agricultural sector. Chart 4.2 summarises the current policy stance.[75] During 1997-99 period Mexico's producer support per farmer and per hectare was the lowest amongst NAFTA countries and well below the OECD average.[76]

Chart 4.2. Producer support 1997-99 $



Source: Agricultural Policies in OECD Countries. OECD 2000.

4.13 Expected improvement in overall performance was not fully realised. Chart 4.3 shows the evolution of key aggregate performance indicators. First, the objective of increasing average growth rates cannot be discerned, as there is no before-after-reform spike in growth. The agriculture share of GDP dropped below 5 percent. This can be attributed to the inertial effects of the previous policy regime combined with a double squeeze effect consisting of an increased non-labour input costs due to the reduction in subsidies combined with low world prices and an appreciating real exchange rate. This unfavourable framework may have mitigated the beneficial effects of the reform during the early nineties.

4.14 Second, the objectives of increased productivity and efficiency were neither numerically nor conceptually defined. Nonetheless, productivity, measured by GDP per worker, and efficiency, measured by unit labour costs, shows positive trends since the eighties, but with no discernible before- after- reform shift.

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[74] See Report 15794, June 1996, WB. Note this loan was during the period when the IDB was authorised to approve sector loans only with the World Bank (1990-91). Preparation, missions, conditionality etc were done jointly with the WB.

[75] See Review of Agricultural Policies in Mexico, 1997, OECD, plus the annual surveys: Agricultural Policies in OECD Countries: monitoring and evaluation, various years.

[76] What the graph doesn't show is that producer support equivalent changed away from price support and towards income support by entitelments (PROCAMPO, Alianza para el Campo) or by input use see OECD, 2000 p 170 op cit.

4.15 Third, the objective of obtaining "functional" markets was only partly achieved.[77] The withdrawal of the government left vacuums in the system, which the private sector has not filled or only created opportunities for local monopolies. Domestic markets remain segmented and financial services remain poor while public entities, BANRURAL and FIRA have reduced their scope.[78] Storage, which after CONASUPO was closed, remains a weak link in the marketing chain. About 30% of production is lost due to inadequate transport and storage. Nonetheless, exports grew by 70% during the first six years of NAFTA.[79] There remains a huge potential, as Mexico has one of the lowest agriculture trade to agriculture GDP ratio, 46%, in the Region, which if exploited could narrow the trade balance which widened during the nineties.

4.16 Fourth, the objective of reducing rural poverty begins to be realised only by the late nineties. The country did implement, mainly in the second half of the nineties programs to reduce rural poverty. One highly lauded program, PROCAMPO, was redesigned with conditionality of the Bank's sector loan of 1996.[80] PROCAMPO, since 1994, provides a fixed amount of money per hectare of land cultivated by rural farmers. The program is for a transitional period of 15 years, and was designed to mitigate the effects of NAFTA. It covers today 90% of Mexico's cultivated area. Although the benefits are not means tested, a large majority of beneficiaries are small farmers. Evidence suggest that one peso through PROCAMPO creates 2 pesos for the household.[81] Other pro-rural poor programs were also introduced in the second half of the nineties: Alianza para el Campo; and Progressa. P*rima facie* evidence of the programs' effectiveness is that rural poverty and extreme poverty have started to fall.

4.17 The rural poverty pattern can be partly attributed to insufficient emphasis, until very recently, on policies to create opportunities or enhance capacities of the *ejido* sub-sector and the land-less peasants (who represent about 70% of rural employment). Rural households have a lower level of educational attainment, reflecting both supply factors (availability and quality of schools) and the higher opportunity cost of schooling for households (loss of wage income, farm labour). Higher levels of education would allow entry into the higher end of off-farm activities.[82] The 1992 reform authorising the sale, rental, and sharecropping of ejido land, and the subsequent land certification program (PROCEDE), should have enhanced the return to land.[83] Not so, a PROCEDE certificate bears the risk to be subject to land tax, raises the possibility of losing PROCAMPO payment, and has had little impact on farmers' access to formal credit. The latter reflects not only the limited access to financial services but also that *ejido* certificates do not provide the right of seizure, like private land.

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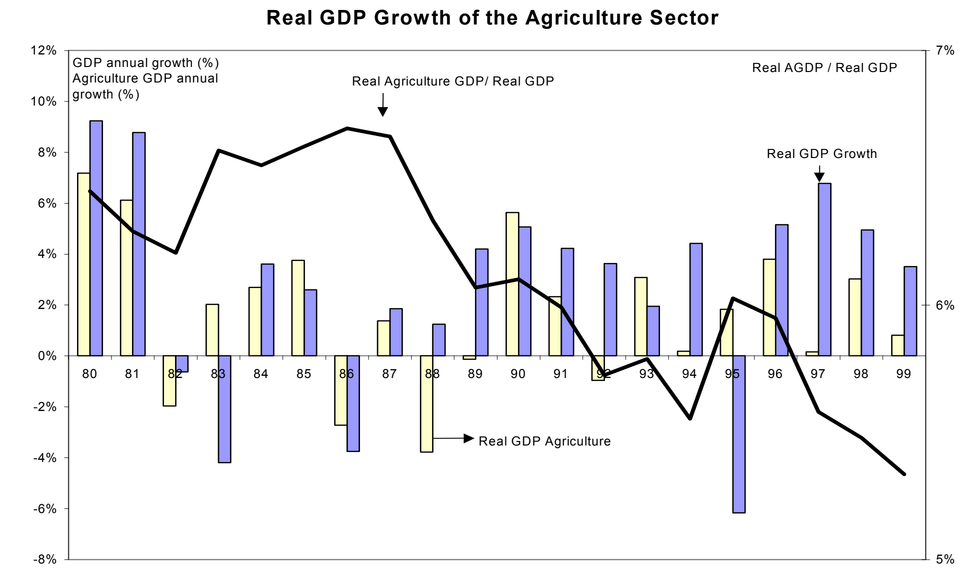
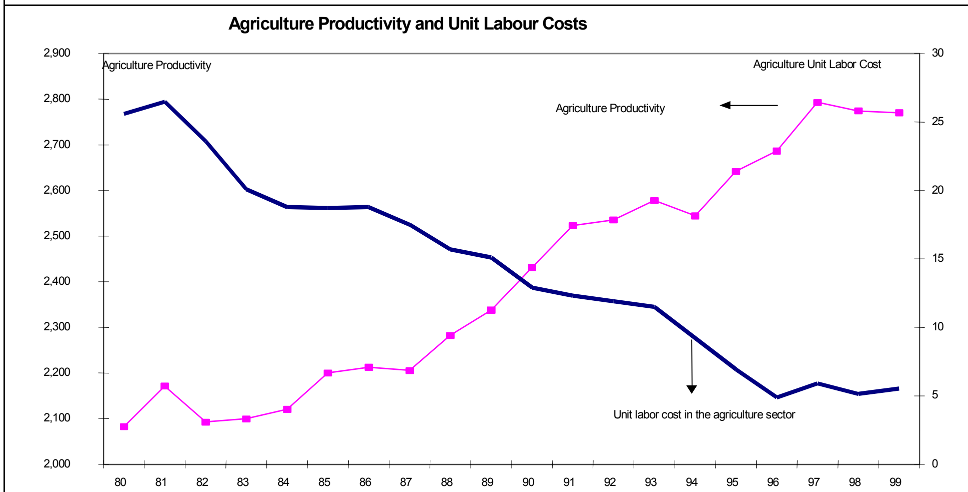
[77] This paragraph draws upon Chapter 15 of Mexico: a comprehensive development agenda. WB 2000.
[78] See Rodrigo Chavez and Susana Sanchez "*Financial markets in Rural areas in Mexico*", 1994, WB.
[79] See "El TLCAN en el sector Agroalimentario a seis años de su entrada en vigor", SAGAR/SECOFI, 2000.
[80] See "Cash transfer Program with Income Multipliers: PROCAMPO in Mexico" by E. Sadoulet and A. de Janvry, 1999, University of California, not processed
[81] See L. Cord and Q. Wodon "Do Mexico's Agricultural Programs Alleviate Poverty? Evidence from the Ejido Sector". Report 19214-ME World Bank 1999.
[82] "*Since 1994 the share of ejidatarios involved in off-farm activities rose by 50%. By 1997, 60% of all households participated in off-farm activities and about 80% had at least one family member residing outside the community and 45% had at least one member in the USA. About 40% of ejido income comes from non-farm sources including remittances*." See Louise Cord, "Mexico Ejido Reform: Avenue of Adjustment-Five Years Later". WB, 1999.
[83] The change was in art. 27 of the Constitution, in 1992. Ejidos were created in were created in 1917 in the aftermath of the revolution. Ejidos and communal lands comprised approximately half of total land. The program, PROCEDE, started slowly but by 2000 had certified about 70% *of ejido.*

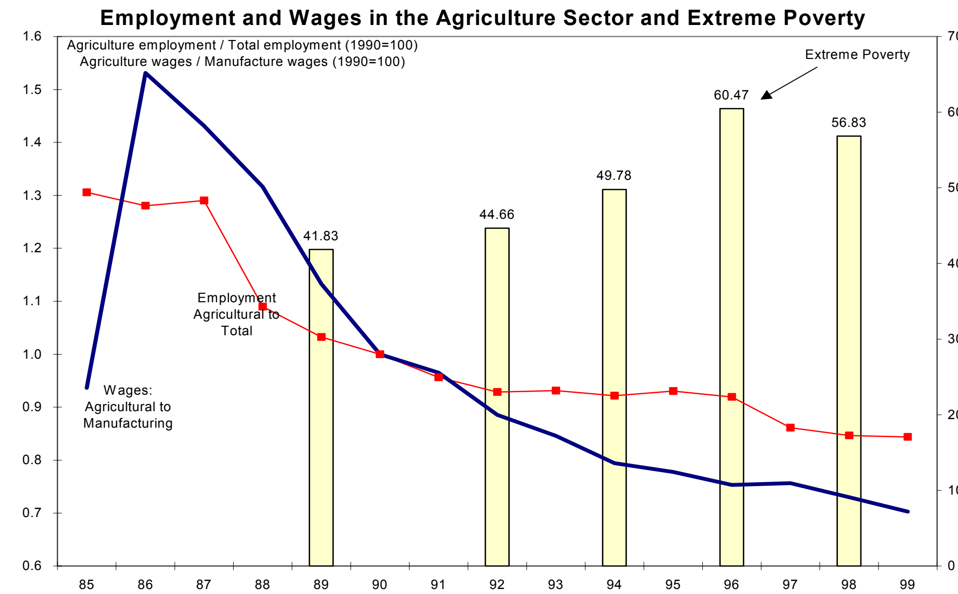
Chart 4.3. Agriculture Sector Performance



There is no identifiable pre-post reform shift in agriculture's GDP growth. The growth rate has yet to return to the highs of the early eighties.

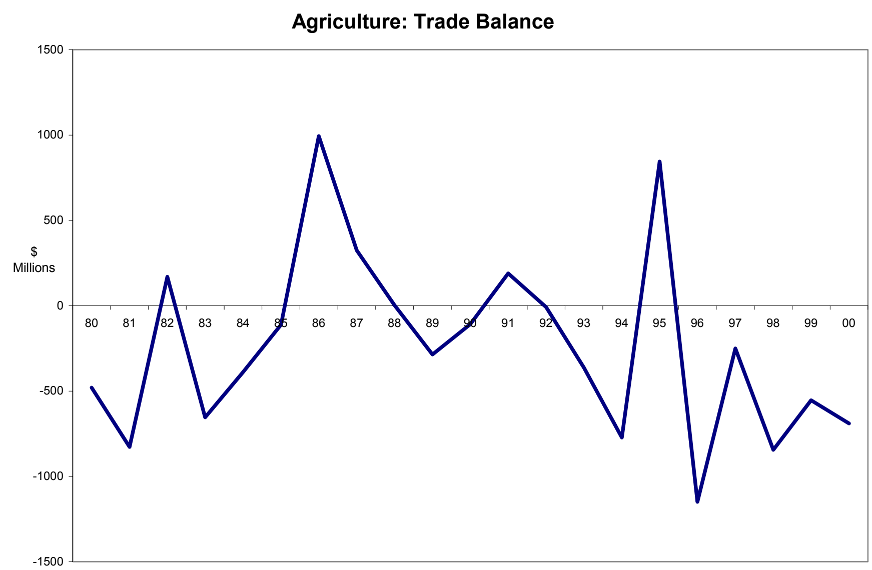


Agricultural sector's productivity has increased and unit labour costs fallen. However, these trends started in the early eighties, therefore difficult to attribute to the reforms.



The agriculture to manufacturing wage ratio has steadily fallen since the mid-eighties as has agricultural to manufacturing employment.

Extreme rural poverty has steadily risen and begins to fall only in 1998.



The agriculture's balance of trade was narrowing until the mid-eighties. This trend was reversed in 1986, and, with sharp fluctuations has widened.

A.2. Financial Sector

4.18 The detonator for Bank intervention in the financial area was a systemic banking sector crisis, which erupted in 1995. Events leading to the crisis included the following.

1) During 1988-89, the rapid financial liberalisation occurred without a strengthening of the regulatory framework and its institutional basis.

2) In 1990-2 the Banks were privatised (but avoided foreign ownership), they oversaw a 1991-94-credit boom.[84] Domestic credit grew 8 times faster than GDP reflecting asset inflation, over-exposure to real estate sector and foreign exchange-denominated loans.

[84] During this period 13 Mexican banks and one foreign bank entered into operation, which combined with the 18-privatised banks plus Obrero and Citibank gave 32 banks.

3) The Bank's role in the intermediation of capital inflows facilitated the expansion of the profitable non-tradable goods, contributed to the deterioration of the tradable sector and set the stage for the tradable sector's contagion to the economy and back to the banking sector. Indeed, during late 1994 and early 1995 solvency problems and a potential collapse of the banking system became evident.[85]

4.19 The country's response to the crisis can be classified into three phases. The first phase, 1995-96, was characterised by containment i.e. with the objective to avoid a collapse of the system.[86] The second phase was characterised by the introduction of debtors support programs, loan purchase mechanism and bank interventions. [87] The third phase, from 1998 onwards was characterised by the consolidation of the legal framework and moving from problem solving towards problem preventing regulation by setting-up an appropriate incentive structure and enhancing market discipline. [88]

4.20 The World Bank took the lead in the financial sector crisis, beginning with a technical assistance operation in Jan 1995. However, tensions emerged between and among World Bank staff and them and the government during the, preparation and execution of the $1 billion Financial Sector Restructuring Loan (FSRL) of 1995. Stocktaking of conditions of the banking system by the Bank's Operations Committee, eventually led to a *mea culpa:* the loan was classified as unsatisfactory: it over-promised on results, and under-estimated the depth of the crisis. The Bank

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[85] In 1995.I the banks had to renew about 20 billion worth of credit lines.

[86] Three actions were taken. First, the liquidity problem was tackled through the creation in BANXICO, of a special window for dollar denominated loans. Second, additional provision requirements were set to deal with the rising PDL. New regulation required banks to provision 60% of PDL or 4% of the total portfolio which ever was larger. However, the new provisions would have taken the capital ratios of some banks below the 8% minimum requirement. Thus, third, a temporary capitalisation program (PROCAPTE), through which Fobaproa acquired convertible debentures issued by some banks, was installed. This was complemented with legal reforms allowing greater participation of foreign Bank's in the bank's capital.

[87] The most important mechanism for the removal of bad assets from the Bank's balance sheets was the swap of non-performing loans for a ten year non-tradable zero coupon bonds which accrued interest to be paid at maturity. Working in the context of very poor accounting standards, weak legal framework the authorities may have been lax in giving liquidity/forbearance to insolvent institutions often un-transparent case by case forbearance. Additional, programs were implemented directed at small-medium size debtors.(credit cards, personal loans, mortgages and loans to small-medium enterprises. These gave short -term relief by reducing interest rates and the removal of interest on un-paid instalments. FINAPE and FOPYME programs partial prepayment allowed a reduction of the principal as well of interest, and banks were committed to providing new financing. The authorities intervened by taking control or transferred to third parties 14 institutions due to inefficient or irregular management or solvency problems

[88] The 1998 banking law (ley de Protección del Ahorro Bancario) created a new deposit agency replacing FOBAPROA with a new institution, IPAB (it is a Federal decentralised agency with its own legal status, governing body and equity.) It also provided a framework and timetable to sell bad assets acquired by FOBAPROA and create a mechanism for the transparent resolution of under-capitalisation and insolvent banks and allows full participation of foreign investors in Mexican banks. It is also oversees the different bank support programs: (i) banks in the capitalisation and Loan portfolio purchase program i.e. a program in which the government offered to buy two pesos worth of loans recoveries for each peso of fresh capital injected by shareholders; (ii) banks under the "saneamiento" program; (iii) intervened banks in the final stages of liquidation or resolution managed by CNBV-appointed administrators; and (v) intervened banks in the process of being sold: (i) Included Banamex, Bancomer, Banorte, BBY and Bital; (ii) included Serfin, Inverlat, Bancrecer, Promex, and Atlantico, (iii) included eight small banks Anahuac, Capital, Cremi, Interestal, Obrero, Oriente, Pronorte, and Union.

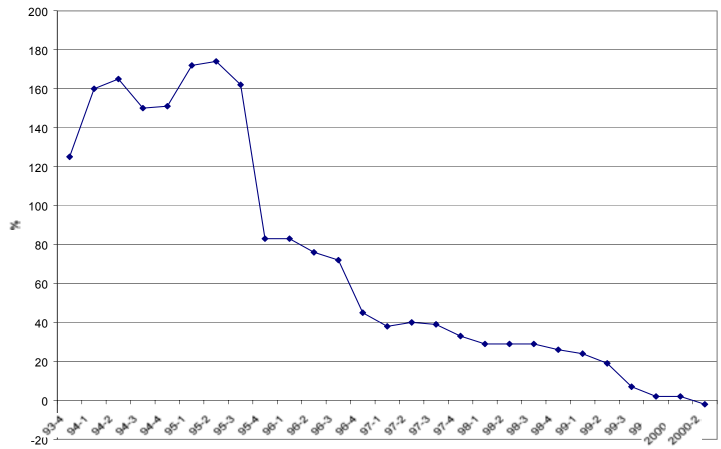
followed suite, but apparently avoided both acrimony and also soul searching. [89] The Bank's policy based loan (ME-0188), a joint operation with the World Bank, also fully disbursed.

4.21 During the second half of the nineties the Bank's intervention included all three typical financial sector operations: two PBLs for the legal reform of the sector (ME-0188 and ME-0227), one investment loan for the strengthening of supervisory entities (ME-0059), and two more loans for providing credit to the private sector (ME-0126, ME-0117). Only one operation is closed. No project had a pro-poor bias. Some financial sector operations as well a number of non-financial sector operations had institutional strengthening components directed at the development banks: NAFIN and BANOBRAS. We do not review these components hence do not evaluate their impact on the public development banks.

[89] However, almost tongue-in- cheek "… objectives as initially formulated could not be met within the time frame planned for those operations." "…. World Bank concluded, in its evaluation, that the performance of its loan operation had been unsatisfactory." See par. 2.35, Loan Proposal, ME-0227, 2000.

Chart 4.4. Banking performance indicators

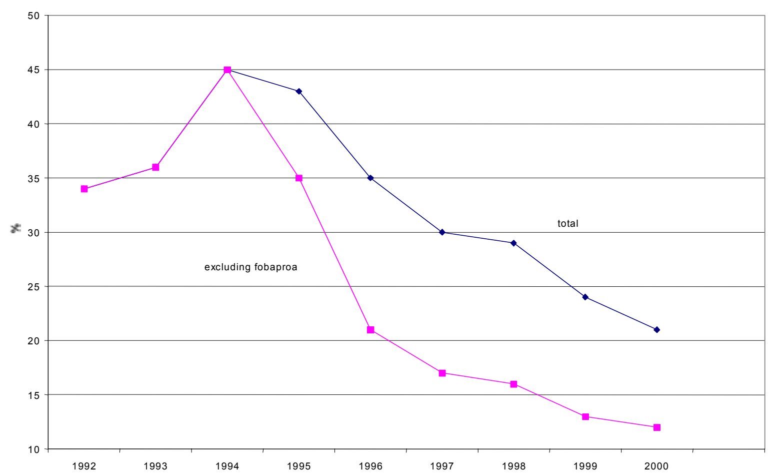
Solvency (non performing-provisions)/capital



Source: El Sistema Bancario Mexicano, Hacienda, Sep. 2000

Comparable solvency data shows that by 2000 the banking system had reached solvency.

Dis-intermediation (credit to private sector as % of GDP)



Source: El Sistema Bancario Mexicano, Hacienda, Sep.2000

Commercial banks credit to the private sector remains below the –inflated – levels of the early nineties.

4.22 The Financial System Restructuring Program (ME-0188)'s objective was to restore solvency and soundness in the Banking system, but no benchmarks were defined with respect to this objective. An evaluation of this project could echo the WB's evaluation: it over-promised on results, and under-estimated the depth of the crisis. Nonetheless, taking the goals of a loan to be outside the project's time frame, then it was successful: the banking system is on the road to recovery (see Chart 4.4), most commercial bank performance indicators show, by 2000, an improvement in solvency.[90]

4.23 The intermediation capacity of the banking system, however, remains constrained. Bank credit has not recovered from the –inflated- levels prior to the crisis, and has continued declining in real

[90] Of the 18 privatised banks plus Obrero only 6 remain under the control of their original shareholders. By 2000 of those only 7 operate normally. As of December 2000 the number of banks in the system was the same as of 1994. The 32 banks were the result of entry of 17 banks, the closure of 9 banks, and the merger and acquisition of 8 banks. The process of consolidation has increased foreign participation

terms. The final fiscal cost of the banking crisis will depend on the recovery value of IPAB assets. Recent cost estimates are 21.3% of GDP, plus that servicing the real interest on IPAB's debt will require approximately 1 point of GDP per year for the foreseeable future. This is a heavy and lasting fiscal burden in a country with low tax effort (10% of GDP).

4.24 The Financial Institutions Corporate Consolidation project (ME-0126)'s objective was "to strengthen the financial sector", however, "strengthen" was not mapped into numerical benchmarks. The component financing this objective – essentially multi-credit lines with financial intermediaries as beneficiaries and which gave the raison d'être of the project's title - was reassigned to the conventional multi-credit component. The largest component of the project was a straightforward multi-credit program, which has fully disbursed. However, indicators of the number or size of the beneficiaries were not specified, nor was an attempt made to relate the project to the country's policy of restructuring the debt of SMEs. The final component was directed at the modernisation of NAFIN.

4.25 The Support to the Comisión Bancaria y Valores de México project (ME-0059)'s objective was to finance the "strengthening" of the Banking Superintendency and Comisión Nacional Bancaria y de Valores (CNBV): no dimensions of "strengthening" were specified. Due to the government's decision to strengthen the supervisory entities but without using Bank finance the loan was cancelled with 88% undisbursed. The remaining two loans (ME-0117 and ME-0227) were approved in 2000, hence insufficient time has passed to give an evaluative judgement.

B. Infrastructure and the Private Sector

4.26 Since the initiation of pro-market structural reform the country has attempted to replace public for private infrastructure investment. The policy involved large-scale divestiture, as well as widespread trade and investment liberalisation and the development of a regulatory framework to ensure a competitive framework. However, the private sector's response has been mixed. The fall in total public investment was not taken up fully by the private sector. Thus during the nineties there was a depreciation of the country's infrastructure capital stock. The reduced stock combined with increasing demand, derived from the economy's growth has resulted in a rising infrastructure gap. Closing that gap will require about $20 billion per year for the next decade. Such an outlay is well beyond the financing capacity of the public sector without compromising fiscal prudency.

B.1. Transport and Communication [91]

4.27 The transport and communication sectors, either through privatisation or concessions have been opened to the private sector throughout the nineties. This opening has been broadly successful, and led to the emergence of a competitive environment. Although the improvement in the efficiency and quality is mixed.

4.28 The Bank participation in the transport sector during the nineties was minor, two loans. The first loan was approved jointly with the World Bank to support reform in telecommunications and transport in 1990.[92] Both tranches disbursed, but not without problems. In the first tranche there were difficulties with the provision of procurement information. In the second tranche there was a

[91] For more information about the sector see: Reyes Gerardo. "The infrastructure, water and electricity sectors in Mexico" at the OVE intranet: http://ove

[92] This operation was during the period that the Bank was authorised to approve sector loans only jointly with the WB.

slower than expected progress in achieving satisfactory regulatory capabilities in the SCT. This was a once for all intervention, and largely achieved its objectives.

4.29 The 1993 and 1995 CPP[93] and CP[94] strategies pointed out the need for the promotion of private-sector participation in the financing of infrastructure, road rehabilitation and modernisation of the transport sector to make sure that the "…*Mexican exports do not find any 'bottlenecks' in the transport system…*".[95] In 1993 the Bank approved a loan directed at measures to improve and modernise feeder highways and rural roads by financing a US$ 180 million loan. Major problems in project implementation, the disappearance of the executing unit and lack of interest from the Federal and State governments in the program led to cancellations equivalent to 92% of the loan.

4.30 Further intents to intervene by the Bank in this area were frustrated. The Rehabilitation and Improvement of Federal Highways Program, was proposed in the 1993 CPP strategy as a US$ 400 million global multi-works program to start sometime between 1995 and 1996. Given the economic crisis of 1995 it was put on hold until 1996, when the Bank proposed a US$ 250 million program to be co-financed with the World Bank sometime between 1997 and 1998. The project has disappeared from the pipeline. The Rural Roads Program (1997/99) for US$ 200 million project appeared as part of the 1995 CP strategy for the transport sector, but never left the profile I stage. The Port Corridors Program (1997/98) for US$ 100 million was a program aimed at improving inter-modal and customs operations between the country's main ports and their hinterlands. The project was never put for the consideration of the Board for approval.

B.2 The Electricity Sector [96]

4.31 The general policy of meeting investment requirements through the private sector remains on the policy agenda for the electricity sector. The sector remains, as Constitutionality mandated, dominated by two vertically integrated state owned enterprises in transmission and distribution: *Comisión Federal de Electricidad* (CFE) and *Luz y Fuerza del Centro* (LFC)).

4.32 Nonetheless, some restrictions on the private sector in power generation have been eased. A law was enacted in December 1992, which facilitated private sector participation in co-generation (independent Power Production (IPPs). In addition, in 1996 the government modified the expenditure and public debt laws to allow private sector involvement in the financing of public infrastructure projects.[97] An attempt at a major reform, however, remains stuck in Congress with little perspective of an early approval. [98] Despite the partial reform, private investment in the

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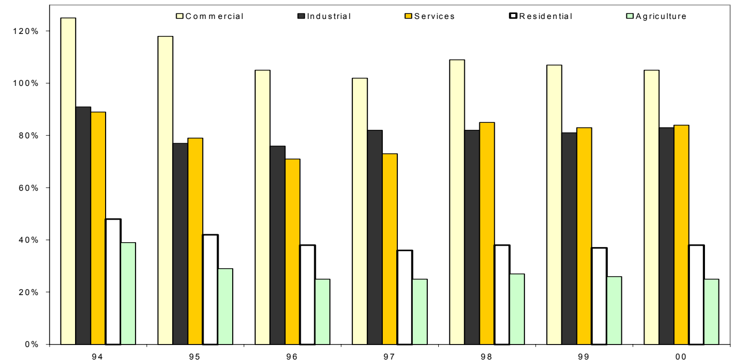
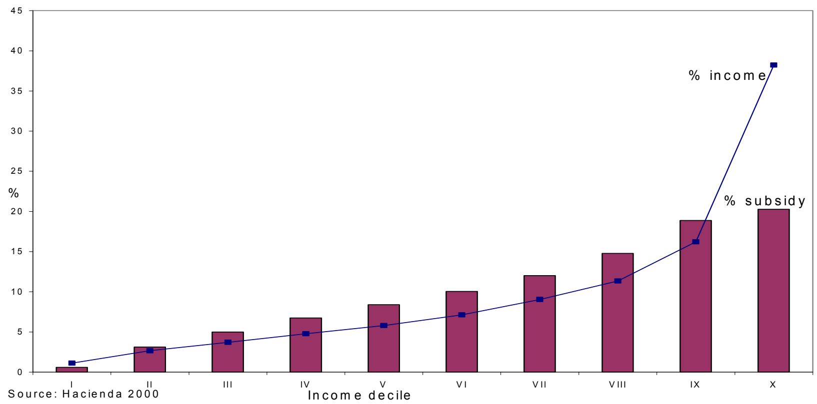
[93] Country Program Papers.
[94] Country Papers, formerly known as Country Program Papers (CPPs).
[95] See 1993 CPP for Mexico
[96] For more information about the sector see: Reyes Gerardo. "The infrastructure, water and electricity sectors in Mexico" at the OVE intranet: http://ove
[97] These were under the modality of *Proyectos de Impacto Diferido en el Registro del Gasto* (PIDIREGAS). This type of approach has been implemented in the petroleum and electricity sectors in two different modalities: a) Direct investment projects.- Projects built and financed by the private sector, which upon completion ownership is transferred to the public sector in exchange for annuity payments that cover the debt-service cost and; b) Conditional investment projects.- Projects built, financed, owned and operated by the private sector; the government entity assumes only the obligation to purchase the services provided by the private owner.
[98] In 1999, Zedillo's Administration proposed to amend Articles 27 and 28 of the Mexican Constitution to allow a major structural reform of the electricity industry. Government officials have pointed out doubts regarding the approval of the reform mainly due to political opposition and that no party holds absolute majority in the Chamber of Deputies

sector accounted for only 17% ($3 billion) of the total investments in Mexico between 1995 and 2000.

Chart 4.5. Key indicators of the electricity sector
Price-cost ratio 1994-2000

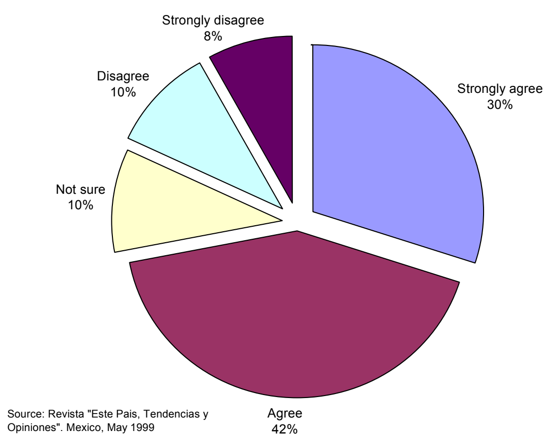


Implicit subsidy to households by income decile (1996)



Negative perceptions on divestiture

Should strategic areas NOT be administered by foreign investors?



4.33 The sector has four issues:

1) Mexico is heavily dependent on hydrocarbon based generation. Such dependence has implied that operation and maintenance costs of thermal and carbon power plants in the last five years have been approximately 75% of the programmed expenditure.

2) There is a complex tariff scheme characterised by cross subsidies and requiring government transfers. The implicit subsidies amounted to roughly 30% of the oil tax revenues of the government (see Chart 4.5). Although granted according to a scale that varies by volume of consumption, the subsidies have a regressive impact because the bulk of the benefits accrue to middle and high-usage consumers.

3) Electricity services are provided to approximately 95 percent of the population. Five million people are without access, with 85% located in the rural areas. The government attempted to expand electricity services to these communities in the mid-1990's under programs like SOLIDARIDAD and PRONASOL.[99] A World Bank study found: "while the financial costs of expanding electricity access to these communities and for productive purposes are relatively small compared to the sector's overall financing requirements (approximately US $750 million to US$900 million), the development of sustainable decentralized service delivery mechanisms remain a major challenge." [100]

4) Future demand is forecasted to grow at 5.8% per year for the following ten years. The implied investment requirement is an annual average of $37 billion pesos. According to a Standard and Poor's study of the Mexican electricity market, *"...shortages are estimated* to occur as early as 2004. Failure to make new investments in generation and transmission will affect international competitiveness of key northern industrial regions and the economy as a whole".[101]

4.34 During the last decade, the World Bank withdrew from the sector citing as the reason the inadequate regulatory framework. The Bank in contrast approved nine loan operations to the electricity sector. Interestingly, of the 9 energy loans approved by the Bank in the nineties, only two were non-PRI-IDB loans.[102] Seven operations ($398 million) correspond to the IDB private sector and only two ($353.4 million) are of the investment type; one to CFE, and the other to Fideicomiso Ahorro de Energía Eléctrica.[103]. Of the previously identified four issues, the Bank essentially tackled only one: power generation. No project had a pro-poor bias. ME-0116 objective was straightforward " … financing the 1991-1992 investment program as part of the general long-term investment program of CFE." This appears to be the initiation of a long-term commitment by the Bank. However, no follow-up operation was approved, partly due to the Bank's policy shift away from financing public enterprises towards promoting divestiture.

4.35 With respect to PRI-IDB operations, insufficient data availability restricts the ability to evaluate PRI-IDB's operations. PRI-IDB states that the evaluative criterion should be one of additionality

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[99] These were supported partially by ME-0051 approved in 1995.
[100] Giugale M. et.al. "Mexico: A Comprehensive Agenda", World Bank, 2001
[101] Wolinsky, J. "Mexico's Electric and Natural Gas Industries: The Need to Attract Foreign Capital" Standard and Poor's, November 2000
[102] The last World Bank loan was in 1990, and thereafter it withdrew from the sector. According to OED's evaluation, "the Bank has correctly refrained from new lending to the power sector." See Mexico: Country Assistance Evaluation, Nov. 2000, Draft, OED.
[103] The main reason is that "the Bank Public Utilities Policy establishes some requirements for Bank participation in a project in public utilities sectors. The Mexican electricity sector does not meet these requirements. For that reason, the Bank has not approved power projects in this country since 1997…" See Memorandum from Paulina Beato to the Mexican Power Sector Reform Working Group June 8, 1999

i.e. "*…provided longer tenors… risk allocation*"… *played a catalytic role… provides… environment, social health and safety aspects*…", for which no data is available, however, one can say that it did not secure *"... changes in regulatory regimes*…"[104] However, PRI-IDB intervention has led to a healthy discussion regarding IDB strategy in the sector. According to one position[105], held by RE2/FI2 and SDS, the "*...IDB should not participate in the financing of any IPPs ... and should limit financing capacity to the support of the new generation of IPPs*". In opposition, PRI-IDB[106] considers that the Mexico's IPP program is eligible for Bank financing. Its arguments are: (a) GOM's commitment to the electricity reform is reflected in the reform package sent to the Mexican Congress in 1999; b) " *... all PPAs being bid are very efficient and tariffs are well below CFE's generation costs and contribute to closing the gap between marginal costs and tariffs*". How this discussion ended can be seen by the fact that PRI-IDB had three new operations in 2000. What is pending to achieve is a significant consensus on the sector in order to be able to meet the needs of the 5 million people without access to electricity.[107]

4.36 To meet future demand requires opening investment to the private sector, within a clear and transparent regulatory framework. Reform would liberalise 30% of federal oil revenue for other uses, including the extension of services to those without electricity. The challenge for the country and the Bank is the hostility towards divestiture. Public opinion, about 72% of those surveyed, rejects giving control of the electricity sector to private companies particularly foreign ones (see Chart 4.5).

B.3. Water Sector

4.37 Reforms to the sector have come slowly partly due to the complex relationship between the main stakeholders (three levels of government, *Comisión Nacional del Agua* (CNA) and final users). Four problems and challenges faced by the water sector can be identified.

4.38 First access is low in rural areas. While total provision of potable water (87%) and sewerage services (73%) expanded significantly during the decade,[108] only 65.7% of the rural population has access to potable water (Chart 4.6), while only 33% do so in sewerage services.

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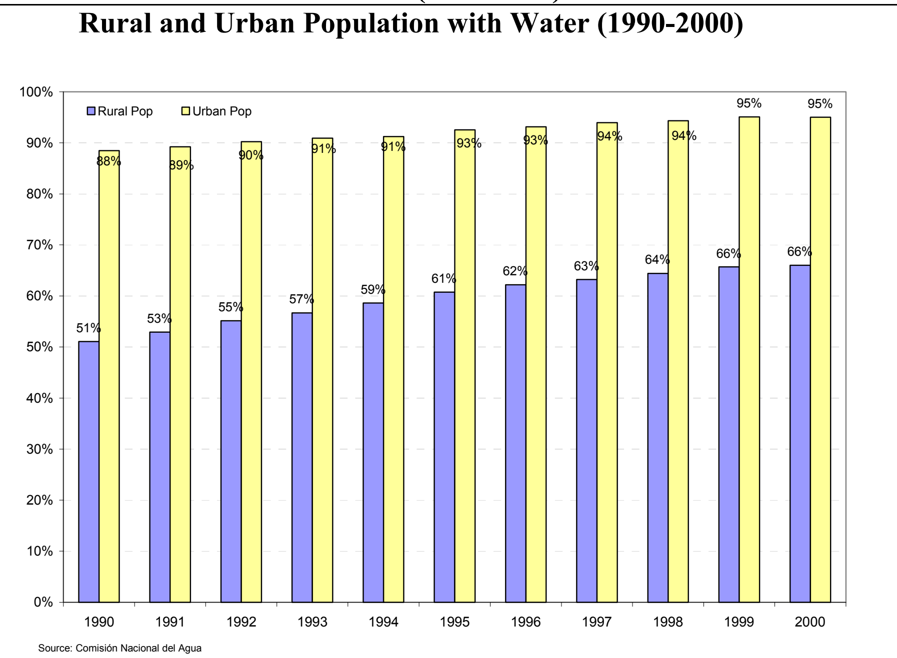
[104] See p.8 and Appendix C of "Response to the Report on Private Sector Operations by the External Review Group", CA-421, March 2001.
[105] See the June 16th 1999 Memorandum from the members of the Technical Group from RE2/FI2 and SDS to Roberto Vellutini (PRI). File Classification: Mexico-PRI
[106] See the document "PRI's Position Regarding Bank Support to Mexican Independent Power Producers"
[107] The Project ME-0051, financed –through PRONASOL- some rural electrification projects.
[108] These levels are comparable to other countries in the region like Brazil (90% and 60%) and Chile (99% and 89%).

Chart 4.6. Key Water Sector Indicators:
Rural and Urban Population with Water
(1990-2000)



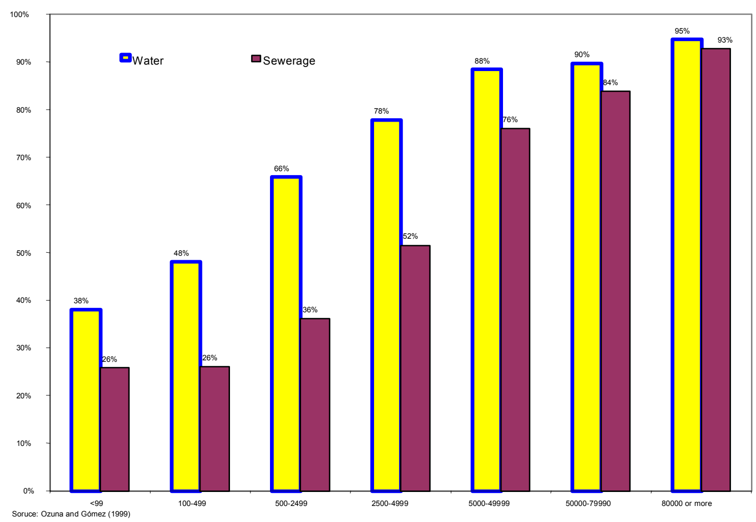
National water access indicators have steadily improved. However, 34% of the rural sector still has no access to potable water.

4.39 Analysis by size of locality also confirms a strong bias toward highly populated localities, creating another serious problem regarding geographical and demographic distribution (see Chart 4.7): water availability is concentrated in the Southeast area of the country, but populace and productive activities are located in the north. [109]

[109] Over 76% of the population live in the northern and upland regions of Mexico, which has 20% of the water resources. Nevertheless, 70% of the industry and 90% of irrigation is carried out in these areas, which utilises nearly 82% of the water resources. Mexico's irrigation land covers approximately 6.3 million hectares, but only 50% of the water is effectively utilised.

Chart 4.7. Key Water Sector Indicators:
Level of Coverage of Pot Water & Sewerage Services by Size of Locality in 1994

Level of Coverage of Pot Water & Sewerage Services by Size of Locality in 1994



The smaller is the locality, the lower is the access to water and sewerage services.

4.40 Second, decentralisation remains incipient. In 1983 the government enacted laws to give responsibilities over the provision and management of water and sanitation services to the municipalities. While CNA grants water uses rights, municipalities control these rights and are authorised to delegate water service responsibilities to third parties. However, in practice, incomplete reforms and ineffective decentralisation has forced the federal government, through the CNA, to be involved in most activities of the sector (e.g. financing projects, maintenance, administrative processes, etc.) [110].

4.41 Third, water-operating companies remain weak. In 1992, the government enacted the *Ley de Aguas Nacionales* (National Water Law), which among other things regulates and promotes private investment in the potable water and sewerage sector. The Law also established the *Organismos Operadores* (local water utility companies) as an attempt to make the operation and administration of water utilities at the state and municipal level more efficient. Unfortunately, these organisms are limited to routine operation and maintenance, billing and collection functions. They have no power to decide on strategic planning, investing or contracting long-term debt. They are heavily dependent on complex federal transfers that usually respond more to emergencies at the operational level and less to financial policies that contribute to stimulate reform, efficiency and long-term investment. Thus private sector participation in this sector has been marginal.

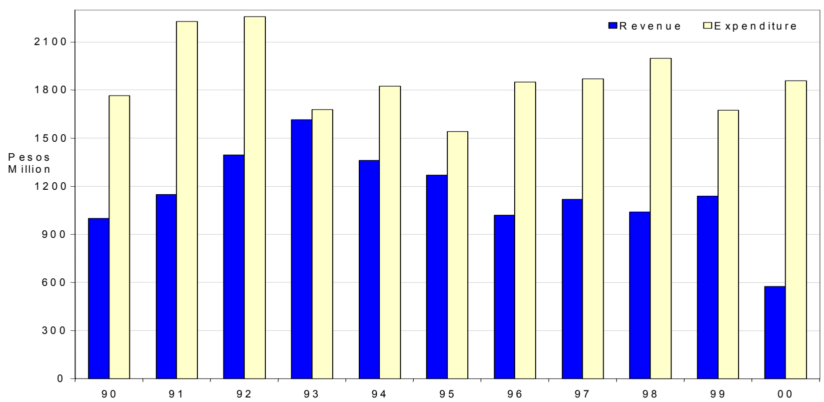
4.42 Fourth, there are low levels of investment and maintenance expenditure. Inefficiencies in the water system due to lack of infrastructure investment (see Chart 4.8) and maintenance levels

[110] Municipalities in rural areas have partially fulfilled the provision of services. At the community level, operation and maintenance of the systems is inadequate and only limited efforts have been made to recover costs through utility rates.

causes physical losses with an estimated range of 40-45% of the water being lost through leakage.[111]

Chart 4.8. Key Water Sector Indicators:
Federal Revenues and Expenditures in the Water Sector 1990-2000 (1990=100)

Federal Revenues and Expenditures in the Water Sector 1990-2000 (1990=100)



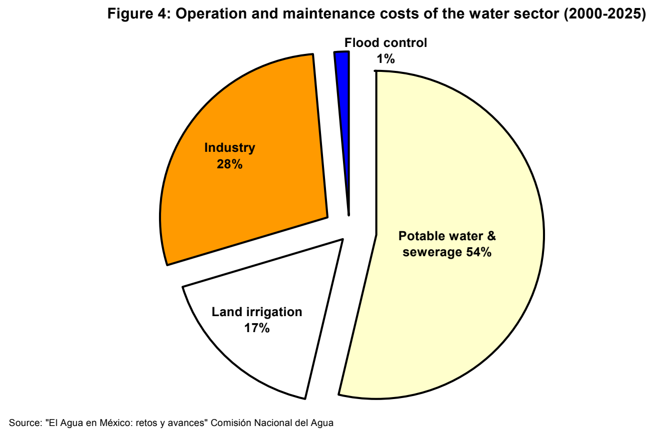
Expenditure outweighs revenue, with the financing gap increasing during the second half of the nineties.

4.43 In addition, in general, the sector revenues barely cover costs of operation and maintenance (see Chart 4.9), creating low levels of collection and strong dependency on federal resources.[112] Investment in the sector declined steadily during the second part of the nineties.[113] According to the CNA, the sector will need an annual average investment of $3.4 billion dollars in the next 25 years to cover the basic needs of potable water and sewerage services of the growing population.

[111] According to CNA studies, irrigation is responsible for more leakage than total residential and industrial demand combined.
[112] According to a World Bank study, on average tariffs are about 2.5 pesos, while 10 pesos are needed to cover operational and investment needs.
[113] Investments during the period 1996-2000 accounted only for 1.2% of the GDP

Chart 4.9. Key Water Sector Indicators:
Operation and Maintenance Costs in the Water Sector (2000-2025)

Operation and Maintenance Costs in the Water Sector (2000-2025)



The highest cost is for potable water and sewerage.

4.44 During the 1990's, the Bank approved a total of six operations in the sector for $1.5 billion dollars.[114] Of the four issues identified previously the Bank was mostly involved in one: provision of potable water and sewerage. Two projects had a pro-poor bias (ME-0150, and ME-0138). Three operations are in execution (ME-0128, ME-0150 and ME-0179), two are fully disbursed (ME-0033 and ME-0138), and one was fully cancelled (ME-0056). Most of these projects have suffered from slow disbursements, partial cancellations (17.5% of the total approval amount has been cancelled) implementation problems, delays, etc. Three projects are looked at in more detail.

4.45 ME-0138 Potable Water and Sewerage Monterrey IV's is considered a success story. Water losses dropped significantly, treatment plants allowed a more efficient use of water, distribution network expanded reaching to low-income communities, etc.[115]

4.46 ME-0179 Mexico Valley Sanitation Program objective was to reduce wastewater pollution in a system covering both the State of Mexico and the Federal District. The project has been in execution for four years with a cumulative disbursement of only 0.73%. The loan is in problems. The project was designed, approved and signed when all main actors (SHCP and both governors of Mexico City and State of Mexico) were from the same political affiliation (PRI). However, the opposition Revolutionary Democratic Party won in Mexico City's 1997 elections. The new city administration put on hold the program, questioning the design, dimensioning (most of the debt was to be assumed by Mexico City while most expenditure was located in Mexico Valley).

[114] The WB approved a total of $670 million in water and sanitation between 1989-2000. This intervention was classified as "inappropriate engagement" by the WB's Operations Evaluations Department. See p. 19 of Mexico Country Assistance Evaluation WB, June 2001.

[115] Delays in the signing of the contract were due to: "La demora en la suscripción del préstamo de cofinanciamiento de la OECF de Japón, tuvo un efecto negativo en el logro oportuno de los objetivos, la contracción de las plantas de tratamiento de aguas servidas entraron en operación con un atraso de un año con relación al calendario original."

4.47 ME-0150 Program for Sustainability of Water Supply and Sanitation Services in Rural Communities objective was to increase potable water access to marginalised rural communities. It has a pro-poor bias and is classified as a SEQ project. It had a long gestation period, six years One component (4.1% of the total amount) was directed to strengthening sector functions and improving decentralisation institutional mechanisms. Except for computer purchases and other materials, the Bank's resources of this component have not been used. The government has continued to carry out the institutional strengthening at the municipal level with its own funding.[116] The PPMR ratings suggest that the development objectives of the program are likely to be achieved, although no progress data is available.

C. Poverty and Social Development

4.48 The paradox in Mexico is that the country made large strides in overall improvements in social and demographic indicators both over time and with respect to other developing countries. (See Table 4.1) but poverty and extreme poverty, even taking into account the crisis generated spike of 1996, has remained stubbornly high (see Table 4.2). The resolution of the puzzle lies in the increasing inequalities not only of income (see Table 4.2) but also in capabilities and opportunities that have accompanied the improvements in average values of socio-demographic variables.[117]

Table 4.1. Selected Social Development Indicators Mexico and Developing Countries Averages

	1990	1999 or latest data
Infant mortality (per 1000 live births)	34 (50)*	27 (45)
Under 5 mortality (per 1000 live births)	46 (77)	33 (65)
Life expectancy	70.4 (64.7)	72.1 (66.1)
Access to reproductive health care services (% of births attended)	69 (69.4)	86 (72.4)
Adult illiteracy (rate)	12.2 (29.9)	9.2 (24.5)
Children (6-14 years old) attending school \+	85.8	92.3
Access to sanitation	60 (67)	73 (74)
Access to safe drinking water	80 (68)	86 (77)

Source: Social Watch, http://www.socialwatch.org/; * (.) developing country averages

[116] According to the sector specialist this is not a very attractive component for the government since the institutional strengthening at the municipality level has been a continuous effort that started before the program therefore, this component brings no value added to the authorities

[117] Note Mexico has a considerable advantage over many countries in the Region in that it has a wealth of information that can be used by the Bank in pro-poor bias of project design. In particular it produces a "marginalisation" index desegregated down to below the municipality level, hence facilitating geographical targeting.

Table 4.2. Poverty and inequality

	Extreme Poverty			Moderate Poverty			Income Inequality		
	Urban	Rural	National	Urban	Rural	National	Urban	Rural	National
1989	18.3	41.83	27.04	50.70	69.32	57.84	0.498	0.444	0.519
1992	16.79	44.66	24.42	49.14	73.26	55.74	0.498	0.434	0.529
1994	10.95	49.78	21.46	40.64	78.82	50.97	0.508	0.419	0.534
1996	18.6	60.47	29.72	53.25	84.84	61.88	0.493	0.452	0.519
1998	16.6	56.83	27.18	49.70	81.8	58.40	0.511	0.480	0.543

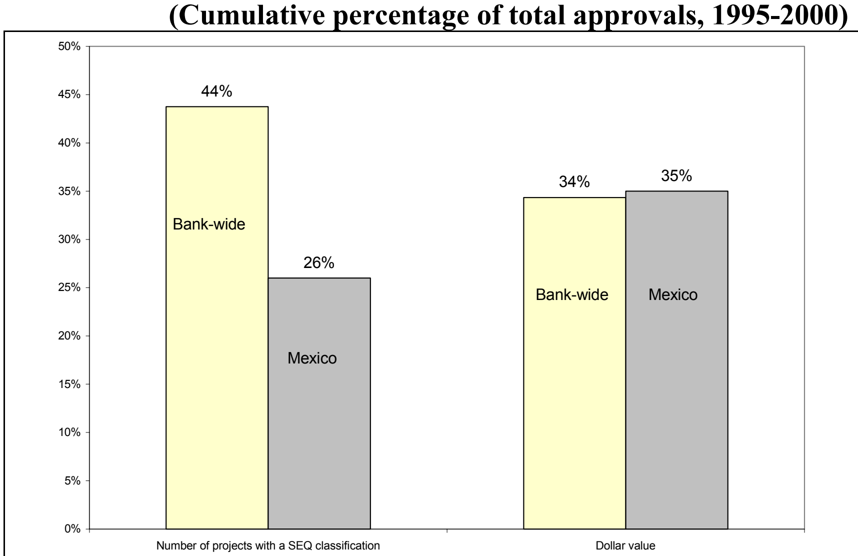
Source: Country Assistance Strategy Progress Report, WB, May 2001. Data on poverty generates considerable controversy. Levels can be different according to whether income or consumption is used or due to the adjustments made to the raw data. However, such adjustments normally leave the overall pattern constant.

4.49 Three key issues can be identified with respect to poverty and social development during the nineties:

- the lack of a broad-based economic growth.
- the high economic volatility's effect on transitory poverty.
- the effect of lack of equalities of capabilities and opportunities on structural poverty.[118]

4.50 Of the four types of capabilities that are prone to policy action (human capital accumulation, improving health, investment capabilities, housing and basic services) the Bank was involved in all except health. In terms of enhancing opportunity clear areas of intervention are employment and investment opportunities, the Bank was involved in both. IDB-8 mandated that 50% of the number of projects approved and 40% of the dollar value of approvals should be dedicated towards promoting social equity and poverty reduction. Although not intended to be a mandate for the country level, the cumulative percentages of approvals in Mexico fell short of these percentages (see Chart 4.10).

Chart 4.10. Social Equity Classified Projects \+
(Cumulative percentage of total approvals, 1995-2000)



During 1995 to 2000, 26% of the number of projects and 35% of the dollar value of approvals were classified as social equity – SEQ-projects.

Source: SDS

\+ These include: ME-0052; ME-0118; ME-0137; ME-0150; ME-0186; ME-0187; ME-0051.
Source: POV/SDS.

[118] For an argument that development and poverty policy should almost be the one and same see "Where To From Here? Generating Capabilities and Creating Opportunities for the Poor" by M. Szekely, March 2001, RES/IDB.

C.1. Macro-shocks and the Social Safety Net

4.51 There is a growing consensus amongst policy makers that macroeconomic shocks hit the poor disproportionately and that fiscal policy should be anti-cyclical such that existing dormant (during normal times) poverty mitigating public programs can be triggered-expanded during a crisis.

4.52 The Bank's intervention, to tackle the issue of transitory poverty, consisted of a $500 million, time slice, SEQ, investment project developed in only two months as part of the international rescue package.[119] It should have encountered difficulties because it was an investment project and covered a number of programs that involved many executing agencies.[120] It did not; it disbursed like a PBL. [121] It financed, selected, existing government budget items, without the "pain" typically charged against investment projects.[122] Its value added was of the financial type and potentially follow-up operations. A potential value added was an evaluation as input for follow-up operations. The program's $2.1 million for monitoring and evaluation was entirely financed by the WB.[123] To date there is no mid-term evaluation, nor a PCR, (the project was closed in June 1998) nor indeed PPMR reports.

4.53 In terms of the appropriateness of the instrument it is difficult not to concur with the World Bank's assessment that "*Given the nature of Budget support operations, treating them as investment operations leads to confusion regarding items to be financed and method of disbursement. A sector loan consisting of the release of tranches on the basis of physical targets and fulfillment of critical policy conditions would have been more efficient instrument in time of economic emergencies*." [124]

4.54 The program was a palliative for the crisis of 1995. Its goal was to "*ensure that the essential services it has identified as priorities will be protected from future budgetary reductions*"[125]. Ideally, the criteria should have been the evolution of real expenditure in the selected budget items before-during- after the crisis of 1995. However, such data is not available.[126] It is difficult to encounter numerical sub-component output targets in Bank documentation, however, according to the WB's project completion report the targets for basic education services and school construction –financed by the IDB- were defined and provides data on the degree of under- achievement (see Table 4.3).

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[119] It accompanied the WB's, $500 million, Essential Services Program project approved in July 1995. In fact both loans had identical Loan documents except for the cover note.

[120] SEP, CAPFC, CONALITEG, CONAFE \+ STPS, SEDOSOL * SEDESOL, SSA,DIF

[121] Cumulative disbursements (% of total value of loan) profiles for PBLs are:

Year	1	2
PBL Mexico	62	81
PBL Bank wide	39	70

[122] Note monitoring control was ex post not ex ante and IDB did not finance, textbooks, health or retraining of the unemployed which were so by the WB. Only the nutrition component was co-financed by both Banks.

[123] This is surprising as the policy letter placed great importance on evaluation as input for the budget of 1997. Further, there is no documental evidence of the proposed review, jointly with the WB, by the end of 1995 of monitoring indicators.

[124] See p.12 of "Implementation Completion Report, Loan 3912-ME", Number 18850, Jan.1999, WB.

[125] Loan Document, PR-2038.

[126] The World Bank PCR does not either but states that "… in 1996 the social sectors received 54.5% of the federal programmable budget, representing a 2.5% real increase, while the overall budget received only 1% increase in real terms" p ix , see reference in footnote 114.

Table 4.3. ME-0187 PROSSE Selected targets and the realisation of those targets

	Units	Targets set in 1995 through 1997	Percentage of targets achieved by 1997
Urban kindergarten	Classroom	1038	-18
Urban kindergarten	Annex	861	-8
CAPEP	Classroom	59	-9
CAPEP	Annex	338	-12
Indigenous kindergarten	Classroom	798	-64
Indigenous kindergarten	Annex	481	-21
Kindergarten	Classroom	1259	-60
Kindergarten	Annex	1155	-7
Total School construction		8,777	-9

Source: World Bank Implementation Completion Report, pg. 20 Report No. 18850

C.2. Generating Capabilities and Opportunities

4.55 There are two main issues in the education sector: high dispersion of education with low access by the poor; and an unsatisfactory quality of education. The country has made major advances in the education sector. Years of schooling in passed from 6.5 in 1990 to 7.6 years in 2000, a level much higher than implied by its GDP.[127] The country's primary education terminal rate rose from 70% in 1990 to 85.6% in 1999, as repetition rates and dropout rates fell.[128] This partly reflects an increase in public expenditure and a reallocation of that expenditure towards basic education.[129] The increased level of schooling is reflected in an increase in the average years of schooling of its labour force. However, Mexico remains eighth in ranking in LAC.[130], and there is a high dispersion in years of education of the economically active population by income decile and geographically. Regarding quality of education, the country is characterised by a low educational achievement. Students consistently have performed below the international average on standardised tests in Spanish, math and science. Repetition rates and dropouts are still high. Poor teaching quality and teacher absenteeism (low salaries and the incentive structure discourage teachers to settle in teacher-poor rural areas) and shortages of teaching materials, outdated curriculum and poor physical facilities dominate.[131]

4.56 During the nineties, the Bank approved two loans basically directed at the issue of access. ME-0170, Elementary Education Program, of $393 million, had the objective to raise the lifelong living standards of approximately three million Mexicans "*born between 1990 and 2005 into families in the lowest income decile*." This overarching goal –no baseline or outcome indicators

[127] See pp.96-98 of Mexico. Enhancing Factor productivity Growth, Report No 17392-ME, WB, August 1998.
[128] Terminal efficiency rate of primary education is defined as ratio of the member of students completing – grade six – to the number of students entering in grade I six years before. Note that states like Chiapas, Guerrero, and Oaxaca still have low terminal efficiency: 71.6 percent. See Mexico: A comprehensive Agenda for the New Era, pg. 453, World Bank 2001
[129] Public expenditure increased from 59% in 1996 to 65% in 1999. Federal expenditure on university students was 10 times that on primary in per capita terms. Today it is five times. See Mexico: A comprehensive Agenda for the New Era, pg. 451, World Bank 2001
[130] See *Primer Informe Anual de Gobierno, Vicente Fox, 2001*. http://www.presidencia.gob.mx
[131] In 1994, SEP released a report on the knowledge and skills of 480,000 teachers and achievement of 2.8 million children at the primary and secondary levels. The principal conclusions of the report were that children attending urban or private schools did much better than those in rural and public schools; those who achieved the lowest scores were in indigenous and community schools with poor facilities and less highly trained teachers. See Evaluación de la Educación Preescolar, Primaria y Secundaria. Dirección General de Evaluación Educativa, SEP 1994.

were defined- was to be achieved by: (i) increasing access to disadvantaged children in nine states; (ii) improving child rearing for families with low to illiterate parents; (iii) improving access to community education to isolated and small communities; (iv) reducing adult illiteracy. On the other hand, regarding outputs, the project's components have detailed quantitative indicators, specified in its logical framework. The national program, in which this project was inserted, had a national coverage (32 states) and within each states three executing agencies. In 14 other states the World Bank is involved. The project has been in execution for six years and has been subject to a 24-month cumulative extension over the final disbursement original date. Its MTE has not been carried out and there is no data on progress towards the project's set targets, nor have the surveys proposed in participating municipalities been carried out. Nonetheless the latest PPMR classifies all components as satisfactory.

4.57 ME-0052 Distance Education Program of US $171 million, SEQ classified investment project, had as its objectives to improve the distance education system and expand the secondary program to adolescents and adults. The project components and sub-components leaned toward quantitative objectives (expanding the program, building libraries, supplying physical resources, etc.). The program included an evaluation and monitoring sub-component aimed at supporting SEP to design and implement achievement tests at the secondary level.[132] This is a program with problems. The SHCP cancelled US $100 million (58%) of the program and further partial cancellations are in the pipeline. Different manifestations of problems are essentially due to the project's choice of the executing agency ILCE, an international organisation located outside SEP.

4.58 An example where the Bank did not respond to a Government request was a proposed Student Loan Program. In 1997, the Bank prepared a project proposal for higher education, the "Student Loan Program". Its objective was to provide student loans (fees and tuition only) to qualified students via a private credit agency (to be created for the administration of the Program with capital provided by private universities). RE2 established that the program could not be classified as equity oriented. "*Given the Bank's mandates and policies, it is not recommended that this proposal, in its present version, be submitted for the consideration of the Bank management or Board*."[133] Instead, the following alternatives were explored: "*a) to abandon the proposal, and leave it to the World Bank which has indicated interest in funding it; b) to suggest that the program be treated as a purely financial operation; or c) to recommend that the government resubmits the proposal with substantive changes focussed on increasing its equity*."[134]

4.59 The Bank decided for the first option as no consensus was reached with the government regarding redesigning the project such that applicants would be limited to students from poor households. The World Bank approved the "Higher Education Financing Project" in 1998, and is currently active.

4.60 The Mexican labour market is not rigid relative to other countries. "*Mexico shows neither a high degree of informality (a measure of segmentation) or low turnover (a common measure of flexibility).*[135] The informal sector accounts for 50% of the workforce. However, rather than

[132] This component was tacked onto the project at the request of the Loan Committee, and became a bone of contention for SEP that argued that ILCE, the executing agency, did not have a mandate for such an activity, only SEP did so.
[133] See Student Loan Program Special Mission. RE2/SO2-172/97-M
[134] Idem
[135] See: p. 512, Chapter 22 of "Mexico, A Comprehensive Development Agenda, WB, 2001"; M. Shinkai, " Does The Stolper-Samuelson Theorem Explain the Movement in Wages?, WP 436, IDB, Nov. 2000; M. Cragg and M. Epelbaum, " Why has Wage Dispersion grown in Mexico?, Journal of Development Economics, Vol 51,1966; A.

segmentation it reflects the combined impact of the low opportunity cost of self-employment and the disjoint between contributions and benefits in the formal sector. This is confirmed by the high flows of workers to and from formal and informal sectors. However, structural reforms, have had a number of unintended negative effects. First liberalisation has led to an increase in labour demand elasticities such that the labour market suffers a greater impact from macroeconomic shocks. Second, labour income inequality has increased dramatically. The decreased job stability, however, is in the context of no unemployment insurance, a costly severance payments regime and a system prone to litigation. Trade liberalisation has also led to an excess demand for skilled labour, which have contributed in the short run to increase labour income inequality.

4.61 In terms of labour market opportunities the Bank approved a time slice, SEQ investment operation ME-0186 in 1996. Its objectives were to improve the efficiency of the labour market (through liberalisation of the labour market), facilitate mobility and improve the productivity of the economically active population (through training). This project was inserted in existing budget items and programs, but unlike PROSSE, had a significant value added in reforming such programs. It supported existing programs PROBECAT (for the unemployed) and CIMO (for the employed), and labour market liberalisation.

4.62 PROBECAT program was born in 1987 as an income support program that used training and placement services mainly as a targeting device. The Bank operation allowed for experimentation with new modalities of services and new delivery mechanisms (including the transference of more operational responsibility to State governments in alliance with the local private sector). The evaluation of those experiments was an invaluable learning device for both the Mexican government and the Bank. The new administration has decided to transform the activities of PROBECAT into the mainstay of the government's efforts to provide employment and intermediation services to workers and employers. Thus, what began as an income support program with little regard for the needs of employers and the likelihood of beneficiaries getting a job, has allowed the STPS to learn about, and implement, best practices in the operation of employment and labour intermediation services. Table 4.4 shows that the PROBECAT over achieved its numerical output targets. However in contrast to this rosy picture " *…most recent studies show that ...PROBECAT has not been especially effective at either raising wages or shortening the unemployment spell. The training period may be to short ... or…PROBECAT's safety-net function conflicts with its training role."* [136]

Table 4.4. PROBECAT component of ME-0186

	Units	Target (1997-9)	% of target realised	Target (phase II)
Applicants	Persons	1,259,500	132	1,087,000
Vacancies	Persons	941,000	142	929000
Informed	Persons	1,034,000	98	747,000
Job found	Persons	354,000	162	341,000
Training	Grants	1,302,800	102	903,964

4.63 All this said, the project failed in the achievement of what in the original document was presented as an important objective: the liberalisation of the labour market regulatory framework. The Bank raised this issue despite the evidence that labour market rigidity was not a problem. In fact studies were contracted and realised, technical input was given, and a network of labour specialists was created to discuss reform ideas. However, no reform was enacted or even seriously discussed.

Harrison and G. Hanson, " Who Gains from Trade Reform?", WP 6915, 1999, NBER; and R. Robertson, " Trade Liberalization and Wage Inequality: Lessons from the Mexican Experience", Macalester College, unedited.

[136] See p 522 of Chapter 22 (reference in footnote 126) and Wodon, "Mexico Poverty Assessment", 1999, WB.

The real problem seems to be low wages and productivity. And these are precisely the problems that the operation is helping to solve through training, placement, and intermediation services.

C.2.1. Investment Opportunities and Capabilities

4.64 The first issue is that in the absence of formal credit the poor cannot finance economic activity either by saving or using informal credit market. Policy action in this case is to create the regulatory framework that promotes the existences of small-scale financial institutions that provide the poor with safe ways for holding liquid savings and promote lending institutions that make micro-loans. The second issue is information failures in SMEs.

4.65 The Bank supported investment opportunities and capabilities by both promoting credit to SMEs and by providing technical assistance to them. There were 3 operations; none of them dealt with the regulatory framework governing credit mechanisms to SMEs:

1) Credit provision was through the project ME-0152, Global Credit to Small and Medium Enterprises approved in 1992. Its objectives were twofold:

   (i) integral support to SMEs (credit to SMEs and strengthen technical capacity of private financial intermediaries providing credit to SMEs) and

   (ii) reform of NAFIN.

   The components of the loan are summarised in Table 4.5.

Table 4.5. SME component of ME-0186

	Units	Planned (97-99)	% achieved	Planned II phase (200-1)
Training of workers including worker certification	Workers	1,420,750	113	1630,000
Number of firms	Firms	318035	256	739,692
Dissemination events, for demonstration effect, emphasis on gender.	Events	136,652	109	159,199
Promotional units	Units	10	0	10

Source: ME-0186, PCR.

   The project channelled credit mainly to SME's. However, according to the PCR, "lo que *no se podrá cumplir es la creación de una un infraestructura privada* " and the component to create NAFIN attention centres also failed. The PCR also succinctly points out that: "*el haber definido como primer objetivo el proporcionar recursos de financiamiento, haciendo caso omiso que ello es un medio. El haber definido como segundo objetivo el apoyar al prestatario en su cambio estructural sin haber definido actividades e indicadores de logro.*" As there is no follow-up information of the SMEs that received credit not much more can be said.

2) A second intervention was a component of ME-0186 that was directed at improving the productivity and competitively of micro, small, and medium enterprises. CIMO (productivity enhancement program) had been originally started by STPS in 1989 and was a component of the WB's 1993 Labour Market Modernisation Program.[137] The ME-0186's components specific objectives were to expand and enhance CIMO services, promote private sector absorption of the operation of CIMO, with the overall objectives of increasing the productivity and competitiveness of SMEs. Productivity and competitiveness outcome indicators were not defined, nor has the proposed survey to determine the program's effect on productivity been carried out. [138] Intermediates output

[137] A cost benefit study covering 1991-94 found that CIMO beneficiaries reported higher profits, improved productivity, organisational schemes and the quality of their products than the control group.
[138] However, the Bank is preparing a follow-up operation. ME-0233.

targets were defined and have in the main been surpassed (see Table 4.5). The Bank experience in this program has had important side-benefits: CIMO is being disseminated in the region in the context Bank's operations in Argentina and Panama. In a sector loan in Argentina, Mexican consultants were brought in by the Bank to help the Argentine government to develop a system of privately operated employment offices.

3) The third intervention was the Facility for the Financing Program for the Southeast of Mexico, approved in January 1997. This consisted of $15 million program directed at financing small projects (between $50,000 and $100,000) plus parallel non-reimbursable technical assistance in marginalised zones in the states of Chiapas, Guerrero and Oaxaca. (See Table 4.6).[139] It is an innovative project in three senses: (i) individual projects are developed bottom-up by the local office without the intervention of intermediaries;(ii) individual projects, in contrast to the norm, are well specified in terms of outputs, outcomes and progress milestones; (iii) it attacks capabilities and opportunities of the poor and the extreme poor, indigenous groups.[140]

4.66 Although still consisting of ongoing projects, most were approved during the late nineties, there was an initial evaluation in July 2001.[141] It's conclusion, based on an evaluation of 50% (6 projects) of approved projects, was "… *el programa esta contribuyendo a mejorar la capacidad de generación de ingresos de grupos marginales de bajos ingreso…, …así como a fortalecer a las organizaciones que respaldan su desarrollos*"[142], the two central objectives of the Facility. As the table shows, the program' s beneficiaries are low-income excluded groups (women and indigenous), living in small rural communities.

Table 4.6. Southeast program (As of May 2001)

Sector	operations (number)	Amt (Th.$)	Impact				
			Direct beneficiaries	Indigenous (%)	Women (%)	Communities (Number)	Multiple of daily minimum wages
Credit	6	2339	12,360	76.4	37.2	395	2.4
Coffee	2	889	1394	87.7	10.0	65	1.9
Agriculture	2	645	420	86.3	21.6	11	2.5
Apiculture	2	973	330	91.8	15.0	78	1.9
Sub-total	12	4,846	14,504	78.1	33.6	549	2.3
TCs	14	7,239					

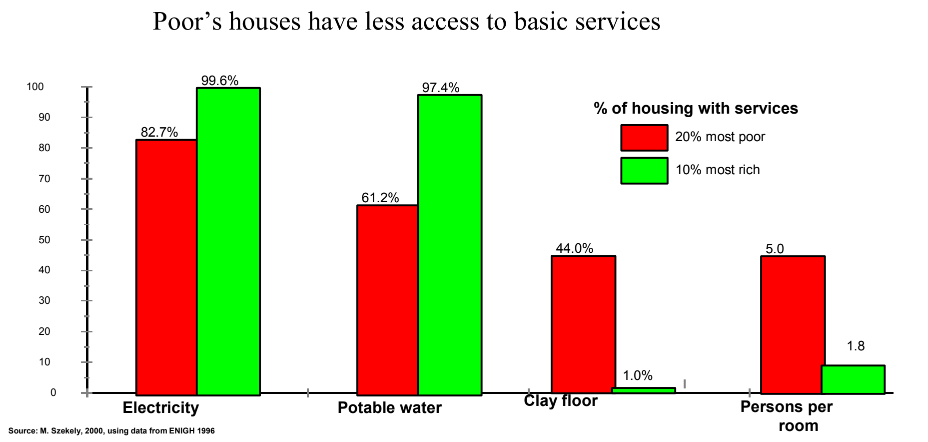
Source: "*Programa de financiamiento para el Sureste de México, Mayo 2001.*" BID/CME

C.2.2. Housing and Basic Services

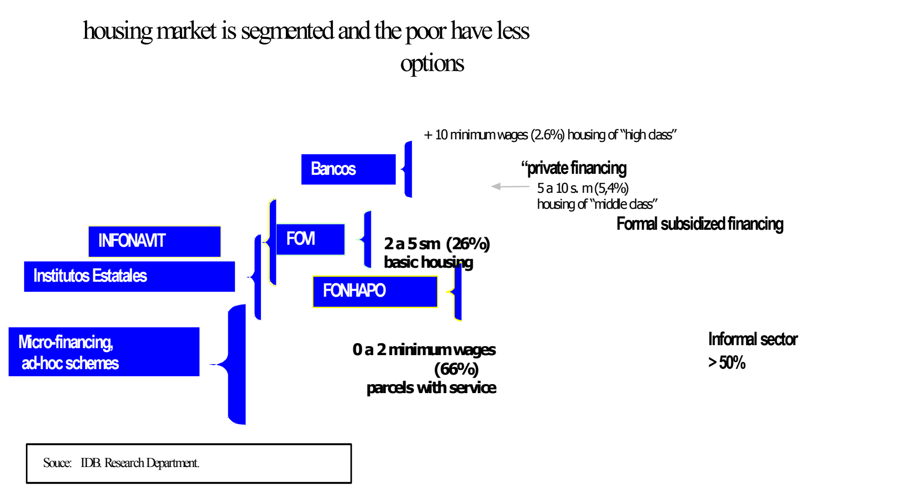
4.67 A critical factor underlying capabilities and opportunities is the availability of housing and basic services, which are measures of basic infrastructure to operate in society. The poor, however, have little access to housing solutions and their households have little access to basic services (see Chart 4.8). There are myriad public housing entities, while private financing remains incipient. [143]

[139] The facility was extended from July 2000 to January 2003.
[140] The percentage of the Mexican population classified as indigenous was around 10%, and are about 33% of the extreme poor. See www.unam.mx.ciesas.
[141] See Evaluación inicial a la facilidad de péqunos proyectos y cooperación técnica para grupos marginados del sureste de México (SP/TC 95-06-24-9-ME), July 2001.
[142] See page 2 of Programa de financiamiento para el Sureste de México, Mayo 2001.
[143] The main actors in Social Housing are: (i) INFONAVIT, which has 67% of the market, and acts as a retail mortgage lender. Since 1994 it receives 40% of an individual workers pension contribution, and collects a 5% payroll tax. Attempts at reform have so far failed. It has a delinquency rate of 40% although the rate falling; (ii)

Chart 4.11: The Poor have little access to housing solutions and access to basic services



17% and 59% have no access to electricity and potable water.



The housing market is fragmented with projects having a high community participation rate and the informal market providing the main source of housing financing for the poor.

4.68 The Bank entered into the Mexican housing sector, only recently, through its SEQ classified $505 million Program to Finance Housing, ME-0137, approved in December 2000, but signed only in September 2001.[144] It follows hard on the heels of a World Bank project approved in 1999. Both operations are holding actions, "*...the proposed Program aims to consolidate the reforms of "...FOVI, and to finance eligible housing subsidies and mortgages "...for the next two years- the period of time needed for the new government to articulate and implement an overall*

FOVI is a trust fund that on-lends to low-income borrowers through commercial and mortgage banks (mainly SOFOLES, which started in 1995). It has about 20% of the market. Its *prosavi* program targets households earning up to 3 minimum wages; (iii) FOVISSTE, which has about 6% of the market with public employees as its beneficiaries. For low income housing, which represents about half the population informal housing predominates. There are also two federal agencies (FONHAPO and SEDESOL) plus a number of state housing institutes

[144] Indicative of the complex political economy of reform in this area is that it had an 18-month preparation. This was positive " *this process led to a solid agreement on the core of the reform*" p24, and optimistically "*it is therefore expected that conditions prior to first disbursement will be met by January 2001*." The prior conditions were that the new operating regulations have entered into effect.

housing strategy, including a sustainable funding strategy for FOVI'.[145] Thus the program mainly finances FOVI's credit and subsidy operations albeit with better targeting[146]: credit represents 85%, while subsidy represents 12% and technical assistance is 2% of the total. Increasing access to basic services was an objective of one of the decentralisation projects of the Bank.

D. Decentralisation

4.69 Mexico during the nineties initiated a policy towards more autonomy, fiscal responsibility at sub-national governments (SNGs), and increased transparency in the tax -transfer intra-government system. States today spend about half as much as the Federal Government and broad sector responsibilities are reasonable. However important issues remain.[147] Tax revenues of SNGs are only 4.5% of total revenues, with "*perverse incentive structure in revenue sharing arrangements…*"[148] Transfers consist of a number of programs, (11 major transfer programs in 2000 up from 3 in 1997), many of which were discretionary.[149] The amount per capita available to each state has a coefficient variation, which is low by international standards and does not correlate strongly with poverty. Total resources are about the same for states with middle and high poverty rates, and higher for low poverty states.[150] Transfers are in the main earmarked giving little room to manoeuvre by the States. Sub-national borrowing is not an unmanageable problem.[151] Further as a pre-emptive measure policy was that the "*participaciones"* transfers could not be used as collateral and gave strong incentives for states to publish their fiscal and financial information, and eliminated discretionary transfers.[152]

4.70 The Bank participated during the nineties in Mexico's effort to consolidate its decentralisation process by approving two different project type operations totalling US $1.3 billion. Both projects are still in execution. The Municipal Development Program (ME-0051) was approved in 1995 amidst the economic crisis. The SEQ classified project is really a traditional social investment operation aimed at providing financing of municipality based small-scale infrastructure projects in potable water, drainage, electrification, and rural roads, amongst others. It financed the Municipal Solidarity Fund, part of PRONASOL, which had begun in 1990. The Fund was directed at the poor municipalities. It had an innovative design. Although classified as an investment loan, it worked like a multi-credit loan, but with poor municipalities as beneficiaries. The slower pace in execution (6 years and 36 months of cumulative extensions) than originally expected in the loan document is attributed by the latest PPMR to the legislative reforms.[153] The

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[145] See p.17 of the Loan Proposal.

[146] Currently policy benefits households up to the 90th percentile, new policy will restrict beneficiaries up to median income this over time facilitate expansion down the distribution curve, and an immediate impact of reducing 20 to 40% of the median income of new beneficiary households.

[147] See, "Achievements and Challenges of Fiscal Decentralization. Lessons from Mexico", Eds. M. Giugale, S. Webb, WB, 2000.

[148] See p.712 of "Mexico, a Comprehensive Development Agenda", Eds. M Giugale et al, 2001, WB.

[149] A number of studies have shown that these discretionary transfers were the means through which PRI used resources to solidify constituent support, and were used to help PRI win elections. See: A. Diaz-Cayeros "Political Response to Regional Inequality: taxation and Distribution in Mexico. Ph.D. Thesis, 1997 Duke University; and B. Magaloni "Institutions, Political Opportunism, and Macroeconomic Cycles" , 2000, WP, Stanford University

[150] The high per capita transfers to low- poor states are partly counterbalanced by poverty-targeted transfers to high poverty states.

[151] However, in the wake of the 1995 crisis all states received bailouts.

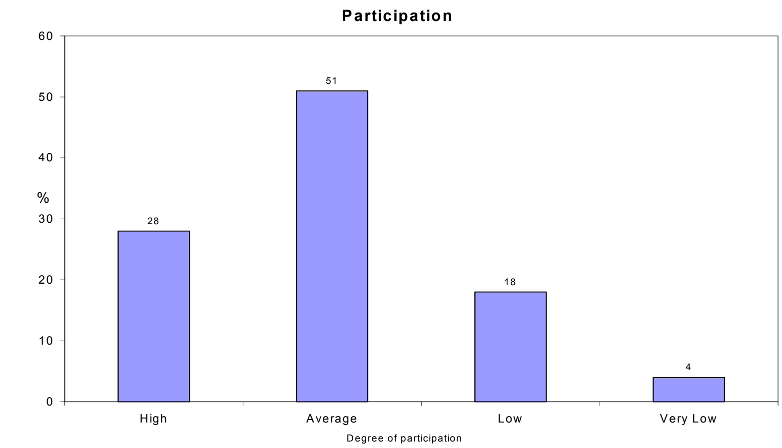
[152] See "A new model for market-based regulation of sub-national borrowing: the Mexican approach", PRWP No 2370, 2000, WB.

[153] However the changes occurred in the third year. In 1998, the Mexican legislation reformed article 33 of the "*Ley Orgánica de la Administración Pública Federal"*. The "Ramo 33" transfers more resources to the sub-national

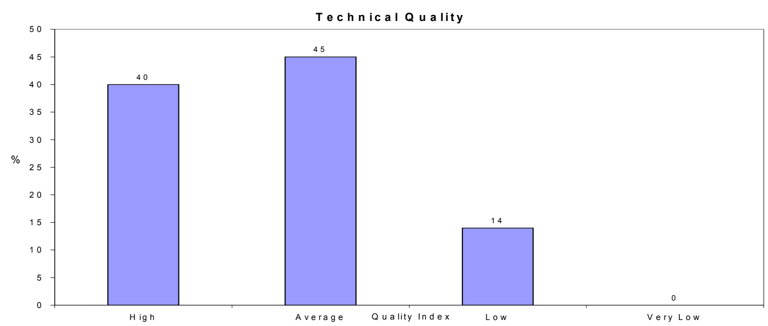
latter led to a partial cancellation. Data on progress towards the aggregate targets specified are not available (see Chart 4.9). However, the project had a mid-term review based on a sample of projects, 56, in 12 municipalities in two states, Nayarit and Queretaro. As the chart shows there is a bias in the distribution towards high participation, high technical quality, towards the poor (about 90% of beneficiaries had less than 2 minimum wages) and high economic returns. The bottom line is "*La distribución de la inversión a nivel estatal y municipal claramente beneficia a los estados y municipios con la mayor concentración de población de bajos recursos"*.

entities under a pre-established schedule of disbursements, and allowing for autonomy in deciding how the resources are going to be used.

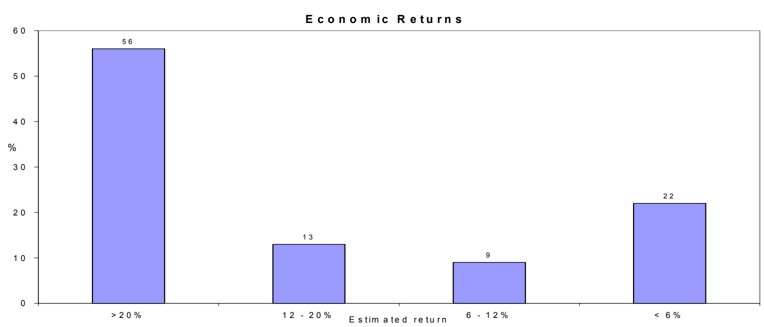
Chart 4.12. Indicators of selected projects financed by ME-0051



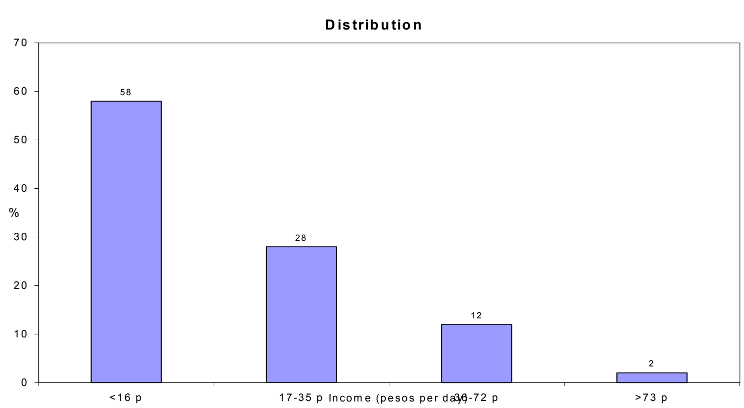
The projects had a high community participation rate.



The projects had a high technical quality.



The projects had high economic returns.



The projects had a pro-poor bias: most of the beneficiaries earned less than 16 pesos per day.

Source: "*Fondos de Desarrollo Social Municipal*", C. MacDonald and S. Joseph, Nov. 1996

4.71 There was a follow-up operation, ME-0208, which was approved in 1999, as a hybrid loan (half PBL and half-traditional investment loan). The PBL component consisted of two tranches of $198 million each. The first (conditions prior to Board presentation) consisted of the enactment of a legal-regulatory framework for a new non-discretionary transfer system (budget branch 33). The second tranch consisted of the restructuring of Banobras and the reform of the guarantee system to promote private sector participation in municipalities' debt. The second component was a credit line to be managed by Banobras to improve administrative and financial management in sub-national governments. Credit was given if the municipality satisfied the *a priori* defined seven eligibility criteria.[154] The fast disbursement component of the loan (US $400 M) was fully disbursed in only 1.5 years.

4.72 Regarding Banobras restructuration, unessential assets and functions were eliminated from the internal operations of the Bank. The scheme of sub-national indebtedness was reformed. In the credit market incentives were induced for the banks to undertake loan evaluations and differentiation by prices and risk of the individual loans also, measures were taken to provide incentives to credit providers to avoid excessive credit risk exposure to the sub-national governments above reasonable prudential levels.[155] Since the publication of the CNBV rules, "*the states have begun their rating process in such a way that at present approximately half of the states in Mexico have obtained ratings for their bank debt by two rating agencies recognised by the CNBV and by far most of the state have at least one rating*".[156] While this is a positive step toward the use of third-party audits in Mexico this is still a new practice. There are "*many states that rely solely on congressionally approved audits, which could lead to reporting inconsistencies, a lack of timeliness and less reliable financial data…approval of state's finances by the state Congress could hinge more heavily on political processes than on a thorough analysis of the accounts*."[157]

[154] These had the virtue of simplicity and relevance. In a follow-up operation being prepared, however, it appears that the criteria will be increased.

[155] In December 1999, the National Bank Securities Commission amended the rules for the capitalisation requirements of multi-bank institutions regarding loans and guarantees executed by sub-national governments and their decentralised agencies, and modifying the factors for weighting risk. The SHCP decreed on December 13, 1999 established that all sub-national governments that might potentially seek credit must have, among other requirements, two ratings from risk-rating agencies. According to S&P ratings on sub-national entities, most states maintains manageable debt levels, but others carry heavy debt burdens. For example, the Federal District, Mexico State and Nuevo Leon have more debt than participation payments. This ratio affects states performance since they have little revenue flexibility and participation transfers are one of the few sources of discretionary revenue that can be used to serve debt. These states have very limited capacity to finance future growth through the issuance of additional participation-backed debt.

[156] See Tranche Release Report PR-2433-1

[157] See Standard & Poor "Rating Mexican States" Aug 2001

5. *Recommendations*

5.1 From the foregoing evaluation of the Bank's program with Mexico in the 1990-2000 period, stem five recommendations for subsequent programming cycles.

5.2 **Improve knowledge transfer.** To improve the Bank's program in the country, and to address the ex-ante perception of value, the Bank needs to enhance its stand-alone economic and sector work as well as to increase the provision of technical assistance in general. These actions will contribute towards counteracting the additional administrative burden imposed on executing line ministries and agencies as well as compensating for the Bank's relatively limited range of lending instruments and reflect a greater emphasis on continuous dialogue between the Bank and the country. However, with a limit on the Bank's potential budget the solution to the problematic of knowledge transfer would be to define a limited set of priorities for the Bank.

5.3 **Define priorities**. Mexico's institutions have outstanding capacity to formulate and execute major policies and programs. They can draw upon financial and technical human resources beyond those of the Bank; the Bank's contribution to Mexico's development therefore is, and will remain, marginal. Currently the Bank's marginality implies that its program's developmental results are hard to demonstrate. But they need not be so.

5.4 To produce demonstrable results the Bank needs to define – jointly with the country –. a limited range of areas of action in which it can define measurable goals whose achievement can be effectively monitored. Such a niche would facilitate the Bank in marshalling its resources efficiently and effectively to provide technical services in addition to financial services. This recommendation reflects the Bank's Institutional Strategy, which noted: "The Bank should concentrate its operations in a country in a limited set of sectors, so as to provide a stronger and sustained support where it has the potential to add more value to the development process." GN-2077.

5.5 **Specify results and introduce accountability**. If a niche will make demonstrable results possible, transparency and accountability will make such results likely. Mexico's new administration presents an opportunity for the Bank to transform its programming exercise into a results-oriented agreement with the country. In recent years, the Mexican government has stressed repeatedly the triad of transparency-accountability-results. The Bank should respond by making country programming documents negotiated performance agreements with the government, concerning the development challenges that the Bank and the country will jointly take on.

5.6 Country programming documents should become negotiated agreements with the government concerning the development challenges that the Bank will take on. The basis of the agreements should be specific, verifiable and realistic. Verifiable implies that such an agreement has to specify the expected developmental outcomes and milestones within an explicit timeframe. The expected results may be made realistic by pertaining to the Bank's niche of operations

5.7 **Re-emphasize completeness of project design and progress data**. Accountability would be aided by completeness of the designs of individual projects. Projects should include comprehensive statements of their objectives (in terms both of outputs and developmental outcomes), define the objectives' indicators, and state the relevant baselines and milestones. While such guidelines are not new, our review of the Bank's Mexico projects indicates that they require renewed emphasis.

5.8 In addition, data on progress towards objectives should be collected and reported. Current Bank reporting systems rarely substantiate the progress of projects using data respecting outputs; they simply do not substantiate progress using data respecting outcomes. More complete progress data would be another aid towards holding the Bank accountable for project results, and for the Bank to demonstrate its development impact.

5.9 **Introduce pro-poor tilt.** The Bank should introduce a demonstrable pro-poor tilt to its interventions in Mexico. Such a tilt could be in any of the sectors that the Bank and the country agree upon as long as they demonstratively improve the capabilities and opportunities of the poor. Such a tilt would be compatible with the Bank's eighth replenishment and its new Institutional Strategy. Indeed some projects already name poverty reduction among their objectives; the key word, however, is *demonstrable*.

5.10 Bank projects' beneficiaries are generally broadly dispersed both by income class and geographic location. The corresponding indicators of project outcomes can not be expected to change substantially as a result of the projects. Introducing a demonstrable pro-poor tilt would imply, by contrast, designing projects that target much more precisely poor populations in poor or rich localities. The Mexican government generates data that are desagregated to fine income and geographic units; outcome indicators for the proposed pro-poor tilt are thus available. The Bank should seize the opportunity.