Report No.

Mexico
Country Assistance Evaluation

June 28, 2001

Operations Evaluation Department

Document of the World Bank

Abbreviations and Acronyms

APL	Adaptable Program Loans
ARPP	Annual Review of Project Performance
BANOBRAS	National Bank for Public Works and Services
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CMU	Country Management Unit
CNBV	Comisión Nacional Bancaria y de Valores (National Banking and Securities Commission)
DRD	Decentralization and Regional Development
ESW	Economic and Sector Work
FSAL	Financial Sector Adjustment Loan
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
IMSS	Mexican Institute of Social Security
IPAB	Bank Savings Protection Institute
LAC	Latin America & Caribbean Regional Office, World Bank
LIL	Learning and Innovative Loans
NAFIN	Nacional Financiera, SNC (public development bank)
NAFTA	North American Free Trade Agreement
NGO	Nongovernmental Organization
OECD	Organization for Economic Cooperation and Development
OED	Operations Evaluation Department
PACTO	Economic Solidarity Pact
PROGRESA	Programa de Educación, Salud y Alimentación (Education, Health, and Nutrition Program)
QAG	Quality Assurance Group
SECALs	Sector Adjustment Loans
SHCP	Secretaría de Hacienda y Crédito Público (Ministry of Finance and Public Credit)
SSI	Southern States Initiative
TA	Technical Assistance
TDO	Total Debt Outstanding
WSS	Water Supply and Sanitation

Director-General, Operations Evaluation	Mr. Robert Picciotto
Director, Operations Evaluation Department	Mr. Gregory K. Ingram
Manager, OEDCR	Mr. Ruben Lamdany
Task Manager	Mr. Daniel Morrow
Peer Reviewers	Messrs. Pieter Bottelier and John Heath

The World Bank
Washington, D.C. 20433
U.S.A.

the Director-General
Operations Evaluation

June 28, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Mexico—Country Assistance Evaluation

This report evaluates the World Bank assistance to Mexico during the period FY89–00. At the beginning of this period, Mexico was still struggling to overcome the legacy of interventionist policies from the 1970s and early 1980s. The administration of President Salinas accelerated a reform program designed to consolidate an open, market-oriented economy and successfully negotiated reduction in its external debt. The response to these policies was favorable, and surging capital inflows financed a growing current account deficit. During 1994 a mix of economic and political factors induced substantial capital flight, and in December 1994, the newly inaugurated Zedillo administration had to devalue. After a banking sector crisis and a sharp recession, the economy recovered rapidly after 1996, fueled by strong exports and more recently by high oil prices. However, the banking sector is still recovering from the crisis, the poverty rate remains high, especially among indigenous communities, and the country faces pressing environmental problems. Notwithstanding these weaknesses and despite the setback of the crisis, during the period under review Mexico has been an active reformer.

During FY89–91 the Bank dramatically increased its financial support to Mexico, using large adjustment loans linked to the accelerated reform program and to external debt reduction. In FY92–94 the Bank's program shifted to project lending and associated sectoral policy reforms—focusing on transport, education, health, environment, agriculture and housing. In response to the 1994/95 crisis, the Bank provided US$1.5 billion for quick-disbursing loans associated with financial sector restructuring and social services. During FY97–00 the Bank pursued an ambitious program of both adjustment and investment lending designed to support growth with social stability. The bulk of new lending has supported second-generation reforms related to pensions, health, decentralization, and the banking sector, but investment lending in many areas fell short of expectations. The Bank's analytic work has made a useful contribution during the transition to a new administration in 2000.

This evaluation concludes that on balance the Bank's program over the past 11 years has been relevant to Mexico's developmental needs. The efficacy of the Bank's assistance has varied over the period. It was highest during the first years of the Salinas administration when Mexico's government technocrats and the Bank had a common vision about required reforms and Mexico needed external financial assistance. The record since FY92 has been mixed and should be considered only partially satisfactory. The beginning of the administration of President Fox presents important opportunities for the Bank to contribute more effectively to Mexico's development agenda.

The Bank's experience since FY89 shows that, due primarily to the depth and quality of human capital available to the government and to the changing nature of Mexico's key developmental tasks, it is increasingly challenging for the Bank to have non-financial value added in Mexico. Nonetheless, given the accumulated IBRD debt, continuing fiscal pressures, and the volatile environment for sovereign borrowing in international capital markets, Mexico still wants substantial financial support from the Bank. The lessons of experience suggest that:

- The Bank and the government should reach a common understanding about a reasonable range for Bank lending commitments and disbursements in the coming years that is consistent with the Mexican desires to manage its external debt and the opportunities for the Bank to have non-financial value added in terms of development impact. Two alternative scenarios should be considered: reducing the debt stock to the Bank in order to create additional "surge capacity" for large-scale lending in the event that Mexico faces more limited access to capital markets at some point in the future; or maintaining a robust program of new lending that at least maintains the current debt stock or may use fully the available headroom for Bank exposure to Mexico. Under either scenario, the Bank and government may find that Adaptable Program Loans (APLs) or other programmatic lending instruments could be effective in achieving both value added from Bank involvement and predictable disbursements.

- The Bank can hope to have non-financial value added in Mexico only if it carefully manages its own human capital. As demonstrated by the successes at the beginning and again at the end of the 1990s and by the problems during the middle years of the decade, efficacy requires that the Bank assign very experienced and capable staff to work on the country for extended periods of time. Furthermore, rotation of staff should be managed carefully to prevent sharp discontinuities in the Bank's collective knowledge of the country.

- Making an intellectual contribution to policy debate and decision-making in Mexico requires a serious and sustained engagement in carefully chosen areas. The Bank will need to be quite selective in defining its program of non-lending and lending services. Given its institutional mandates, priority in selection should be given to targeted poverty reduction policies and programs and to environmental issues, which remain pressing developmental challenges for Mexico.

Government comments on the initial draft of the CAE were received in November 2000 and are attached as Annex III. A draft of this evaluation was discussed by CODE on June 6, 2001 and a report of that discussion is attached as Attachment 2.

Contents

This Country Assistance Evaluation was prepared by a team led by Mr. Daniel Morrow. The team consisted of Messrs./Mmes.: Alice Galenson, Jorge García-García, Manuel Hinds (consultant), Robert McMeekin (consultant), Octavio Gomez-Dantes (consultant), and Felicia Knaul (consultant). Jacqueline Banh, Norma Namisato, and Silvana Valle provided administrative support.

Contents (cont.)

Annexes

Attachments

1. Purpose and Context

1.1 This report evaluates the World Bank assistance program to Mexico during the period FY89–00, covering the administrations of Presidents Carlos Salinas and Ernesto Zedillo. The Country Assistance Evaluation (CAE) seeks to answer three questions. First, given Mexico's development needs and taking into account the Bank's capacities, did the Bank focus its program on relevant objectives? Second, given these objectives, how effectively has the Bank's program been implemented? Third, in what dimensions and by what means has the Bank had value added in Mexico?[1] In addressing these questions, the CAE hopes to extract lessons about how the Bank can most effectively contribute to development efforts in Mexico in the years to come.

1.2 The CAE is based on a review of existing documentation and on interviews with a broad range of actors within and outside the Bank. An OED team visited Mexico in October and November 1999 and again in April 2001. Government comments on the initial draft of the CAE were received in November 2000 (see Annex III). In preparing the CAE, the OED team has also drawn extensively upon OED evaluations of the Bank's work in Mexico.[2] A draft of this evaluation was discussed by CODE on June 6, 2001 and a report of that discussion is attached as Attachment 2.

1.3 The Bank's assistance program in Mexico can only be understood and evaluated in the context of the rapidly changing developmental challenges that Mexico has faced. The recent course of Mexico's development has been of global interest. This is in part due to its size—a population now approaching 100 million and the thirteenth largest GDP in the world. But, perhaps more importantly, Mexico has been on the frontlines of crisis and economic reform among developing countries, especially since the onset of the debt crisis in 1982. The following paragraphs present the highlights of Mexico's recent developmental challenges. Annex I provides a fuller description of its developmental history in recent decades.

1.4 From the end of World War II until the mid-1970s, Mexico enjoyed high rates of economic growth, moderately low inflation, and rapidly improving social indicators. Following the discovery of large oil reserves in the mid-1970s, Mexico embarked on an ambitious expansion of the state's economic role within a highly protected and distorted economic environment, and this expansion was financed largely by external borrowing. In 1982, burdened by the decline in oil prices and the sharp increase in international interest rates, this policy collapsed, and Mexico led the way into the developing country debt crisis. In the middle of that "lost decade" for Latin America, Mexico began to pursue reforms intended to create an open, market-oriented economy. In 1989, with the

[1] In terms of OED methodology, the "counterfactual" will be considered a "without Bank" scenario—but this can only be approached on a sector-by-sector or episodic basis.

[2] The OED study of *Bank/Mexico Relations, 1948–1992*, dated April 1994, provides some analysis of the first three years that will be covered by this CAE. OED has completed evaluations of 68 closed loans to Mexico that exited the portfolio since 1990. In June 1998 OED completed *The Transport Sector in Mexico: An Evaluation*. On the environment, the CAE team has drawn heavily upon the case study of Mexico that has already been done for OED's overall environment study. Also, the CAE team has made use of the several QAG studies of the Bank's work in Mexico.

election of President Salinas, Mexico deepened its reform efforts, qualifying Mexico to be the first beneficiary of the Brady Plan for debt reduction and leading to the North American Free Trade Agreement (NAFTA). Modest growth resumed, and, on the strength of these achievements, Mexico was admitted to the Organization for Economic Cooperation and Development (OECD) in 1994. But, by the end of that year, a combination of economic and political factors brought about an acute financial crisis and a recession that eliminated the gains in poverty reduction achieved during the preceding ten years. Since 1995 Mexico has recovered sharply due in large part to rapid export growth. In 2000 GDP growth reached 6.9 percent, and exports grew by 16 percent. The recent windfall from the rise in oil prices, if sustained and used prudently, could also afford Mexico faster growth without requiring external financial support.

1.5 The growth rate of per capita income over the past decade has been a disappointing 1.4 percent, partly due to the 1994/95 crisis. However, the structural reforms have apparently put Mexico on a higher growth path since its recovery from the crisis. Many social indicators have improved (see Annex II, Table 2). Nevertheless, in 1998, about 28 percent of Mexico’s population remains in poverty (compared to 34 percent in 1984, 25 percent in 1994, and 32 percent in 1996). The share in extreme poverty, of which a significant share are indigenous people, fell from about 10 percent in 1984 to 7 percent in 1994; it rose to over 10 percent during the recession in 1996 and has since fallen only marginally since then. Throughout this period, Mexico has suffered increasing environmental degradation, especially urban air pollution and threats to its amazing biodiversity.

1.6 On July 2, 2000, the Mexican people elected a new president from the conservative Partido de Acción Nacional (PAN), and many governors from the PAN and the Partido de la Revolución Democrática (PRD) left-wing opposition. This marks the first time in over 70 years that the Partido Revolucionario Institucional (PRI) will not rule the country and represents the culmination of the gradual democratization that has taken place over the period under review. This process was closely interconnected with the economic liberalization conducted by the PRI administration and supported by the Bank. Many aspects of policy formulation at the federal and state levels are likely to change, opening new opportunities for Bank support.

1.7 Within this context, the World Bank Group has endeavored to define and implement its assistance program in Mexico. Chapter 2 describes the Bank’s assistance strategy as it evolved since 1989 and provides details about the many components of the assistance program. An overall assessment of the Bank’s assistance strategy and its program, and lessons from that experience, are presented in Chapter 3.

2. The World Bank's Assistance: Strategies and Program Components

2.1 Since the beginning of the Salinas administration in December 1988, the World Bank's program of assistance has adjusted repeatedly to the changing circumstances in Mexico.[3] This chapter summarizes the Bank's assistance strategy as it evolved through four distinct stages during the past 11 years. It also discusses the main elements of the Bank's assistance program—roughly in the chronological order in which they first became important within the overall program. This chapter comments on the efficacy[4] of these elements, and the final chapter presents judgments of the relevance and efficacy of the Bank's overall strategies and programs.

Overview of the Bank's Assistance Program FY89–00

2.2 In reviewing the Bank's assistance program, it is useful to divide the past 11 years into four periods based on the primary objectives of the Bank's activities and on the instruments of Bank lending as summarized in Box 2.1.

Box 2.1: Summary of Bank Assistance Strategies: FY89–00

Fiscal Years	*Primary Objectives of Bank Strategy*	*Annual Average Loan Commitment (US$m)*	*Share of Adjustment Lending (%)*
1989–91	Support accelerated structural reforms and debt reduction using large adjustment loans. Initiate investment loans in social sectors and rural development	2,240	57
1992–94	Focus investment lending on poverty reduction and human resource development, environment, and private-sector led growth	1,391	0
1995–96	Assist recovery from economic crisis with quick-disbursing loans linked to financial sector restructuring and social service delivery	1,457	34
1997–00 [a/]	Support growth with stability, social development, and modernization of the state using a mix of investment and sector adjustment lending	1,212	54

[a/] These primary objectives were presented in the FY96 CAS. A CAS Progress Report in FY98 and a new CAS in FY99 made relatively modest adjustments to this basic strategy.

---

[3] Before the period under review, the Bank's program went through two general stages. Prior to the administration of President de la Madrid (1982–88), the Bank provided a high volume of lending to Mexico—primarily for infrastructure investments and for on-lending to industry and agriculture through public financial institutions. Following the onset of the 1982 debt crisis, the Bank began to orient its ESW, policy advice, and lending toward support of structural reforms, especially trade liberalization, which contributed to Mexico's access to NAFTA.

[4] Throughout this text *efficacy* and *effectiveness* are used interchangeably.

2.3 The lending program by sector during each of the four periods is presented in Table 2.1. The most important sectors in terms of the volume of lending have been the financial sector, education, agriculture, transportation, and health. The pattern of annual loan commitments has fluctuated sharply during the decade (see Annex II, Graph 1). Of the total new commitments of US$18.6 billion since FY89, about 58 percent fell into the first five years. Adjustment lending accounted for 40 percent of total lending and occurred disproportionately in the first three years. Given this pattern of new loan commitments, the Bank's *net* financial relationship with Mexico has shifted dramatically over the course of the decade (see Annex II, Graph 2). With amortization payments running at about US$700 million annually in the early years of this period, the infusion of adjustment loans at the beginning of the Salinas years made possible a record net disbursement of over US$2.9 billion in FY90. When the grace period for these large adjustment loans ended, amortization payments jumped sharply to over US$1.2 billion in FY95—just when the new crisis hit. Since then, net disbursements have been negative except in FY96 and FY99 when new quick-disbursing loans were made available.

Table 2.1: Distribution of Loan Commitments by Sectors, FY89–00
(US$ million)

Sector	*1989–00*		*1989–91*	*1992–94*	*1995–96*	*1997–00*
	Total	*Adjustment*				
Agriculture	2,012	400	546	750	85	631
Education	1,928		152	916	265	595
Electric Power and Energy	910		910	…	…	…
Environment	605		…	418	187	…
Finance	2,948	2,405	500	0	1,037	1,411
Health, Nutrition & Population	1,215	700	180	0	310	725
Industry	750	500	750	0	0	0
Mining	200		200	…	…	…
Multisector	1,749	1,560	1,560	189	0	0
Private Sector Development	1,030	500	500	0	530	0
Public Sector Management	609	606	0	0	0	609
Social Protection	900	400	0	0	500	400
Telecommunications	22		22	…	…	…
Transportation	2,105	380	730	900	0	475
Urban Development	1,000		350	650	…	…
Water Supply & Sanitation	670		320	350	…	…
Total	**18,653**	**7,451**	**6,720**	**4,173**	**2,914**	**4,846**
Adjustment (percent)	40	100	57	0	34	54

Source: WB Business Warehouse as of May 2, 2001.

FY89–91: Focusing on Structural Reforms

2.4 *Massive support for reforms and debt reduction.* The core of the Bank's strategy in the first three years of the Salinas administration was to provide very substantial support to Mexico's accelerated reform program through an intensive program of policy advice and adjustment lending. In the fall of 1988, the Bank began a period of intensive work with the Mexican economic team on a package of loans to support the planned reform program. On June 13, 1989, about six months after the inauguration of President Salinas, the Bank approved three large adjustment loans for US$500 million each—the Financial Sector Adjustment Loan, the Industrial Sector Policy Loan, and the Public Enterprise Reform Loan. Following substantial analytical work on the first-ever "Brady Plan" for debt reduction, the Bank approved US$1.3 billion as an Interest Support Loan to finance collateral for the new Brady bonds. By FY91, additional quick-disbursing loans were approved for Road Transport and Telecommunications, the Export Sector, and Agricultural Sector Adjustment. According to OED evaluations, all of these adjustment operations had satisfactory and sustainable outcomes. However, in retrospect, it is clear that the reforms associated with Financial Sector Adjustment Loan did not put the banking system on a sound footing, as discussed below.

2.5 *Improving basic infrastructure for the poor.* Complementing its structural reform programs, the Salinas administration implemented a massive, social fund-like program called Solidaridad, which was intended to provide employment opportunities and to improve basic services in poor communities. Implementation was primarily the responsibility of state and municipal governments with substantial community participation, although its critics charged that funds were often directed to political clients. The Bank was involved in the design phases of Solidaridad, and the first and second Decentralization and Regional Development (DRD) Projects (approved in FY91 and FY95 respectively) provided US$850 million primarily to finance Solidaridad in the poorest states. OED rated the development outcome of DRD I as satisfactory, although its sustainability was uncertain and its institutional development impact was modest. Through 1997 the DRD II project had disbursed about US$355 million (out of US$500 million) under similar arrangements as the first project. But basic changes in the government's decentralization framework eliminated the mechanisms by which the Bank could monitor project expenditures, and disbursements were suspended. By the end of 1999 the project had been restructured in a manner consistent with this new framework, and disbursements resumed. Upon closing, the evaluation of the DRD II project concluded that it helped to increase the access of poor rural communities to rural roads and water supply systems and also strengthened the institutional capacity of state and local levels in supporting rural development. The experience gained through this project helped to shape parts of the decentralization law issued by Congress in 1997.

2.6 *Partially effective support for housing finance.* Early in the decade, the Bank made two large loans that were continuations of its earlier support for housing finance and a relevant response to a critical need of low-income urban households. The FY90 Second Low-Income Housing Loan fully achieved its objective of providing housing credit to over 250,000 low-income families, and its outcome, sustainability, and ID impact were evaluated favorably by OED. The FY92 Housing Market Development achieved some regulatory reform objectives and exceeded targets for the number of units financed, although it missed the target for the lowest-cost units. The Bank's formal and informal sector work on housing finance issues have been well regarded by Mexican counterparts. Seminars on experience in other countries were reportedly especially useful. Nonetheless, the policy and institutional framework for housing finance has remained weak and fragmented; attempts to reform the largest public financial institution for housing (INFONAVIT) have been unsuccessful; and on balance the performance of the housing sector has been poor. In FY99 the Bank approved a US$505 million to support a much-needed restructuring of a major public housing finance institution (FOVI) and associated policy reforms. But much remains to be done to correct the weaknesses in social interest housing finance and allow the government to focus its own resources on the housing needs of the poor.

2.7 *Brief reentry to the power sector.* Until 1972 the Bank had been a major lender to the publicly-owned power company. Thereafter it withdrew from the sector because of disagreement with the government's policy of subsidized tariffs. In FY89 and FY90, following a tariff adjustment, the Bank approved large loans for a hydroelectric dam and for transmission and distribution. This was a reasonable response to improvements in the policy environment, and both operations had satisfactory outcomes. However, over the decade, there was no further progress toward efficient pricing and private participation in the sector. While this has been a topic for dialogue with the government, the Bank has correctly refrained from new lending to the power sector.

FY92–94: Shifting to Investment Lending

2.8 *Shift in strategy.* During the second half of the Salinas administration, the Bank's program shifted to investment lending in three broad categories: poverty and human resource development, environment, and support for private sector-led growth, especially through infrastructure investments. There were no new adjustment loans, although many project loans supported sectoral reforms. The pace of new commitments fell, as shown in Table 2.1, reflecting both the absorptive capacity constraints for investment lending and the Bank's intention to reduce Mexico's share of Bank Total Debt Outstanding (TDO), which had grown beyond the guideline of 10 percent. Work on ESW was reduced, although the Bank continued an active dialogue on macroeconomic policy issues.

2.9 *Productive support for basic and technical education.* Prior to FY89, the Mexican Government had not been interested in Bank involvement in education and health. However, the Salinas administration invited the Bank to work in these sectors. In education, the Bank's program over the decade has concentrated on basic education (four loans for a total of US$857 million) and technical education (three loans totaling US$591 million). This program was especially relevant because it has focused heavily on basic education in the poorest states, encouraged bilingual education (which is crucially important for Mexico's very large and poor indigenous population), and supported a program to expand coverage to marginalized rural areas. However, the relevance of the Bank's work on education has been diminished by its exclusion from meaningful dialogue on many politically sensitive issues—decentralization, testing and evaluation, curriculum development, and teacher training. The basic education projects have been reasonably effective: OED rated the outcomes of the first two projects as satisfactory and judged the results sustainable. Each project incorporated lessons from the earlier projects. Bank staff were regarded by their Mexican counterparts as useful conduits of global experience. The value of sustained engagement in the sector, as demonstrated by the first three basic education projects, led logically to the FY98 Adaptable Program Loan for Basic Education. However, key shortcomings have been lack of attention to monitoring and evaluation and relatively weak community participation, especially in the pre-school project. The first two technical education projects—approved in FY91 and FY93—were evaluated by OED as satisfactory and sustainable. By the time of the third project in FY95, which gave more attention to involving the private sector, the government agency staff felt that they were leading the Bank in promoting innovations.

2.10 *Useful support for improvements in primary health services.* The Bank's initial lending in the health sector involved two investment loans (FY91 and FY96) focusing on public sector delivery of basic services to the poorest areas of the country. Project work was well complemented by ESW and policy dialogue. On balance, the outcomes of these two investment loans have been satisfactory, and many health indicators in the project areas have improved significantly. Unfortunately, resources remain concentrated on third and second level activities, and utilization rates of primary facilities have lagged behind expectations due in part to persistent problems with staff availability in isolated areas and with inadequate supply of drugs. Despite weak attention to monitoring and evaluation, the government and the Bank have continuously learned through the implementation of these programs. For example, targeting was substantially improved in the second operation. However, the Bank's effectiveness in supporting the decentralization process has been very limited: under the first project, the government halted the decentralization efforts that the project had intended to support. Decentralization resumed, but under the second project the Bank was inadequately staffed to effectively engage officials below the national level. Furthermore, the sustainability of the achievements under these two projects remains uncertain: it depends on the evolving financial and administrative capacity of the sub-national governments.

2.11 *Positive impacts in the transport sector but reduced presence in recent years.* The Bank's involvement in the transport sector has involved substantial policy advice as well as the FY90 adjustment loan and investments in road transport via the FY93 Highway Rehabilitation and Traffic Safety Project and the FY93 Medium Cities Transport Project. The Bank concentrated on reforming the institutional framework—through the deregulation and the privatization of transport services. While the Bank may not have influenced the government's decisions to privatize key services, it almost certainly had an impact on the quality of the process and the favorable outcomes in the railways and ports sectors. The Bank was not directly involved in the toll road program; it did provide adequate advice at the technical level, but this failed to prevent a significant policy mistake with respect to the details of the toll road concessions. In road transport, the two investment projects—which are still ongoing—have had satisfactory implementation ratings. The Bank made positive contributions in several areas: the adoption of a road maintenance management system; the shift in government priority from road construction to maintenance; major increases in contracting out of road works; and prevention of uneconomic investments in unneeded four lane highways and unnecessarily high road standards. Nevertheless, there has been little new lending to the sector since FY93 because the transport ministry has been uninterested in new Bank projects. In 1996–97 the Bank prepared and even obtained Board approval for a US$400 million loan for Federal Road Modernization. The government initially delayed signing the loan due to disagreement with the Bank's resettlement policies. Then, in the wake of the decline in oil revenues in 1998, the government decided to cut back new investment in roads in favor of maintenance, and the Bank loan was never signed. However, during the last two years, the dialogue with the sector has been renewed, and a US$218 million loan for Federal Highway Maintenance was approved in November 2000.

2.12 *Unjustified support for water supply and sanitation (WSS).* Following substantial involvement in the WSS sector throughout the 1970s and 1980s, the Bank approved WSS loans in FY91 and FY94 and subsequently devoted resources to preparing a sector loan originally planned for FY99. Although these two projects substantially achieved the targets for physical works,[5] there has been very little improvement in the weak policy and institutional framework for the sector. The central government continues to provide grant financing to municipal public enterprises, undermining the incentives for adequate water tariffs, financial self-sufficiency, and operational efficiency. The outcome of the Bank's engagement in this sector over the decade has been partially unsatisfactory, institutional development impact has been negligible, and sustainability of project-financed investments is unlikely. Given that the problems in the policy environment were well known in advance, the Bank should have refrained from these loans and limited itself to ESW and policy dialogue intended to encourage policy reforms in the sector.[6]

2.13 *Mixed results in agriculture.* As a complement to its effective support for the sweeping reforms in the agricultural sector during 1989–91, the Bank financed several investment projects in this sector during the first part of the decade. Although these operations were quite relevant to restoring growth within the new policy environment, they have had mixed results. In particular, the outcomes of the FY90 Forestry Development Project and FY92 Agricultural Technology Project were considered unsatisfactory. The two irrigation sector loans—approved in FY92 and FY94—have not yet closed due to cutbacks in counterpart funds and consequent delays. Despite underperformance in terms of construction targets, these operations have supported successful policy changes, especially the transfer of irrigation districts to water use associations, increases in water charges, development of water rights, and improvements in water markets. But, after 1994 the quality of the engagement in the agricultural sector weakened due in part a substantial turnover among Bank staff and senior government officials and a lack of consensus about next steps in the sector. At the beginning of the Zedillo administration, the Bank failed to respond to an initial invitation for dialogue on a new program called "Alianza para el Campo" (Alliance for Rural Areas). This program provided input subsidies to all farmers, and, as the Bank would probably not have supported such an untargeted approach, it is not clear that a productive dialogue would have developed at that stage. Subsequently, through both ESW and project development, the Bank has tried with modest results to find a useful role in programs to reduce rural poverty. The FY95 Rainfed Areas Development Project was essentially inoperative until

[5] The second project, approved in FY94, was affected by cutbacks in counterpart funds after the 1995 crisis, and about one-fifth of the loan amount was cancelled.
[6] In its comments on the CAE, the Mexico Country Management Unit (CMU) points out that, "This assessment fails to consider that at the time (late 80s–early 90s) a project was the only viable Bank instrument through which to pursue policy dialogue. It is impossible to determine *ex ante* whether a project would be successful; that it fails proves only that, not that the engagement was not prudent or necessary."

redesigned to support the “Alianza para el Campo.” Thereafter, the project achieved its physical objectives (irrigation and water conservation works) and generated high financial rates of return (17 percent–22 percent), but the implementing agency—the Trust Fund for Shared Risk (FIRCO)—was not strengthened and small farmers did not benefit from the project as originally intended. The FY98 Rural Development in Marginal Areas is an Adaptable Program Loan intended to improve targeting of the input subsidy program in the poorest areas. Designed with good community participation, it might prove to be a vehicle for assisting poor farmers if its resources are not captured by local political elites. Under the second phase, it has now been expanded “horizontally” to other states. In FY99, following a rekindling of a policy dialogue in the sector and some government efforts to direct benefits to smaller farmers, and reflecting the desire to increase disbursements, the Bank provided a US$444 million loan to help finance the “Alianza para el Campo” program. It is debatable that the prospects for improvement in this program yet warranted such direct financial support. Using the 1997 SRA/World Bank survey, a study by the Bank found that the Alianza program had little impact on poverty among households on the collective (“ejido”) farms. Little has changed in Alianza since that evaluation, and its bias towards better-off farmers continues, as the recently published World Bank policy notes for Mexico confirm.

2.14 *Mixed start on environmental issues, then a much reduced presence, except for recent GEF grants.* In the first half of the 1990s, Mexico’s institutions for dealing with rapidly growing environmental problems were embryonic. The Bank appropriately sought to contribute to institutional and policy development through sector work and lending operations. The FY92 Mexico Environment Project, despite serious management problems (including five different Bank Task Managers), helped finance the growth of the Instituto Nacional de Ecología and the environmental enforcement agency (PROFEPA). However, major components were cancelled and key proposals for decentralization and market-based instruments made little progress. Lack of local funds, a cumbersome project design and major changes in implementing agencies explain poor project results. The FY93 Transport and Air Pollution Control Project in Mexico City contributed significantly to development of institutions and policies to limit air pollution. However, the largest Bank loan for environmental activities—the US$328 million Northern Border Environment Project in FY92—was a substantial failure. Designed hastily in response to environmental concerns among NAFTA opponents in the US, the government assigned low priority to the project, especially after the 1995 crisis, and 80 percent of the loan was cancelled. Similarly, the FY94 Solid Waste II Project also became a very low priority after the 1995 crisis, and all but 2.5 percent of the loan was cancelled. At the beginning of the Zedillo administration, the Bank’s involvement in the environmental sector lost momentum and focus. The financial crisis forced restructuring or cancellation of projects, and the frequent changes of staff in the Bank and several changes in the organizations of the environment sector in Mexico prevented an effective cooperation with the government. During that period, there was very little sector work. Apart form the soil and water conservation components in two agriculture projects, the only new loan with direct environmental objectives has been the Community Forestry Project (FY97, US$15 million), which has had a slow but promising start. A FY97 Aquaculture Development Project, aimed at promoting sustainable aquaculture development, had to be cancelled because the Borrower and the Bank differed on fundamental issues of design, and the Bank overestimated the Borrower’s capacity to prepare and implement this type of projects. Through the Global Environmental Facility (GEF), the Bank has been effectively involved in protection of biodiversity. A GEF grant of US$30 million for conservation of protected areas was approved in FY93 but suffered from various management problems until responsibility was given to an NGO in FY97.[7] More recently, several additional GEF grants (FY00 Renewable Energy, FY01 Indigenous and Community Biodiversity Conservation, and Mexico Mesoamerican Biological Corridor) for biodiversity protection have been approved, and these have provided important additional financial resources to the environmental ministry (SEMARNAT). In October 2000, the Bank prepared, and discussed with members of the outgoing and incoming administrations, policy notes that dealt with issues on water, biodiversity, forestry and land management, air quality, solid waste management and management of natural disasters policy. In short, during the second half of the decade, the Bank had a limited presence in this critical sector, but the Bank's role has grown somewhat during the last two years by supporting environmental projects through the GEF and engaging the government in policy dialogue based on its analytical work and policy notes.

2.15 *Macroeconomic policy dialogue: largely on target but unheeded.* Although the priority during FY92–94 was development of its portfolio of investment loans, the Bank continued to give appropriate attention to macroeconomic management issues. During 1993–94, after completion of the formal IMF program, the Bank took a lead role in this dialogue. The Bank devoted particular attention to the exchange rate regime, advocating from mid-1992 a departure from the use of the exchange rate as the nominal anchor in the stabilization program and a more flexible exchange rate regime. The 1994–95 peso crisis suggests that this was the correct advice. However, the Bank's good advice about the exchange rate regime was not accompanied by equally urgent warning about the rapid credit expansion by the banking system and the associated growing weakness of the banks. As discussed below, it was the weakness in the banking sector that, by early 1994, made the economy so extremely vulnerable to the eventual devaluation. Furthermore, staff awareness of the increasing vulnerability of the economy during 1993 and 1994 was not matched by an adjustment to the Bank's external statements about Mexico, which remained extremely confident and laudatory. In retrospect, it is clear that the Bank had assumed an advocacy role, and that senior management had become unreceptive to the worrying messages from staff.

FY95–96: Responding Quickly to the Crisis

2.16 *Another strategic shift.* The Bank's shift in FY92 toward investment lending was interrupted as the Bank responded to the financial crisis that erupted with the peso devaluation in December 1994. After initial uncertainty about its appropriate role, the Bank agreed in early 1995 to provide up to US$2 billion in quick-disbursing loans as part of the IMF-led international "rescue package." The Bank's new strategy had four components: assistance with restructuring of the financial sector; support for essential social services to help protect the poor in the wake of the crisis; technical assistance for

[7] Another early GEF project—the High Efficiency Lighting Trust Fund approved in FY94—successfully distributed light bulbs. Also over the decade the Bank provided US$17.8 million from the Ozone Trust Fund (OTF) for projects to reduce the production of ozone depleting substances.

additional privatization; and restructuring of the existing Bank portfolio to reflect the new fiscal constraints and interest rate environment. Previously prepared lending operations for the social sectors and basic infrastructure were also approved during this period.

2.17 *The tortuous path of the Bank's engagement in the financial sector*. The story of the Bank's engagement on financial sector issues in Mexico is complex. Through its FY89 Financial Sector Adjustment Loan, the Bank had supported the initial financial liberalization.[8] Reserve requirements were completely eliminated, and, in hindsight, the Bank should have recognized the risk in the loss of this instrument for monetary policy. Subsequent to the release of the FSAL second tranche in 1990, the government indicated to the Bank that it needed no further advice or assistance in the financial sector. In 1991–92 the government privatized the banks that had been nationalized during the crisis period in the early 1980s.[9] During 1992–93 competition to gain market share by a rapid expansion of consumer loans led to alarming deterioration in asset quality among some banks. The bank superintendency was institutionally weak and unable to fulfill its mandate. During this period, the Bank had two financial economists who became well aware of the state of affairs. But their initial efforts to call attention to the increasingly dangerous situation failed to induce senior management to urgently raise these issues at the highest levels of the government. The inadequate high-level attention to the financial system during 1992–93 was by far the most serious omission in the Bank's agenda in Mexico during the period under review. Nevertheless, the warnings from these Bank staff to the government probably did contribute to the decision in April 1994 to appoint a new, dynamic head of the superintendency, and thereafter the Bank and the agency began to cooperate on a program of training and technical assistance

2.18 After the crisis erupted, the Bank's US$1 billion Financial Sector Restructuring Loan (FSRL), approved in June 1995, had two objectives: the urgent transfer of resources to the government to help restore confidence; and restructuring of the insolvent banks. It soon became clear that there was some tension between these two objectives and that the Bank and the government had different views about the right policies with respect to bank restructuring.[10] Nevertheless, the Bank gave priority to the first objective and proceeded with the operation, including disbursement of the second tranche in June 1996. With respect to the second objective, the Implementation Completion Report for the FSRL concluded that the outcome was unsatisfactory. Although the loan contributed in avoiding systemic collapse, progress toward restoring the solvency and soundness of the banking system was slower than expected. Despite its good technical advice, the Bank's effectiveness was seriously impaired by poor management of its staffing and relationships at the working level. Specifically, in its work with the superintendency of

[8] The government decontrolled interest rates, reduced directed lending, strengthened prudential regulations and intended to improve the capacity of the bank superintendency.

[9] In fact, the 1992 privatization process—in which the Bank was not involved—suffered from several serious problems that became critical when the 1994 crisis unfolded. For example, by severely restricting participation by foreign banks, the new ownership of the banks had limited bank management expertise and financial depth.

[10] The main substantive disagreements were: the trade-offs between the immediate cash requirements of bank restructuring and the long-term costs; the merits of rapid sale of the assets acquired by the deposit insurance fund; the potential role for foreign ownership and management of banks; and the importance of new laws dealing with collections and with the elimination of conflicts of interests.

banks (CNBV), the Bank lacked stability in the composition of its staff, engaged CNBV too sporadically, failed to control internal dissension between Regional and central staff, and created suspicions among its counterparts that Bank staff were leaking information.

2.19 From 1996 through early 1999, the acrimony generated by these issues seriously complicated the Bank's work on the financial sector and severely limited its macroeconomic dialogue generally. Although in March 1995 it had indicated an intention to provide an FSRL II for an additional US$500 million, the Bank appropriately refrained from making this additional loan. It nevertheless worked patiently to convey its concerns to the government and to provide technical assistance on the key unresolved issues such as laws dealing with bankruptcy and reform of the deposit insurance system. After the approval in December 1998 of a new law establishing the Bank Savings Protection Institute (IPAB) and other initiatives, a basis was established for renewed Bank financial support for bank restructuring, and a US$505 million Bank Restructuring Facility Adjustment Loan was approved in December 1999. Through this three-tranche operation and related dialogue, the Bank has usefully contributed to the momentum within Mexico for further legal and regulatory reforms to create a much stronger basis for the banking system.

2.20 *Partial success at protecting social services and promoting additional privatization.* The second principal vehicle for the Bank's response to the crisis was the FY95 Essential Social Services Loan for US$500 million. This was designed to provide budget support for ongoing government services in education, health and worker training and to initiate a system of monitoring and evaluating social expenditures. Although the overall outcome was rated as satisfactory by OED, conflicts over procurement procedures led to major delays. The Privatization Technical Assistance Loan, the third component of the Bank's response, had equally mixed results. While successful in its objectives for the transport and telecommunications sectors, it disbursed only about half of its resources because the government decided to delay privatization of electricity and petrochemical enterprises due to political opposition.

FY97-00: The Post-Crisis Strategy

2.21 *Searching for a balanced program to help restore growth and reduce poverty.* In mid-FY97, when economic recovery from the crisis was underway, a new CAS set forth an assistance program that would contribute to three objectives—growth with stability, social development, and modernization of the state. The "base case" program envisioned IBRD gross commitments in FY97–99 of up to US$5.5 billion, of which US$1.3 billion would be quick-disbursing loans for financial restructuring and for "second generation reforms" such as in the pension system. Proposed new elements of the IBRD program included a "Southern States Initiative" to boost growth in the poorest section of the country and explicit Bank assistance on public administration reforms. The CAS included a Private Sector Strategy Paper prepared jointly by IBRD and IFC. The CAS presented in March 1999 embraced a very similar set of broad objectives and lending program. Base case lending for the two years of FY99–00 was set at US$3.3 billion, of which US$1.2 billion would be adjustment loans. Proposed lending over the full three years included new APLs for Regional-Level Competitiveness, Rural Social Infrastructure, and Environmental Management and Decentralization as well as investment loans for irrigation, low income housing, and federal roads and eight Learning and Innovation Loans (LILs).

2.22 *Effective work on contractual savings reform.* During this period, the Bank's work on the reforms of the contractual savings (i.e., pension) system, designed to boost domestic savings rates and to deepen capital markets, has been largely successful. Several Mexican counterparts commented very favorably on the quality of the Bank's substantive input. In FY97 and FY98 the Bank approved two single tranche adjustment loans of US$400 million each. Agreed policy actions were taken in advance of the approval of each loan, and the Bank maintained an appropriately low profile on these politically sensitive issues. However, reforms of the National Worker's Housing Fund Institute (INFONAVIT) that had been agreed as the basis of the second loan were only partially implemented.

2.23 *Useful support to health sector reform.* In addition to the ongoing implementation of its Basic Health Projects mentioned above, the Bank contributed to the reform of the segment of the health care system that is the responsibility of the Mexican Institute of Social Security (IMSS). Following sector work that was well appreciated by government counterparts, the Bank approved in FY97 a US$700 million Health Sector Reform Loan and a parallel technical assistance operation. The QAG Quality at Entry Assessment for both operations was satisfactory, although the QAG panel commented that the objectives of the reform program seem quite modest for the size of the loan. But institutional and political obstacles to full implementation could slow or undermine the complex reform program. To some extent, opponents of the reforms have publicized the Bank's support as a means to discredit the reforms.

2.24 *Productive engagement on decentralization policies.* Efforts toward decentralization to sub-national governments began sporadically in Mexico in the early 1990s. The Bank initially focused on the implications for Bank-financed projects—for example, DRD II, as discussed above. However, the government seemed to have little interest in the Bank's involvement in broader issues until early 1999. At that time the government requested the Bank's contribution to analytical work in this area and to the preparation of a Decentralization Adjustment Loan. The analytical work was reportedly well regarded by the government for its synthesis of complex issues, and a loan of US$606 million was approved in December 1999 subsequent to a series of regulatory measures by SHCP governing the financial relationships between the national and state governments. Thereafter, the Bank began a dialogue on fiscal management issues with the reformist government in the State of Mexico, and this led to the first-ever state-level adjustment loan of US$505 million in November 2000. Given that responsibilities for many public services, including education, health, and basic infrastructure, have been given the sub-national governments, the Bank has increasingly sought to expand its engagement with particular states. Experience to date suggests that this will likely be constrained not only by the high costs in terms of staff time but also by the weak institutional capacities and/or governance problems in many states (except among the wealthier states that do not need Bank assistance).

2.25 *Expanding agenda for IFC*.[11] In the five years prior to the 1994/95 crisis, the IFC's investment volume in Mexico averaged only about US$200 million per year. In FY96, in response to the liquidity shortage caused by the peso crisis, new investments rose to US$728 million. Beginning with the FY97 CAS, the IFC aimed to contribute to more rapid, broader-based growth through a growing program in Mexico—it projected US$1 billion of new commitments annually. Given the quick recovery of Mexican companies' access to the U.S. market, the lack of reforms to support private investment in power and petrochemicals, and the continuing weak state of the financial sector, demand for IFC financing has fallen below these expectations, reaching US$143 million in FY98, US$84 million in FY99, and US$318 million in FY00. Box 2.2 presents the main elements of IFC's program during this period. In the FY99 CAS, IFC added the social sectors as a priority, financing a private hospital and recently a private high school.

Box 2.2: Highlights of IFC's Program in Mexico During FY97–00

- To strengthen the financial sector, IFC has financed projects for capital markets development and for the banking sector, and two TA projects assisted with the financial sector restructuring and the framework for regulation and supervision of the securities market.
- To improve the competitiveness of the corporate sector, especially middle-sized companies, IFC has had several projects for direct financing.
- To support infrastructure development, IFC has financed four port projects, following on the Bank's earlier work on port reform, two independent power projects, and a private railway in Chiapas.
- To accelerate growth in underdeveloped regions, IFC created a venture capital fund for small companies and provided TA for shrimp farming in Chiapas.

[11] Mexico has not become a member of the Multilateral Investment Guarantee Agency (MIGA).

3. Evaluation and Lessons of Experience

3.1 This chapter evaluates the overall relevance and efficacy of the assistance program as outlined in Chapter 2. The question of relevance is whether or not the Bank assistance focused on the right developmental objectives given Mexico's needs and the Bank's resources. The question of efficacy is whether or not the Bank and the government effectively implemented agreed programs and policies. The chapter also comments on salient aspects of the performance of the Bank and the borrower, and highlights lessons of experience that may be useful in formulating an assistance strategy for the coming years. In making judgments about the Bank's assistance in Mexico, it should be recognized that the World Bank takes a largely supportive rather than a leading role and therefore assessing its impact is especially difficult. The government has a substantial capacity to conceptualize and to carry out major programs and new policies, especially in the core economic ministries, and the Bank's policy advice and technical assistance have seldom been a dominant factor in Mexico's policy dialogue and decisionmaking.[12] Even in those areas in which the Bank's ideas and policy dialogue may have been influential, it is hard to trace their impact given a strong reluctance within the government's bureaucratic culture to acknowledge the influence of outside parties and the fact that such impact may occur with a long lag. Given the size of Mexico's economy and public sector financial resources, the net financial contributions of the Bank have been modest (except in 1989 and 1990 when net disbursements were extraordinarily high). As should be expected and desired in a country of its size and resources, Mexico has always been firmly "in the driver's seat" in its relationship with the Bank.

Judgments of Relevance and Efficacy for Each Period

3.2 Because the character of the Bank's assistance program varied significantly in the four periods outlined above, it is appropriate to consider separately the program's relevance and efficacy in each period before attempting to sum up over the entire period under review.

3.3 *FY89–91: Justified and effective support for reforms*. By the end of FY91, Mexico was by far the largest recipient of adjustment lending, accounting for six out of the Bank's nine adjustment loans over US$500 million and the first-ever Bank loan for over US$1 billion. This unprecedented level of Bank support during the first three years of the Salinas administration was highly relevant to Mexico's development needs. These reforms—within the context of a sound macroeconomic program that was supported by a large IMF program—were essential steps in creating a more outward-oriented, market-driven economy that could achieve rapid, poverty-reducing growth. (Of course, as discussed very briefly in Box 3.1, there have been dissenting views within Mexico on the basic economic policy framework pursued since the mid-1980s.) The reduction of the outstanding debt to commercial bank creditors promised a long-term solution to the

[12] In their comments on the CAE, the Mexico CMU stressed this point, noting, "We believe it is important to put in perspective the relative weight of the Bank's financial and advisory services in a large, middle-income country such as Mexico . . . . We certainly would like to think that our advice made a difference, but there are many other, probably more important political and socioeconomic factors as well."

external debt overhang that had plagued Mexico since the 1982 debt crisis. The substantial increase in net transfers from the Bank helped to rebuild Mexican international reserves. In large measure, these components of the Bank-supported strategy—with the important exception of its work on the financial sector—were also implemented effectively.

Box 3.1: Alternative Views of Mexico's Economic Reforms

In parallel with the Bank's SAPRI exercise, in which the Mexican Government choose not to participate, a group of Mexico NGOs prepared their own critique of the structural reform policies supported by the Bank in Mexico. This group argues that the shift from import substitution to trade liberalization was designed primarily to ensure repayment of the external debt contracted in the 1970s. By exposing small and medium enterprises and farmers to competition from abroad and orienting domestic firms to the external market, these policies, they say, have permanently marginalized much of Mexican society and increased social polarization. Furthermore, Mexico has remained excessively dependent on external capital flows and has pursued fiscal discipline primarily at the expense of social programs, while inequality of incomes worsened.

3.4 *FY92–94: Relevant strategy with partially unsatisfactory outcomes.* The revised Bank's assistance strategy during this second period was, on the whole, highly relevant. As growth began to recover, it was appropriate for the Bank to help Mexico implement its vision of a new role for the state—investing in human resource development, environmental protection, and basic infrastructure—and to advise on macro and exchange rate policies. However, as described above, the relevance of the Bank's program was seriously impaired by inadequate attention by senior Bank managers to banking sector issues. The Bank program gave little attention to gender issues, but it is unclear that the authorities would have welcomed more involvement.[13] In terms of efficacy, the results of Bank lending operations were mixed, and the effective implementation of many of the operations launched during this period was seriously impaired by the effects of the 1994/95 economic crisis. On the exchange rate policy, the Bank staff gave advice that was largely correct but unheeded. Overall, the crisis that erupted in December 1994 was a substantial setback to the objectives of the Bank's assistance program that was put in place during the FY92-94 period.

3.5 *FY95–96: Right but risky, partially effective response.* In light of the need to maximize international support and to restore confidence in the Mexican economy, the Bank was correct in FY95 to contribute to the international rescue package. It was also appropriate to link its support to two critical issues facing Mexico after the devaluation—restoring soundness to the banking system and protecting social services to the poor. However, in the absence of any contingency planning between the Bank and the

[13] With a Gender Disparity Index of .778, Mexico ranks 49 among 143 countries. The male-female literacy gap is only 4 percent. However, domestic violence toward women may be a serious issue. While over the period FY89–99, about 40 percent of Bank-financed projects integrated gender issues, ESW and CASs have seldom given much attention. In 2000, the Bank and the government agreed on a Learning and Innovation Loan (LIL) on gender equity and completed a study on *Gender Differences in Education in Mexico.*

government for dealing with the financial and social impacts of a devaluation and recession, these linkages entailed considerable risk of subsequent disagreement with the government on policy and/or of implementation problems. As it turned out, both of the Bank's lending operations in response to the crisis—the Financial Sector Restructuring Loan for US$1 billion and the Essential Social Services Loan for US$500 million—encountered substantial difficulties. Overall, the Bank's effectiveness in this period must therefore be regarded as partially satisfactory.

3.6 *FY97–00: A large, relevant program that has been only partly implemented.* Conceptually the strategy during this last period was relevant to Mexico's post-crisis circumstances in which generating broad-based growth was the most important requirement for social stability and poverty reduction. The commitment to remain engaged in the problematic banking sector was especially relevant, as credit and hence growth opportunities for much of the economy depend on restoring health to the banking system. The desires to focus on the poor southern states, to contribute selectively to better public administration, to become more effectively engaged on environmental issues, and to support policies for decentralization were also quite appropriate. However, the Bank strategy did not include involvement with or financing for the Zedillo Administration's new anti-poverty program, PROGRESA, which provides cash incentives to specifically targeted poor households for education and health services. The Bank or other multilaterals were not invited to help finance this program.[14] The government's intention has been to ensure that PROGRESA is publicly recognized as the initiative and policy of the government rather than of external development agencies.

3.7 Many elements of the assistance programs set forth in the FY97 and FY99 CASs have already been effectively implemented. These include the adjustment lending operations for health reform, decentralization, and bank restructuring, which has been discussed in Chapter 2, and a robust program of non-lending services and technical advice, including some 40 reports or seminars during FY99–00 leading up to the change in administration and culminating in a comprehensive set of Policy Notes. For the investment lending operations approved during this period, it is premature to assess their effectiveness. However, there were many lending operations envisioned in the assistance programs during this period that did not materialize. Some operations were appropriately not pursued because the government was not ready to undertake the associated policy reforms. This was the case, for example, for loans to the energy and water sectors and for policy-based lending for fiscal adjustment. Other proposed elements of the program have not materialized primarily because the government was not persuaded that the Bank could contribute sufficient value added, as discussed further below. Such elements included: investment loans for the so-called Southern States initiative, natural resource management, pollution control, nutrition, and targeted poverty reduction; technical assistance loans for the financial sector, private sector development, tax administration, and environmental management; and a set of eight LILs proposed in the FY99 CAS. Finally, the intention of the FY97 CAS to provide guarantees for infrastructure

[14] Individual Bank staff had been engaged informally with the government in the design of PROGRESA. Also, a pilot program of targeted cash transfers like PROGRESA had been supported by the Bank's 1992 Agricultural Sector Adjustment Loan, and this may have provided relevant experience in the subsequent design of the PROGRESA program. Finally, the health component of PROGRESA is linked to the Program for Extension of Health Coverage (PAC) that the Bank has financed.

investments was not realized due primarily to the inability of the Bank to clarify and effectively pursue this instrument. For the combination of factors just mentioned, actual lending during the post-crisis years has fallen below the level of about US$2 billion annually that the Bank had indicated to the Mexican government soon after the crisis. This had been a source of some tension in the relationship between the Bank and the government.

Relevance: Summing up over the decade

3.8 In order to sum up the relevance of the Bank's program over the decade, Box 3.2 places the diverse elements of the Bank's assistance strategy during the past ten years into four categories.[15] For the most part, these categorizations are well explained by the discussions above. With respect to the category of *Little or no engagement due primarily to the government's choice*, these were important development challenges in which the lack of engagement reflected the government's unwillingness to involve the Bank in politically sensitive issues. For example, although the FY97 CAS assigned high priority within the Bank's program to the objectives of modernization of the state, the Bank has not had much engagement in areas such as civil service reform, legal and judicial reform, tax administration, financial management and accountability, or anti-corruption programs. This reflects primarily the government's lack of interest in involving the Bank in these politically sensitive areas in which the Bank's potential value added was, from the government's perspective, unproven. For instance, although the dramatic liberalization of the economy during the decade has undoubtedly reduced opportunities for corruption in the public sector, various reports indicate that corruption remains an impediment to private sector growth and public sector efficiency. Whether or not the Bank could have contributed to the government's efforts on issues of governance remains an open question. Regarding the four areas of *Little or no engagement due primarily to the Bank's choice,* it should be noted that the withdrawal from the power sector and financial sector lending during FY97–99 was due to the Bank's disagreement with the policy framework, whereas its disengagement on agricultural sector policy during FY96–98 and environmental programs during FY96–99 reflected largely an incapacity to devote adequate staff resources to these areas. It remains unclear whether or not the government's attitudes and policies would have been conducive to a constructive relationship in the agriculture and environment sectors if the Bank had made a more credible effort to engage in these areas.

[15] *Appropriate engagement* means that the Bank's involvement was justified not only by the importance of the sector and/or policy issue, but also by the circumstances which created sufficient likelihood for effective impact. *Little or no engagement based primarily on the government's choice* indicates that the developmental issue was important, but the Bank was not significantly involved due to the government's preference. *Little or no engagement due primarily to the Bank's choice* refers either to sectors or issues in which the policy environment or other circumstances were unfavorable for the Bank to make an effective contribution or in which the Bank was not engaged due to staff constraints. *Inappropriate engagement* applies to sectors or issues in which the policy environment or other circumstances were unfavorable for the Bank to make an effective contribution but in which the Bank nonetheless was seriously involved.

Box 3.2: Summary of the Relevance of the Bank's Assistance Strategy, FY89–00

Appropriate engagement	• Structural reforms during FY89–91 • Debt reduction program in FY89 • Exchange rate regime before FY96 • Basic education and primary health services • Environmental institutions and policies before FY96 • Transport sector, including privatization • Targeted poverty reduction programs before FY96 • Rapid balance of payments support during 1994/95 crisis • Housing finance • Contractual savings reforms since FY95 • Health sector reforms since FY97 • Decentralization since FY99
Little or no engagement based primarily on government choice	• Financial sector policies during FY92–94 • Modernization of state and governance issues • Decentralization policies prior to FY99 • Targeted poverty reduction programs after FY96
Little or no engagement based primarily on Bank choice	• Power sector after FY90 • Financial restructuring lending during FY97–99 • Agricultural sector policy during FY96–98 • Environmental programs during FY96–99
Inappropriate engagement	• Lending for water supply and sanitation

3.9 *Overall relevance has been satisfactory.* Weighing all of the above, the overall judgment is that the relevance of the Bank's assistance program during the decade has been satisfactory. The Bank has focused its efforts primarily on areas that have been highly relevant to Mexico's development needs and in which circumstances—including the government's interest in Bank involvement—were sufficiently favorable for the Bank to expect a positive impact. This is especially true with respect to the Bank's engagement on structural reforms at the beginning of the period under review and its engagement in improved provision of basic education and health services. Of course, it would have been desirable for the Bank to be more effectively engaged in areas such as environmental and targeted poverty reduction programs in the latter half of the period. Nonetheless, it was appropriate that it did not make its involvement in Mexico conditional on engagement in areas in which the government did not welcome the Bank. However, inadequate high-level attention to financial sector issues during 1992–93 was a very serious gap in the relevance of the Bank's work.

Efficacy: Summing up over the decade

3.10 Given the Bank's areas of focus, did the Bank and the government effectively implement agreed programs? In order to answer this question, the review in Chapter 2 of the Bank's assistance program on a sector-by-sector basis can be usefully complemented by data from OED evaluations, the Annual Reviews of Project Performance (ARPPs), and the Quality Assurance Group (QAG).

3.11 *OED evaluation ratings.* According to OED *ex post* evaluations, the performance of Bank lending operations in Mexico that were approved, completed, and evaluated during the past 11 years has been quite good. As shown in Table 3.1, 87 percent of lending operations that were completed and evaluated during FY90–99 (weighted by net commitments) had outcome ratings of "satisfactory."[16] This compares to 85 percent for the Latin America and Caribbean Region as a whole and 81 percent Bankwide. This relatively high percentage reflects in part the excellent performance of the large adjustment loans: the outcomes of all but one of the eleven adjustment loans during the period were considered to be satisfactory.[17] Even the non-adjustment loans had a 93 percent satisfactory rating for outcomes.[18] However, it is noteworthy that only 45 percent of non-adjustment loans had "substantial" institutional development impact. Although this is almost equal to Regional and Bankwide averages, it is a significant and disappointing figure. Finally, 70 percent of these operations were judged to be "likely" sustainable.

Table 3.1: OED Ratings of Completed Lending Operations, FY89-00
(percent of value of net commitments)

	Mexico	*Latin America*	*Bankwide*
Satisfactory Outcome (all)	**87**	**85**	**81**
Adjustment loans	82	86	
Non-adjustment loans	93	84	
Substantial Institutional Dev. Impact (all)	**49**	**52**	**45**
Adjustment loans	54	57	
Non-adjustment loans	45	46	
Likely Sustainability (all)	**70**	**70**	**64**
Adjustment loans	68	72	
Non-adjustment loans	72	67	

Source: OED's Project Ratings Database as of May 1, 2001.

3.12 *ARPP and QAG data on project performance.* The Bank's Annual Review of Project Performance (ARPP) indicates that the portfolio of lending operations in Mexico has had relatively few problems in terms of implementation and achievement of developmental objectives. As shown in Annex II, Table 6, the percentage of projects which were rated at risk in terms of their development objectives has been under 5 percent during most years of the decade. The comparable average for the Latin American

[16] Considering only those operations that were both initiated and evaluated during FY91–99, as shown in Annex II, Table 5A, 77 percent of those with OED ratings had satisfactory outcomes. The lower figure reflects the highly satisfactory outcomes from loans during FY89–90.
[17] The only unsatisfactory adjustment loan was the 1995 Financial Sector Adjustment Loan for US$1 billion that was part of the post-crisis rescue package.
[18] For this figure, the outcomes for loans are weighted by loan amount net of cancellations. It is, therefore, biased upwards because poorly performing loans that were mostly cancelled receive very little weight.

region as a whole is about 8 percent. Similarly, the percentage of projects with significant implementation problems has generally been lower in Mexico than in the Region as a whole. However, implementation problems affected about 20 percent of the loan portfolio in FY95 and FY96, and this was caused primarily by cutbacks in counterpart funds following the crisis. According to QAG data, there has been only one dimension—environmental and resettlement policies—in which Mexican projects have experienced more frequent difficulties than those elsewhere in the Region. Among active loans in April 2001, the share "at risk" is only 10 percent compared to 16 percent for the LAC Region (see Annex II, Table 5B). Finally, in Mexico there have been no reported cases of violation of the Bank's safeguard policies and no cases brought before the Bank's independent Inspection Panel.

3.13 *Qualitative judgment regarding Economic and Sector Work.* Based primarily on interviews with many government officials, it seems that the Bank's Economic and Sector Work, i.e., its formal and informal reports on programs and policy issues, has had a mixed record in Mexico. As noted repeatedly in Chapter 2, occasionally government staff will cite a report as particularly useful; more often, the positive contributions of informal notes, confidential policy dialogue, or seminars and similar events are cited. There is little evidence that over the decade major formal reports have been influential.[19] To some extent, this may reflect the reticence of Mexican officials to attribute influence to other parties, or the lagged and indirect effects of such reports.[20] But the weight of testimony from Mexican officials suggests that ESW during most of the decade has been partially effective. However, most recently, the Policy Notes produced in anticipation of the new administration were reportedly very useful. These provided inputs to a workshop between the outgoing administration and the Fox transition team and were subsequently published at the request of the government.

3.14 *Overall efficacy was partially satisfactory*. As described in Chapter 2, the efficacy of the Bank's assistance program in Mexico has varied over the course of the decade. In the early years (FY89–91), the program was highly effective in helping the government address Mexico's key developmental challenges. However, the effectiveness of many of the components of the Bank's program during the second period (FY92–94) was seriously undermined by the 1994/95 crisis and must be considered partially unsatisfactory. The effectiveness of the Bank's program during FY95–96 was partially satisfactory given the partial success of the program components introduced in response to the crisis. Finally, in the post-crisis period, the Bank's program has fallen somewhat short of the ambitious objectives of the FY97 and FY99 CASs. Overall, the effectiveness of the program in this last period has been partially satisfactory. Surveying the entire 11 years, the efficacy of the Bank's assistance program has been partially satisfactory.

---

[19] The Mexico CMU points out that to some extent the impact of the Bank's reports may have been limited by the government's reticence about their dissemination, and that this may now change.

[20] For example, a 1998 QAG review of the 1997 CEM on mobilizing savings initially determined that its impact was "marginally satisfactory." A follow-up review changed that rating to "satisfactory" based on its lagged effects on the thinking of Mexican policymakers.

Sustainability and Institutional Development Impact

3.15 Overall, the policies and programs with which the Bank has been associated in Mexico over the decade are likely to be sustainable. The open, market-oriented economic policies pursued since FY89 have helped to generate rapid recovery from the disastrous 1994/95 crisis. The banking system is regaining strength, in part due to the participation of foreign management and equity, a better legal framework, and more effective supervision. Nonetheless, even though poverty headcounts are beginning to decline again, social stability will require sustained success in reducing poverty, especially in the south, and there may be risks of non-market-oriented policies emerging at the state level. With respect to sectoral programs for which the Bank has provided investment loans such as basic education and health, most OED ratings indicated likely sustainability of outcomes. However, the sustainability of programs for which responsibility has been transferred to sub-national governments remains uncertain.

3.16 Assessing the institutional development (ID) impact of the Bank's assistance program is particularly difficult, given its modest size relative to the Mexican economy. On the one hand, the major reform programs which the Bank supported did indeed involve important institutional changes. On the other, OED ratings of investment projects indicate substantial ID impacts only in less than half of all projects. This is consistent with the relative competence and strength of the Mexican central government bureaucracy and the general resistance to outside involvement in institutional change.

Bank and Borrower Performance

3.17 Strong borrower ownership of Bank-supported programs and projects is the main determinant of the favorable outcomes and performance of Bank lending operations in Mexico. This ownership manifests itself in different ways in adjustment and investment loans. With respect to *adjustment loans,* except for the FY95 FSRL, the government and the Bank shared a common vision about desirable policy changes in Mexico and had a collaborative working relationship. In particular, the economic technocrats who dominated the government during the Salinas administration were determined to pursue as aggressively as politically possible an agenda of reform, and the Bank could strongly endorse those reforms. Borrower ownership was not an issue. The dialogue between the government and the Bank usually focused on technical details and on timing, not on basic purpose. Because the Bank had sufficient confidence in the goals of the key economic policymakers, it was somewhat flexible about which policy reforms would be written into the conditionality of adjustment loans and which would remain implicit understandings. The Mexican reformers tended to accept explicit conditionality when it would be useful—or at least not harmful—in internal policy debate and to avoid such conditionality when it would be a political liability.

3.18 With respect to *non-adjustment loans*, two major factors explain the favorable ratings.[21] First, in most cases, Bank loans provided financing for projects that had been

[21] A third, undoubtedly less important factor was an upward bias in the outcomes associated with Bank projects. When the Bank financed a time-slice of a line ministry's investment program, the Bank funds

determined in large part by the executing agency. Bank projects have to fit within SHCP's fiscal program and—always in theory and usually in practice—do not amount to additional financial resources for the executing agency.[22] An important question, addressed below, is whether or not the Bank's participation contributed to the quality and/or efficiency of government-owned programs.

3.19 A second important factor has been that the executing agencies have usually had sufficient institutional capacity to implement projects. As a general rule, the institutions of the *central government* have been able to provide adequate salaries and considerable job security, leading to relatively competent staff and hence good capacity to carry out projects. (An important exception has been at the level of sub-national governments, where lack of institutional capacity has often frustrated implementation of rural development and other activities). Furthermore, in many lending operations, the executing agency has been assisted by either BANOBRAS or NAFIN, the public development banks that serve as the financial intermediaries for most Bank loans. BANOBRAS and NAFIN staff often handled many of the procedural matters associated with Bank loans and also provided technical assistance to the executing agencies. These factors explain in large part the high ratings for sustainability of Bank-financed projects as well as the lower ratings for institutional development impact.

3.20 *Perceptions about the Bank's value added through investment lending.* Given SHCP's approach to budgeting, most Bank loans have involved no additional financial resources from the point of view of the implementing agency. Why, then, do implementing agencies want Bank projects, especially when many government officials feel that Bank projects impose numerous "hassle factors"—the Bank procurement procedures, the audit requirements, and the need to respond to the myriad questions of supervision missions? Mexican government officials indicated that engagements with Bank staff during the design and implementation of a project sometimes have had value added in these ways: 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 resources allocations that might otherwise be subject to excessive discretionality; and injecting a greater measure of discipline in project execution. Nevertheless, on balance, interviews with Mexican government officials suggest that the value added of the Bank's lending operations during the past decade has been *highly variable and, as a trend, diminishing over time.* As a result, it has been increasingly difficult to identify implementing agencies that regard the embedded technical assistance from working with the Bank as worth the "hassle factors." This has been evidenced by

---

were notionally assigned to specific sub-projects on an *ex post* basis. According to both Bank and government staff, sometimes Bank funds were assigned only to the best-performing sub-projects.

[22] There have been some exceptions to this policy. For example, Bank financing for environmental activities led to larger public expenditures in this area. Some observers suggest that Bank loans provided greater stability in budget allocations to the Bank-financed activities. In other words, activities financed by Bank loans were less likely to be cut during periods of fiscal tightening. However, this has not always been the case, as evidenced, for example, by budget cuts to the Bank-financed health and irrigation projects after the 1994/95 crisis.

the shortfalls in approved investment and technical assistance operations, as well as LILs, relative to CAS programs since FY97.

3.21 Since the beginning of the Fox Administration in December 2000, the expressed demand for Bank services—both lending and non-lending—has increased sharply. Several factors explain this increased interest, although their relative importance remains unclear. With respect to non-lending services, the surge in demand probably reflects the desire by newly-appointed senior officials to draw upon the advice—and the credibility—of the Bank as they define their policies and programs. This desire to draw upon the Bank is due in part to the favorable reputation that the senior Bank staff have earned in the last few years, including through the dialogue with the transition team based on the Bank's extensive set of Policy Notes. Regarding lending, it is not clear to what extent the apparent demand from line ministries reflects an expectation that Bank loans would provide incremental budget resources. In any case, it remains to be seen whether or not this increased demand will be sustained.

3.22 *Bank management of its human capital.* Whether or not Bank involvement has value added in the ways cited above seems to depend primarily on the quality of the Bank staff involved—their knowledge of global practice, their understanding of the Mexican context, their ability to work collaboratively and to communicate effectively with their Mexican counterparts, and their willingness to adopt a low-profile, almost self-effacing, role. It is therefore not surprising that the Bank's performance in Mexico during the past decade has depended to a large extent on how carefully it managed its staff. From 1989 through about 1992, the Bank successfully mobilized a cadre of senior staff who had useful international experience, invested themselves in learning about Mexico, and as a consequence usually had very productive relationships with senior officials.[23] These were regarded by many senior officials in Mexico as the "golden years" of the relationship. Between 1993 and 1997, several factors conspired to damage the relationship between Bank staff and government officials. In 1993 and 1994, there was unusually high turnover among the key Bank staff working on the country, including a change in the Bank's Country Director, and the number of core staff devoted to Mexico decreased. Unfortunately, this coincided with a critical period—the transition between the Salinas and the Zedillo administrations, and the economic crisis that started in December 1994. The decision by the Bank in 1996 to "decentralize," i.e., to place its Country Director and core staff in Mexico, again led to considerable turnover among staff. When the new Country Director arrived in Mexico, the team included only one senior economist, who had only six months experience on the country. In large measure because of these staff changes and reductions on the Bank side, the policy dialogue was very weak, and the pipeline of potential lending operations was almost nonexistent. Since the decentralization, the core staff working on Mexico has stabilized significantly, although continuity of task managers who are not part of the core staff may remain an issue. In the last couple years, there has been a high payoff to the continuity of senior staff working on Mexico, especially those stationed in the Mexico Country Office. Such continuity has contributed greatly to the quality of the dialogue in many areas and is undoubtedly a positive factor in the initial receptivity of the new administration to working closely with

[23] To some extent the quality of the relationship rested on the continuity of the Bank's Country Director from 1985 through 1994.

the Bank. In short, the experience over the last decade or so makes clear that the Bank's effectiveness in Mexico depends not only on assigning highly experienced staff but also keeping these staff engaged for a sufficiently long period to know the country and their government counterparts.

3.23 *Consequences of the Bank's decentralization.* The decision by the Bank in FY96 to place its Country Director in Mexico City together with senior staff on each sector (the "sector leaders") has had both positive and negative aspects. On the positive side, the quality of the relationship between the Bank senior staff and senior government officials is now much better than it had been in the two or three years preceding the decentralization[24] or in the initial period after the decentralization.[25] This positive development has been reinforced by the continuity among senior Bank staff since FY96. Also, the proximity of Bank staff and executing agencies has facilitated the day-to-day implementation of projects and the sector policy dialogue.[26] Bank response time on procurement and other matters is decidedly better than it had been. Also, subject to the limitation discussed below, the presence of senior Bank staff has made possible broader contacts with Mexican civil society and with state and municipal governments. On the other hand, sector leaders based in Mexico are more absorbed in day-to-day issues of implementation of projects. They do not have enough time to work on policy issues, and they have less easy access to the international experience of other Bank colleagues. These potentially negative aspects could be mitigated by ensuring that sector leaders in the Mexico office are supported by experienced staff in Washington who also devote significant attention to the Mexico program. On balance, the experience with the Bank decentralization has been positive. However, this evaluation has not attempted to estimate the *incremental* administrative budget cost of the decentralization and therefore cannot make a judgment about net benefits.[27]

3.24 *Bank support for participatory processes.* One of the purposes of the Bank's decentralization—broadening the Bank's contacts with Mexican civil society and encouraging more participatory processes—has been somewhat thwarted during the past decade by three related factors. First, the Mexican Government, in particular SHCP, has been committed to directing the Bank's program, and many in the government oppose the Bank's effort to bring non-governmental actors into a dialogue about the Bank's program. Second, the central government bureaucracy has not been accustomed to open, public dialogue about policy issues and often has had an adversarial relationship with civil society groups, although this has improved somewhat in recent years. Third, many

---

[24] Such improvement may have occurred even without the decentralization since the relationship had been severely eroded due to the high staff turnover.
[25] Initially the decentralization damaged the relationship because the government felt that it had not been adequately consulted about this change and that they would prefer to deal directly with Washington-based senior officials.
[26] Despite the consistent and convincing testimony by government officials that the Bank's decentralization has facilitated project implementation, the ARPP data does not corroborate this. As shown in Annex II, Table 6, portfolio indicators since 1997 (i.e., after some recovery from the crisis) are on average about the same as in 1989-94.
[27] Available cost data suggests that the average costs for preparation of lending operations have come down in the second half of the decade more rapidly in Mexico than in the Regional or in the Bank as a whole, although costs in Mexico remain above the regional average. Supervision inputs in staff weeks have declined in Mexico but increased in the Region and in the Bank as a whole.

civil society and political groups in Mexico have been suspicious of, if not hostile to, the Bank, which they associate with the "imperialistic" power to the north and with reforms that have imposed high costs on some parts of Mexican society. Hence, overt support by the World Bank for a policy change has sometimes been regarded as "the kiss of death" by Mexican policymakers. It was feared—perhaps rightly—that a naive Bank effort to publicly promote a policy reform might undermine the government's ability to pursue that reform. Under the new Fox Administration, it now seems certain that these factors are likely to change: the administration is encouraging a more transparent approach to governance and has displayed a much more relaxed attitude about the Bank's direct engagement with non-governmental actors.

3.25 *Consequences of the Bank's negative image in Mexico.* The Bank's negative image within parts of civil society in Mexico has adversely affected the Bank's assistance program in other ways. For example, it has occasionally led the government to exclude the Bank from financing programs it would have wanted to finance (for example, the anti-poverty program PROGRESA). Also, in 1996, the Bank announced a Southern States Initiative (SSI) to intensify developmental efforts in the poorest parts of the country. But the government was concerned about the repercussions of a high-profile Bank involvement in a politically sensitive program, and the initiative never took off. Significantly, the Bank-financed education and health projects had been heavily targeted on the southern states even before 1994, but this low profile involvement in the area created no political problems for the government. To what extent the Bank's image might change given the new political environment in Mexico remains to be seen. An active outreach effort by the Bank, which the government had previously discouraged, may help to reduce the suspicions of some groups, although others will remain deeply opposed to the policy directions advocated by the Bank.

3.26 *Working with key partners.* The only important partners in the Bank's assistance program in Mexico have been the International Monetary Fund (IMF) and the Inter-American Development Bank (IDB). For the most part, these partnerships have been productive. During the first years of the Salinas administration, the IMF and the Bank worked closely together to support the reforms and the debt reduction agreement. After completion of its formal program with Mexico, the IMF's attention to the country was reduced during 1993 and 1994, when the Bank took the lead in the dialogue about the exchange rate regime. Since the onset of the 1994/95 crisis, collaboration between the institutions has been good, although the fact that the Bank's Country Director is in Mexico marginally reduced his communications with senior IMF staff. With respect to IDB, collaboration on lending operations over the decade has generally been modest in scope but occasionally very useful. Most often the government has chosen to have the two MDBs operate in separate spheres in terms of programs or areas of the country. In those few cases when the Bank and the IDB were co-financing investment projects early in the decade,[28] differences in procedures between the two institutions sometimes aggravated the implementing agencies' administrative burden. At the beginning of the

[28] Cofinanced investments projects were Transmission and Distribution (FY90), Water Supply and Sanitation (FY91) and Irrigation Sector (FY92) Projects.

Salinas administration and again in response to the 1994/95 crisis, the Bank and the IDB cofinanced several large quick-disbursing operations.[29]

Efficiency

3.27 Available data on the costs of lending operations during the period FY91–99 indicates that the Bank's Mexico program has been inexpensive in terms of administrative budget cost per dollar of net commitments. As indicated in Annex II, Table 8, the average cost per project in Mexico has been above the average for the Latin American and Caribbean Region, but the average loan size has been more than twice the regional average. Hence, the average cost per US$1,000 of net commitment in Mexico has been about half of the regional average and about one third of the Bankwide average. The average cost per US$1,000 of net commitment for satisfactory and nonrisky projects in Mexico has also been about one third of the Bankwide average.

Lessons of Experience

3.28 What are the lessons of the past 11 years with respect to the potential contribution of the Bank to Mexico's development in terms of both financial support and non-financial value added through policy advice and technical assistance? The record of the period since 1989 shows that the Bank's non-financial value added in Mexico has been variable and episodic: it depends in part on Mexico's circumstances and in part on the quality of Bank staff. But the trend suggests that it will become increasingly challenging for the Bank to have substantial developmental impact through its advice and technical assistance. This prognosis reflects several factors: the deepening of the human capital available to the government and the gradual strengthening of central government institutions; the decentralization of many responsibilities to state and municipal governments, with which Bank staff could engage less frequently; the emergence of alternative domestic and international sources of good analysis about the Mexican economy and policy alternatives; and also perhaps the nature of remaining reforms, which often require deep and complex changes in institutional behaviors for which the Bank's expertise may be less relevant. Nevertheless, as already noted, since the beginning of the new administration, there has been a renewed interest in the Bank's services. The experience of the last decade and the circumstances of Mexico suggests that this might not be sustained.

3.29 Regarding the value of the Bank's financial contribution, although it has been and will remain small relative to the totality of Mexico's external financing needs, it has proven to be most valuable during periods of rapid reforms that have high external or fiscal costs and during episodes of external crisis. During other, "normal" times, the Bank's financial contribution has limited value. However, some within Mexico would like to maintain a high level of gross disbursements from the Bank even in normal times.

---

[29] Cofinanced adjustment operations were the Road Transport and Telecommunications Loan, the Agricultural Sector and Food Security loan, the Financial Sector Restructuring Loan, the Essential Social Services Loan, and the Contractual Savings Loan. In most cases, the 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, focusing, for example, on the development banks within the FSRL program.

This reflects three considerations. First, private sources of external borrowing by the Mexican Government will likely remain more expensive than Bank loans; and, notwithstanding the recent upgrading of Mexican debt by international rating agencies, the volume of new Mexican sovereign debt that international investors can absorb will likely be limited and volatile. Second, unless oil prices remain very favorable for Mexico, the government faces growing fiscal pressures, in part from servicing the bonds used to recapitalize the banking system after 1995. Third, service payments on the accumulated debt to IBRD remain large. For all of these reasons, the government of Mexico may want substantial new Bank financing in order to help manage its fiscal program and external borrowing costs even in the absence of external crisis or costly reforms. The government may want new Bank loans to be a reliable, non-volatile, long-maturity component to its overall external borrowing program.

3.30 The fundamental challenge in designing the Bank's future assistance program is how to help the government manage its external borrowing program through substantial commitments and disbursements of new Bank lending while at the same time ensuring that the Bank's engagement provides substantial non-financial value added. In this context, three lessons of experience are noteworthy. First, it would be helpful for the Bank and the government to reach explicit, common understandings about the desired range of commitments and disbursements during each CAS period and about likely instruments for achieving that financial contribution while also ensuring that the Bank's overall engagement has adequate non-financial value added. Differences in expectations would create unnecessary frictions in the relationship. With respect to lending levels, two broad scenarios should be considered, recognizing that these scenarios represent opposite ends of a continuum. One possible scenario would be substantially negative net disbursements, leading to a relatively rapid reduction in Mexico's total debt outstanding (DTO) to the Bank. This scenario would have the advantage of eliminating any Bank concerns about the high Mexican share of its IBRD portfolio[30] and thereby creating additional "surge capacity" for a substantial increase in lending in the event that Mexico faces more limited access to capital markets at some point in the future. From the government's perspective, this scenario would be more attractive if the Bank could articulate more clearly its future policies for lending during financial crises. A second possible scenario would be a robust program of new commitments that would at least maintain the current level of DTO or might even use up the available "headroom" within the Bank's current portfolio concentration limit of US$13.5 billion to a single country.[31] Under either scenario, the Bank and government may find that Adaptable Program Loans (APLs) or other programmatic lending instruments could be effective in achieving both value added from Bank involvement and predictable disbursements. Such lending should be designed with realistic and substantial triggers and supported by a very clear framework for monitoring and evaluation to ensure that the APL or programmatic loans remains in place only if mutually agreed objectives are met.

---

[30] With US$11.5 billion Total Debt Outstanding, Mexico is now the second largest IBRD borrower (after Indonesia), accounting for about 9 percent of the Bank's outstanding loans.

[31] The Mexico CMU points out that, given the current level of TDO, the current assistance program allows for both robust lending of about US$1.5 billion per year and a "surge capacity" of US$3.5 billion in a single year. In their judgment, this strikes the right balance between the two scenarios.

3.31 Second, the Bank can hope to have non-financial value added in Mexico only if it carefully manages its own human capital. As demonstrated by the successes at the beginning and again at the end of the 1990s and by the problems during the middle years of the decade, effectiveness requires that the Bank assign very experienced and capable staff to work on the country for extended periods of time.[32] Furthermore, rotation of staff should be managed carefully to prevent sharp discontinuities in the Bank's collective knowledge of the country.[33] Changes in Task Managers must be minimized. To ensure that sector leaders placed in the Mexico City office can be a conduit for evolving global experience while also managing the current loan portfolio, they should be strongly supported by Washington-based staff who also stay engaged in the Mexico program for some time.

3.32 Third, making an intellectual contribution to policy debate and decision-making in Mexico requires a serious and sustained engagement in carefully chosen areas. Even with the best management of the Bank's experienced staff, the Bank cannot afford to be effectively engaged on many different issues. Hence, the Bank will need to be quite selective in defining its program of non-lending and lending services. In seeking to identify unresolved issues of policy and/or program design on which the Bank could make a useful contribution based on its international experience, objectivity, and analytical capacity, the Bank needs to have a dialogue not only with SHCP—which has dominated the dialogue in the past—but also the line ministries and sub-national governments. Given its institutional mandates, priority in selection should be given to targeted poverty reduction policies and programs and to environmental issues, which remain pressing developmental challenges for Mexico.

[32] In this connection, the Mexican Government has noted that the recent Bank decision to assign responsibility for the Bank's programs in Colombia and Venezuela to the country management unit based in Mexico threatens to weaken the attention of key staff to the Mexican program. See Annex III.
[33] This may be especially important in the immediate future since most senior staff working on Mexico begin their assignments at about the same time as the Bank's decentralization.

Annex I

Mexico's Developmental Challenges: The Context for Bank Assistance During the Past Decade

1. The course of Mexico's economic development has been of global interest during recent decades. This is due in part to the size of the country—a population now approaching 100 million and the thirteenth largest GDP in the world. But, perhaps more importantly, Mexico has been on the frontlines of crisis and economic reform among developing economies, especially since the onset of the debt crisis in 1982. The assistance program of the World Bank can only be understood in the context of the rapidly changing developmental challenges that Mexico has faced. This annex presents a very brief summary of those challenges.

2. From the end of World War II until the mid-1970s, Mexico enjoyed high rates of economic growth (averaging over 6 percent per annum), moderately low inflation, and rapidly improving social indicators. This was one of the success stories among developing countries and was often referred to as the "Mexican miracle." During most of this period, the government relied primarily on private sector-led growth (although key sectors such as oil were in government hands), maintained fiscal discipline, and invested heavily in social sector development. Despite this progress, a significant share of Mexico's population remained in poverty, especially in rural areas and among the large indigenous communities.

3. However, the post-war period was also characterized by progressive expansion in tariff protection and quantitative restrictions, fiscal incentives and subsidized credit to priority sectors, and restrictive regulations on business entry and operations, especially for foreign direct investments. The early 1970s saw a rapid shift in favor of public-sector led growth coupled with expansionary fiscal policies. This shift toward state-led development accelerated following the discovery of major new oil reserves in the mid-1970s when oil prices were very high. Relying on this new mineral wealth, the government expanded public investments both in the national oil company (PEMEX) and in nonoil sectors. The resulting fiscal deficits were financed by massive foreign borrowings, primarily syndicated bank loans. Between 1970 and 1983 the share of total manufacturing output (excluding the petroleum sector) produced by public enterprises grew from 4 percent to 8.8 percent. The government's primary fiscal deficit (i.e., the deficit excluding interest payments) grew from 0.4 percent of GDP in 1971 to 8 percent of GDP in 1981, bringing about steadily increasing inflation. Foreign debt increased from US$7 billion in 1972 to US$78 billion in 1981. But rising world interest rates and falling oil prices made these policies unsustainable. In August 1982, with its foreign reserves exhausted, Mexico devalued the peso and declared a temporary suspension of foreign debt service, triggering the developing country debt crisis of the 1980s. In September 1982, it nationalized the entire private banking system, which had become insolvent subsequent to the devaluation.

4. For the remainder of the 1980s, Mexico struggled to stabilize the economy and restore growth while coping with the accumulated burden of foreign debt. Initial efforts focused on stabilization policies. The *primary* fiscal balance (excluding interest payments on the stock of public debt) shifted from a deficit of 8 percent of GDP in 1981 to a surplus of 5.6 percent in 1987, due primarily to deep cuts in public investments and increases in revenues from public enterprises. However, the payments on the massive stock of domestic and foreign debt amounted to more than 12 percent of GDP during these years. Without access to net foreign financing, the government financed the huge fiscal deficits with credits from the domestic banking system. Inflation surged to 159 percent in 1987. The economy was absolutely stagnant, real wages and living standards deteriorated sharply, and per capita GDP fell 11 percent between 1982 and 1988. Social expenditures were cut, and poverty indices rose significantly. The massive Mexico City earthquake in 1985 and the second collapse in oil prices in 1986 compounded these severe problems.

5. As this economic disaster unfolded, there emerged within the administration of President de la Madrid (1982–88) three new approaches to economic management. First, there was a growing recognition among Mexican policymakers that *structural reforms* would be required to regain stability and restore growth. In July 1985 Mexico initiated a trade liberalization intended to promote the growth of exports and to induce efficiency in import-competing sectors. Average tariffs fell from 23.5 percent in June 1985 to 11.0 percent in June 1988, and in 1986 Mexico became a member of GATT. A modest program of privatization of public enterprises was started, and rules governing foreign direct investment were relaxed. Second, in December 1987, the government announced a *heterodox stabilization package* called the Economic Solidarity Pact (the “Pacto”). This agreement between business, labor, and government called for accelerated structural reforms, further tightening of fiscal and monetary policies, controls on wages and basic prices, and a freeze of the nominal exchange rate against the US dollar. The Pacto, which was renewed under the name of PECE in 1989 and continued through 1994, succeeded in bringing down the fiscal deficit and in reducing inflation to an average of 20 percent in 1989–92. Third, following several experimental approaches to debt-equity swaps and collateralized debt exchanges, Mexico reached agreement in July 1989 on the first “Brady Deal” which provided some *reduction in its external debt* to international commercial banks. Under this plan, annual interest payments fell by US$1.3 billion. Taken together, these three developments significantly improved the medium- and longer-term outlook and restored a good measure of confidence among domestic and international investors.

6. In addition to these three major developments, the administration of President Salinas, which took office in December 1988, pursued a wide-ranging program of reforms designed to consolidate an open, market-oriented economy. After several years of negotiation, in January 1994 Mexico entered into the North American Free Trade Agreement (NAFTA) that locked in an open trade regime with its major trading partners. It dramatically accelerated the privatization program, including both large enterprises such as the telecommunications company (Telmex) and the previously nationalized banks. This program provided substantial financial gains. Revenues from the sales—US$21.9 billion—were used primarily to reduce public domestic debt by about 10

percent of GDP. Government net transfers to state enterprises fell from 12.7 percent of GDP in 1982 to 2.5 percent in 1991. In the financial sector, deposit and lending interest rates were liberalized, reserve requirements were eliminated, and prudential regulations were improved, although supervision capacity was virtually nonexistent. Between June 1991 and June 1992, 18 banking groups that had been nationalized following the 1982 crisis were sold to private, domestic shareholders. In manufacturing, previous government programs and regulations to guide the growth of priority sectors were gradually eliminated. In the agriculture sector, the government discarded most nontariff barriers to trade, closed many parastatals, slashed input subsidies, removed official targets for crop production, and amended the constitution to permit privatization of communally-held lands known as *ejidos*. A host of other measures to deregulate the economy and to provide a stronger legal and institutional framework for private sector-led growth were adopted.

7. The initial economic results from this dramatic period of sweeping reforms were positive. After almost a decade of stagnation, GDP growth averaged 3.5 percent annually during 1989–92, and inflation fell to 8 percent in 1993—the lowest level in more than 20 years. Manufacturing exports grew rapidly from US$4.1 billion in 1985 when the trade liberalization began to US$16 billion in 1991. The surge in investor confidence in Mexico, global interest in "emerging markets," and the fixed exchange rate regime brought about an incredible increase in capital inflows. Net capital flows (both short-term and long-term) shifted from a negative US$0.8 billion in 1988 to a positive US$23.9 billion in 1991 and US$26.8 billion in 1992. These inflows, of which the largest share was portfolio investment and short-term capital, were sufficient to finance not only a huge expansion in imports—primarily for consumption rather than investment—but also a US$12 billion increase in foreign reserves during 1990–92. But as a consequence of these inflows, the real exchange rate appreciated very sharply, potentially jeopardizing Mexico's export competitiveness and creating a dangerous dependency on continuing inflows. Indeed, by 1993, led by a decline in exports and the domestic production of tradables, GDP growth fell to 1.9 percent (in 1993 constant pesos). Policy debate began to focus on why the economic response to the reform program was so modest. Attention also focused on the risks associated with the continued use of the nominal exchange rate as an anchor against inflation and with the resulting large current account deficit, which reached 7 percent of GDP in 1994. However, in the run-up to the July 1994 election and during the transition period following the election, no effort was made to correct the exchange rate policy.

8. Beneath the surface of this apparently successful stabilization, a potential crisis was developing rapidly in the banking sector. From 1989 through 1994, domestic credit grew at annual rates over 30 percent. After 1992, the bulk of this credit expansion was lending from the newly privatized banking system to the private sector, fueling the consumption boom, the rapid growth of imports, and the widening current account deficit. Commercial banks were making important credit decisions too fast, and the regulatory and supervisory agency did not have the capacity to track the soundness of these decisions. The banks started reporting increasing levels of non-performing assets, but these reports understated the problem because many loans were reported as performing only because they were continuously refinanced. As the banking system began facing liquidity problems in early 1994, the central bank started to provide them credit.

Compounded by the political uncertainties arising from the guerilla uprising in Chiapas in January 1994 and the assassination of the ruling party's presidential candidate in March 1994, pressure on the peso grew. After various measures to prevent or at least postpone a run against the currency, the newly inaugurated Zedillo administration devalued—and then floated—the peso in December 1994. Within three months, the peso depreciated by more than 100 percent, inflation jumped to about 50 percent, and domestic interest rates went to over 100 percent. A major financial crisis developed as neither businesses nor households could service their debt and most of the Mexican banks faced insolvency.

9. The financial crisis plunged Mexico into a deep recession. In 1995 GDP fell by 6.2 percent, domestic fixed investment dropped by 30 percent, and formal sector unemployment doubled. By March 1995, the government announced a new adjustment program, including a further tightening of monetary and fiscal policies, steps to deal with the severe distress in the banking system, and measures to strengthen the social safety net. Led by the IMF and the U.S. Treasury, the international community provided a package of US$54 billion in new credits to repay all creditors, rebuild Mexico's international reserves, stabilize the exchange rate, and restore investor confidence. The government purchased huge amounts of non-performing assets of the banking system through the issuance of domestic bonds, imposing a fiscal burden for years to come. By 1996 an export-led recovery was underway: GDP rose 5.1 percent in 1996 and 6.8 percent in 1997. Despite the turmoil in international capital markets due to the Asian and Russian crises in 1997–98 and the associated drop in world oil prices, the Mexican economy continued to grow in 1998 and 1999, with inflation falling below 20 percent. The combined effects of the trade liberalization, NAFTA, and the devaluation have brought about an export boom. Merchandise exports surged from about US$61 billion in 1994 to almost US$130 billion in 1999, and exports as a share of GDP have grown from 16.8 percent to over 34 percent over this period. However, this rapid recovery has been limited to export-oriented and large firms that enjoy access to foreign credit. Because of their fragile balance sheets and cash flow constraints, the banking system has been able to provide almost no credit to small and medium enterprises and consumers.

10. On balance, despite the massive setback from the 1994–95 crisis, the Mexican economy had an annual average growth rate of 2.5 percent during the 1990s (based on its trend line). This is much better than the 0.3 percent rate during the 1980s. The economic liberalization and structural reforms since 1985 have put Mexico on a higher growth track. Nevertheless, the results so far have been far below expectations. Given the annual population and labor growth rates of 1.9 percent and 3.0 percent respectively, the modest growth record of the 1990s has not been sufficient to reduce poverty in Mexico. Indeed, 1998 per capita GDP in constant 1993 pesos is the same as that of 1981. Based on consumption measures, the percentage of the population living below a moderate poverty line has changed very little. Between 1984 and 1989, that percentage fell from 29.9 percent to 26.3 percent. By 1994, it had fallen further to 23.3 percent, reflecting both the resumption of growth and government programs such as Solidaridad for improving public services in poor areas. In the aftermath of the deep recession, the poverty headcount deteriorated to over 28 percent in 1996. Although more recent data are not available, it is very likely that the share in poverty has decreased over the past three years. Since 1997 the government's anti-poverty efforts have focused on a new

program (PROGRESA) that provides payments for education, health and nutrition services to 2.6 million poor households in rural and semi-rural areas.

11. In the context of these dramatic swings in economic performance, there has been a rather steady trend in Mexico toward political liberalization. For almost seventy years the Mexican political system was totally dominated by the Institutional Revolutionary Party (PRI). In 1989 an opposition party first won a state governorship, and since then elections for Congressional and local government have become increasingly competitive. In 1994 the PRI's candidate, Ernesto Zedillo, won the presidency while opposition parties won several state governorships. In the mid-term elections in 1997, opposition parties won a majority in the lower house of Congress, resulting in frequent challenges to the policy initiatives of the administration. In July 2000, Vicente Fox, the candidate of the conservative Partido de Acción Nacional (PAN) won the presidential election, ending the 70 year reign of the PRI. No party won a majority in the national Congress, and governorship among the states are shared among the three major parties.

12. This political liberalization has been accompanied by an accelerating process of decentralization of government responsibilities and resources. States and municipalities now have responsibility for most education, health, and basic infrastructure services, and the federal government is now obligated to transfer substantial fiscal resources to local governments. This process is still unfolding, but it is almost certainly irreversible and will significantly affect the way the country operates in the decades ahead.

13. Two other significant developments during recent decades have been important in describing the context within which the World Bank has worked in Mexico: the continuing urbanization of the country, and its environmental problems. Over the course of the past several decades, Mexico has been transformed by the growth of major urban centers, and now about 75 percent of the population is urban. The Mexico City area is one of the largest urban conglomerations in the world. This has brought about serious brown environmental problems of air and water pollution from industrial, vehicular and human wastes. Also, Mexico has become increasingly aware of green environmental issues, especially the need to protect its forests and coastal areas and to preserve its immense biodiversity.

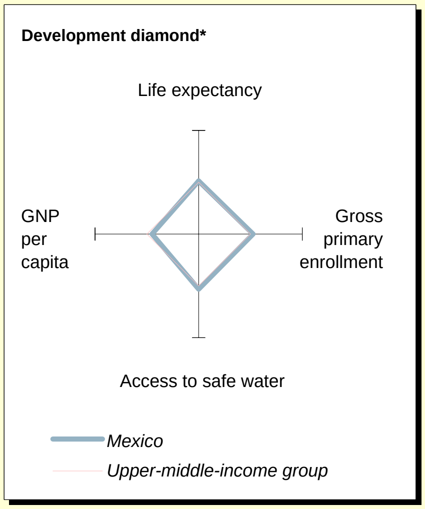
Annex II

Statistical Information

Annex Table 1. Mexico at a glance

#######

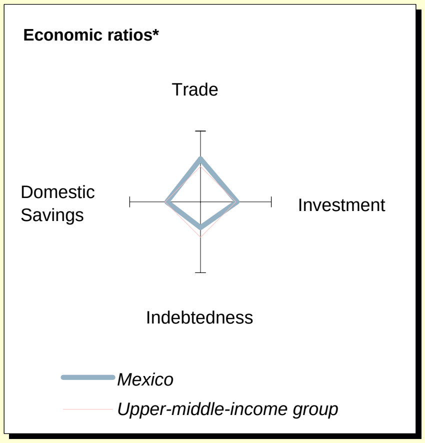
POVERTY and SOCIAL	**Mexico**	**Latin America & Carib.**	**Upper-middle-income**
1999			
Population, mid-year *(millions)*	97.4	509	573
GNP per capita *(Atlas method, US$)*	4,410	3,840	4,900
GNP *(Atlas method, US$ billions)*	429.6	1,955	2,811
Average annual growth, 1993-99			
Population *(%)*	1.7	1.6	1.4
Labor force *(%)*	3.0	2.5	2.1
Most recent estimate (latest year available, 1993-99)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	74	75	76
Life expectancy at birth *(years)*	72	70	70
Infant mortality *(per 1,000 live births)*	30	31	27
Child malnutrition *(% of children under 5)*	..	8	7
Access to improved water source *(% of population)*	83	75	78
Illiteracy *(% of population age 15+)*	9	12	10
Gross primary enrollment *(% of school-age population)*	114	113	109
Male	116	..	..
Female	113	..	..



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

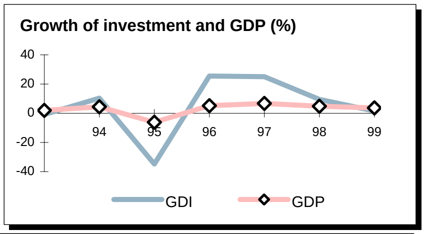
	1979	1989	1998	1999
GDP *(US$ billions)*	134.5	223.0	416.3	483.7
Gross domestic investment/GDP	26.0	22.9	24.3	23.2
Exports of goods and services/GDP	11.2	19.0	30.8	30.8
Gross domestic savings/GDP	24.7	22.9	22.3	21.9
Gross national savings/GDP	21.7	20.3	20.5	20.6
Current account balance/GDP	-4.1	-2.6	-3.9	-2.9
Interest payments/GDP	2.5	3.5	2.4	1.7
Total debt/GDP	31.8	42.1	38.4	34.0
Total debt service/exports	72.4	32.9	19.2	24.6
Present value of debt/GDP	..	..	37.4	33.0
Present value of debt/exports	..	..	111.5	100.4

	1979-89	1989-99	1998	1999	1999-03
(average annual growth)					
GDP	1.3	2.9	4.8	3.7	4.9
GNP per capita	-0.9	1.1	3.1	2.5	3.2
Exports of goods and services	8.4	13.6	12.0	13.9	7.4



STRUCTURE of the ECONOMY

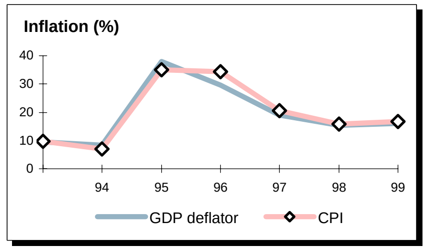
	1979	1989	1998	1999
(% of GDP)				
Agriculture	9.8	7.8	5.3	5.0
Industry	33.4	29.4	28.5	28.2
Manufacturing	22.7	21.9	21.3	21.1
Services	56.7	62.9	66.3	66.8
Private consumption	64.4	68.9	67.3	68.0
General government consumption	10.9	8.3	10.4	10.0
Imports of goods and services	12.5	19.1	32.8	32.0



	1979-89	1989-99	1998	1999
(average annual growth)				
Agriculture	1.2	1.7	0.8	3.5
Industry	0.9	3.5	6.3	3.8
Manufacturing	1.1	4.0	7.3	4.1
Services	1.8	2.7	4.5	3.6
Private consumption	1.4	2.2	5.5	4.3

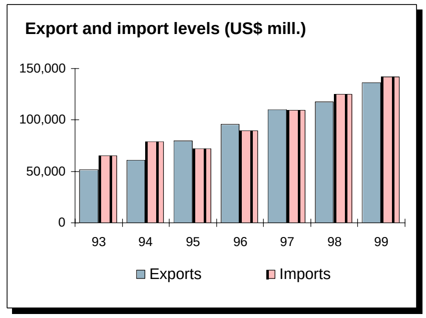
PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
Domestic prices				
(% change)				
Consumer prices	..	20.0	15.9	16.7
Implicit GDP deflator	19.6	26.5	15.4	15.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	25.8	20.4	20.7
Current budget balance	..	-1.8	2.1	1.7
Overall surplus/deficit	..	-4.6	-1.2	-1.1



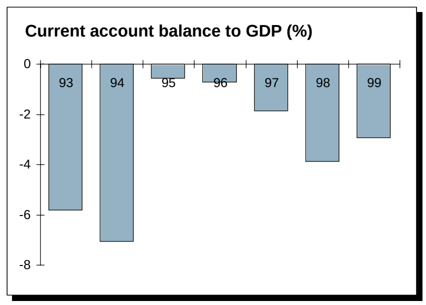
TRADE

	1979	1989	1998	1999
(US$ millions)				
Total exports (fob)	..	35,171	117,460	136,391
Oil	..	7,876	7,134	9,928
Agriculture	..	1,754	3,797	3,926
Manufactures	..	24,936	106,062	122,085
Total imports (cif)	..	34,766	125,373	141,975
Consumer goods	..	3,499	11,109	12,175
Intermediate goods	..	26,499	96,935	109,270
Capital goods	..	4,769	17,329	20,530
Export price index *(1995=100)*	..	96	95	98
Import price index *(1995=100)*	..	89	100	99
Terms of trade *(1995=100)*	..	108	94	99



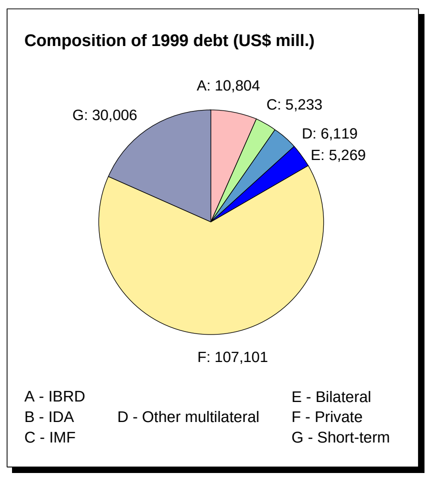
BALANCE of PAYMENTS

	1979	1989	1998	1999
(US$ millions)				
Exports of goods and services	15,131	42,362	128,982	148,083
Imports of goods and services	16,704	42,426	137,801	155,465
Resource balance	-1,573	-63	-8,818	-7,382
Net income	-4,111	-8,302	-13,284	-13,083
Net current transfers	131	2,544	6,012	6,313
Current account balance	-5,553	-5,821	-16,090	-14,153
Financing items (net)	5,868	6,093	18,227	14,746
Changes in net reserves	-315	-272	-2,137	-594
Memo:				
Reserves including gold *(US$ millions)*	..	6,376	29,032	31,829
Conversion rate *(DEC, local/US$)*	2.3E-02	2.5	9.2	9.6



EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
(US$ millions)				
Total debt outstanding and disbursed	42,765	93,826	159,962	164,532
IBRD	1,731	7,821	11,514	10,804
IDA	0	0	0	0
Total debt service	11,591	15,559	26,778	39,072
IBRD	221	1,245	2,024	2,171
IDA	0	0	0	0
Composition of net resource flows				
Official grants	27	37	32	..
Official creditors	284	936	-776	-1,262
Private creditors	3,798	-2,397	12,219	6,308
Foreign direct investment	1,332	3,037	10,238	11,568
Portfolio equity	0	0	730	3,769
World Bank program				
Commitments	527	2,325	2,212	1,616
Disbursements	326	1,297	1,283	839
Principal repayments	76	677	1,257	1,326
Net flows	250	620	26	-487
Interest payments	145	567	767	846
Net transfers	105	52	-741	-1,332



Annex Table 2. Mexico: Key Economic and Social Indicators, 1991-99

Indicator	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*Mexico Average 91-99*	*Argentina Average 91-99*	*Brazil Average 91-99*	*Poland Average 91-99*	*Portugal Average 91-99*	*Latin America & Caribbean Average 91-99*
GDP growth (annual %)	3	-4	2	1	4	5	4	4	2	4	-6	5	7	5	4	3	5	3	4	3	3
GNI per capita, Atlas method (current US$)	2,180	1,990	1,960	2,050	2,360	2,830	3,290	3,810	4,230	4,590	3,800	3,660	3,710	4,000	4,440	3,948	7,098	3,698	3,029	9,930	3,338
GNI per capita, PPP (current international $)	5,050	5,120	5,550	5,850	5,970	6,200	6,470	6,840	6,970	7,260	6,890	7,220	7,590	7,750	8,070	7,229	10,847	6,357	6,676	13,723	6,111
GNP per capita growth (annual %)	2	-6	1	0	2	4	3	2	0	2	-9	4	6	4	3	2	4	1	4	2	1
Agriculture, value added (% of GDP)	10	10	10	8	8	8	8	7	6	6	5	6	6	5	5	6	6	8	5	5	8
Manufacturing, value added (% of GDP)	24	25	26	24	22	21	21	20	19	19	21	22	21	21	21	21	20	24	19	…	22
Services, etc., value added (% of GDP)	55	55	52	60	63	64	64	65	67	67	67	66	66	66	67	66	65	57	59	68	59
Exports of goods and services (% of GDP)	15	17	20	20	19	19	16	15	15	17	30	32	30	31	31	24	9	9	25	29	14
Imports of goods and services (% of GDP)	10	13	13	19	19	20	19	20	19	22	28	30	30	33	32	26	10	9	26	37	16
Current account balance (% of GDP)	0	-1	3	-1	-3	-3	-5	-7	-6	-7	-1	-1	-2	-4	-3	-4	-3	-2	-3	-3	
Total debt service (% of exports of goods and services)	44	44	33	37	33	21	24	34	36	28	28	36	33	20	25	29	41	47	10	…	30
Gross international reserves in months of imports	2	3	5	2	2	2	3	3	3	1	2	2	2	2	2	2	6	7	4	7	5
Gross domestic savings (% of GDP)	26	22	25	24	23	22	20	18	17	17	22	25	26	22	22	21	17	20	19	17	20
Inflation, consumer prices (annual %)	58	86	132	114	20	27	23	16	10	7	35	34	21	16	17	20	24	609	30	5	
Current revenue, excluding grants (% of GDP)	15	15	16	15	16	15	15	15	15	15	15	15	15	13	..	15	13	24	36	34	20
Expenditure, total (% of GDP)	23	28	30	25	20	18	15	14	15	15	16	15	16	15	..	15	14	30	39	41	23
Overall budget deficit, including grants (% of GDP)	-8	-13	-14	-9	-5	-3	3	4	1	0	-1	0	-1	-1	..	1	-1	-5	-2	-4	-3
Population, total	75	77	79	80	82	83	85	86	88	90	91	93	94	95	97	91	35	159	39	10	478
Population growth (annual %)	2	2	2	2	2	2	2	2	2	2	2	2	1	1	1	2	1	1	0	0	2
Urban population (% of total)	70	70	71	71	72	73	73	73	73	73	73	74	74	74	74	73	88	78	64	56	73
Illiteracy rate, adult total (% of people ages 15+)	15	14	14	13	13	12	12	11	11	11	10	10	10	9	9	10	4	17	0	10	13
School enrollment, primary (% gross)	118	117	115	115	114	114	114	114	114	115	115	114	..	..	..	114	111	114	98	127	110
Immunization, DPT (% of children under 12 months)	40	34	62	60	65	66	78	91	85	91	92	94	95	96	96	91	82	79	96	95	82
Improved water source (% of population with access)	82	..	..	..	..	83	..	..	83	..	..	..	..	..	..	83	65	…	…	82	…
Sanitation (% of pop. with access)	57	..	..	..	..	69	..	..	66	..	..	..	..	..	..	66	75	67	…	…	…
Life expectancy at birth, total (years)	69	..	70	..	..	70	..	71	..	..	72	..	72	..	72	72	73	67	72	74	69
Mortality rate, infant (per 1,000 live births)	43	..	40	..	..	36	..	34	..	..	32	..	31	..	29	32	21	37	13	8	33

Source: WDI database as of April 25, 2001.

Annex Table 3. Official Assistance Flows to Mexico (total receipts net)

A. Net Receipts per Year from all Donors: 1985-1998, (US$ million)

Donors	*85-90*	*91-98*	*1996*	*1997*	*1998*
DAC DONORS	-911	7,620	7,747	8,201	7,508
TOTAL MULTILATERAL	1,075	469	426	-109	341
of which: IBRD	83	17	-84	291	8
IDA	…	…	…	…	…
IDB	13	74	174	-222	99
Other	-292	685	931	-2,433	2,538
TOTAL DONORS	156	8,089	8,172	8,092	7,849

Source: Geographical Distribution of Financial Flows to Aid Recipients 1994-1998, OECD.

B. World Bank Commitments by Sectors for FY80-00, (US$ million)

Sectors	*80-90*	*91-00*	*1997*	*1998*	*1999*	*2000*	*2001*
Agriculture	2,941	1,466	85	47	444	55	
Education	251	1,928		595			
Environment		1,009					404
Finance	560	2,448	400		506	505	
Health, Nutrition & Population		1,215		725			
Industry	2,225						
Mining	145	200					
Private Sector Development	500	530					
Public Sector Management		1,114				609	505
Social Protection		900		400			
Telecommunications	22						
Transportation	1,452	1,943	475				218
Urban Development	1,438	650					
Total	13,549	14,542	960	1,767	950	1,169	1,127

Source: World Bank Business Warehouse as of April 24, 2000.

Annex Table 4. Economic and Sector Work for Mexico Since 1989

Sector	*Report #*	*Report Date*	*Title*
			Sector Reports
Agriculture	7609	Apr-89	Mexico - Agricultural sector report
Agriculture	8311	Feb-90	Policy responses to the collapse of world coffee prices : Costa Rica, Mexico and El
Agriculture	8967	Aug-90	Mexico - Cost recovery in the irrigation and drainage sector
Agriculture	10020	Oct-91	Mexico - Study on impact of policy reforms on agricultural growth
Agriculture	9297	Aug-92	Mexico - Agricultural technology sector review
Agriculture	11774	Mar-93	Mexico - Review of conditions for encouraging private investment in irrigation
Agriculture	13425	Sep-94	Mexico - Agricultural sector memorandum
Agriculture	14962	Nov-95	Mexico - Issues in agriculture, natural resources, and rural poverty
Agriculture	19167	Jun-99	Mexico - Strategic information system for Mexico's rural sector : a proposal.
Education	8930	Jun-91	Basic education in Mexico : trends, issues and policy recommendations
Education	10129	Oct-92	Mexico - The initial education strategy
Electric Power & Other Energy	9304	Jan-91	Sectoral electricity demand in Mexico a forecasting model
Environment	8310	Mar-90	Mexico - Enhancing the contribution of the land reform sector to Mexican agricultural
Environment	10045	Mar-92	Mexico - Transport air quality management in the Mexico City
Environment	10646	May-92	Mexico - Soil conservation sector review
Environment	10589	Aug-92	Mexico - Environmental issues and strategy paper
Environment	13175	Oct-94	Mexico - Integrated pollution management : selected issues
Environment	13114	Mar-95	Mexico - Resource conservation and forest sector review
Environment	16221	Dec-96	Latin America and Caribbean Region - Market based instruments for environmental
Environment	18071	Sep-98	Mexico - The Guadalajara Environmental Management Pilot
Environment	19458	Jun-99	Mexico - Guadalajara environmental management pilot an update
Finance	9198	Dec-90	Mexico - Development banks issues a framework of analysis and suggested bank strategy
Finance	14599	Aug-95	Mexico - Rural Financial Markets
Finance	16373	Dec-97	Mexico - Mobilizing savings for growth
Finance	17733	Apr-98	Mexico - Financing the real sector
Industry	8165	Aug-90	Mexico - Industrial policy and regulation
Industry	19864	Sep-00	Mexico - Export dynamics and productivity : analysis of Mexican manufacturing in the 1990s.
Mining	7379	Apr-89	Mexico - Mining sector review
Multisector	7786	May-89	Mexico - Strategy proposal for regional - rural development in the disadvantaged states
Multisector	7813	Jun-89	Mexico - Selected policy papers
Multisector	8144	Feb-90	Mexico - Policy notes on agriculture, food and rural development
Multisector	10851	Jun-92	Mexico - Sector review adjustment in agriculture to the free trade agreement
Multisector	21896	Sep-95	Mexico - The equilibrium informal sector : a dynamic approach.
Multisector	15058	May-96	Mexico - Rural poverty
Multisector	15692	Jun-96	Mexico - Poverty reduction : the unfinished agenda
Multisector	19945	May-00	Mexico - Earnings inequality after Mexico's economic and educational reforms.
Multisector	19870	Apr-00	Mexico - Institutional coordination for regional sustainable development.
Health, Nutrition & Population	7802	May-89	Mexico - Health sector expenditures and financing report
Health, Nutrition & Population	8929	Jul-90	Mexico - Nutrition sector memorandum
Health, Nutrition & Population	15374	Oct-96	Mexico - Health reform under the 1995 social security law issues and actions
Public Sector Management	9017	Oct-90	Mexico - Contractual savings report
Public Sector Management	8924	Jul-91	Mexico - Decentralization and urban management in Mexico sector study
Transportation	7964	Jun-89	Lazaro Cardenas - Central Mexico corridor study
Transportation	12654	May-94	Mexico - The end of transition a review of the tranport sector
Urban Development	11189	Sep-92	Housing delivery system and the urban poor a comparison among 6 LA countries
Water Supply & Sanitation	8150	Nov-89	Mexico - Mexico City metropolitan area water supply and sewerage sector overview
Water Supply & Sanitation	19941	Dec-99	Mexico - Policy options for aquifer stabilization.
			Economic Reports
Finance	11823	May-94	Mexico - Country economic memorandum fostering private sector development in the
Multisector	7785	May-89	Poverty alleviation in Mexico
Multisector	11991	Jun-93	Mexico - Recent developments in Mexico's exchange rate policy
Multisector	12604	Dec-93	Monetary policy in Mexico under NAFTA
Multisector	12605	Jun-94	Mexico - Reform and productivity growth
Multisector	17392	May-98	Mexico - Enhancing factor productivity growth country economic memorandum
Multisector	18899	Feb-99	Mexico - Indigenous peoples profile
Public Sector Management	8097	Nov-89	Mexico - Tax reform for efficient growth
Public Sector Management	8770	May-91	Mexico in transition : towards a new role for the public sector
Health, Nutrition & Population	18899	Feb-99	Mexico - Indigenous peoples profile.

Annex Table 5. OED and QAG Ratings for Mexico and Comparator Countries

Table A. OED Ratings

Country	*Total evaluated*	*Of which Adjustment (US$million)*	***Outcome (percent)*** *Satisfactory*	*Satisfactory Adjustment*	***ID Impact (percent)*** *Satisfactory*	*Satisfactory Adjustment*	***Sustainability (percent)*** *Satisfactory*	*Satisfactory Adjustment*
				Before 1991				
Bankwide	202,737	34,555	72%	68%	34%	38%	54%	56%
LCR	52,378	11,909	67%	73%	34%	46%	58%	75%
Mexico	***15,342***	***5,011***	***80%***	***100%***	***47%***	***70%***	***70%***	***100%***
Argentina	3,561	1,146	39%	26%	27%	31%	69%	69%
Brazil	14,865	1,135	58%	42%	29%	0%	45%	42%
Poland	565	…	30%	…	30%	…	74%	…
Portugal	916	…	72%	…	44%	…	82%	…
				1991-1999				
Bankwide	80,124	43,919	86%	90%	47%	47%	67%	71%
LCR	20,683	11,202	86%	88%	54%	58%	70%	71%
Mexico	***5,829***	***2,500***	***77%***	***60%***	***37%***	***16%***	***55%***	***28%***
Argentina	5,044	3,900	98%	100%	73%	78%	89%	92%
Brazil	3,272	1,010	82%	100%	39%	25%	79%	100%
Poland	1,793	1,284	100%	100%	77%	77%	93%	100%
Portugal	…	…	…	…	…	…	…	…

* The Institutional Development Impact and Sustainability ratings have been in use only since FY89. Hence, the data for these two ratings for the period before FY91 apply for smaller levels of total net commitment than sown in columns 2 and 3 of the table.

Source: OED Ratings database as of April 25, 2001.

Table B. QAG Ratings

Region	*Number of Projects*	*Net Commitment ($US million)*	*Projects at Risk (percent)*	*Commitments at Risk (percent)*
Bankwide	1,567	106,872	15	14
LCR	317	23,983	15	16
Mexico	***25***	***5,050***	***4***	***10***
Argentina	42	4,583	14	17
Brazil	56	6,418	13	17
Poland	14	1,304	0	0

Source: World Bank Business Warehouse as of April 25, 2001.

Annex Table 6. Loan Portfolio Indicators for Mexico

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Percent With Problems In Achieving Development Objectives											
Mexico	0.08	0.03	0.03	0.03	0.03	0.09	0.06	0.03	0.07	0.04	0.08
LCR Region	0.08	0.09	0.1	0.08	0.08	0.01	0.06	0.08	0.06	0.08	0.05
Percent With Problems In Implementation Performance											
Mexico	0.11	0.05	0.08	0.13	0.05	0.09	0.19	0.23	0.1	0.07	0.13
LCR Region	0.15	0.21	0.22	0.17	0.13	0.2	0.2	0.19	0.11	0.12	0.07

Annex Table 7. Mexico: World Bank Project Ratings

Project ID	Project name	Approval date	Approval FY	Net comm amt	OED Rating			ARPP Rating*	
					Outcome	Sustainability	Institutional development impact	Latest DO**	Latest IP***
P007609	HYDROELEC DEV	6/8/1989	1989	460.0	Moderately Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007659	IND RSTRUCTRNG	4/27/1989	1989	250.0	Moderately Satisfactory	Likely	Negligible	Unsatisfactory	Unsatisfactory
P007670	WTR, WOMEN&DEV	6/22/1989	1989	0.0	Unsatisfactory	Not Rated	Not Rated	1	4
P007691	FIN SEC ADJ	6/13/1989	1989	486.4	Satisfactory	Likely	Substantial	Highly Satisfactory	Highly Satisfactory
P007692	PUB ENTERP REF I	6/13/1989	1989	499.4	Satisfactory	Likely	Modest	1	1
P007693	IND SEC POLICY	6/13/1989	1989	497.5	Highly Satisfactory	Likely	Substantial	1	2
P007598	AG MRKTNG II	12/12/1989	1990	100.0	Moderately Satisfactory	Uncertain	Modest	Satisfactory	Satisfactory
P007640	FORESTRY DEV	8/29/1989	1990	16.3	Unsatisfactory	Unlikely	Modest	Unsatisfactory	Unsatisfactory
P007709	SPEC INTERST SUPPRT	1/30/1990	1990	1,260	Highly Satisfactory	Likely	Substantial		
P007662	TRANSM/DISTRIB PRJ	4/17/1990	1990	450.0	Moderately Satisfactory	Uncertain	Modest	Satisfactory	Satisfactory
P007669	LOW-INC HSNG II	12/12/1989	1990	350.0	Satisfactory	Likely	Modest	Satisfactory	Satisfactory
P007699	RD TRNS/TELECOM SCT ADJ	5/29/1990	1990	380.0	Highly Satisfactory	Likely	Substantial	1	1
P007717	TELECOMM T.A.	5/29/1990	1990	22.0	Moderately Satisfactory	Likely	Modest	Satisfactory	Satisfactory
P007647	WTR SUPP & SANIT SCT	11/29/1990	1991	299.5	Moderately Unsatisfactory	Uncertain	Modest	Satisfactory	Satisfactory
P007649	EXPORT SCTR	3/26/1991	1991	300.0	Satisfactory	Likely	Modest	1	1
P007655	BASIC HEALTH	11/29/1990	1991	136.2	Moderately Satisfactory	Uncertain	Modest	Highly Satisfactory	Satisfactory
P007661	AG SCTR/FOOD SECURITY	6/25/1991	1991	400.0	Satisfactory	Likely	Substantial	Highly Satisfactory	Highly Satisfactory
P007672	MINING SCTR	6/25/1991	1991	171.7	Satisfactory	Likely	Substantial	Unsatisfactory	Unsatisfactory
P007688	DECENTRALIZTN & REGL	3/26/1991	1991	350.0	Satisfactory	Uncertain	Modest	Highly Satisfactory	Satisfactory
P007704	fOC TRNG SCTR	6/25/1991	1991	134.0	Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007667	IRRIG SCTR	12/3/1991	1992	350.0				Satisfactory	Satisfactory
P007676	SCIENCE/TECH	5/26/1992	1992	187.0	Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007682	AGR.TECHNOLOGY	5/5/1992	1992	23.4	Unsatisfactory	Unlikely	Negligible	Highly Unsatisfactory	Highly Unsatisfactory
P007690	PRIMARY EDUCATION	9/26/1991	1992	195.2	Satisfactory	Likely	Modest	Highly Satisfactory	Highly Satisfactory
P007696	HOUSING MARKET DEVEL	6/25/1992	1992	450.0	Satisfactory	Likely	Modest	Satisfactory	Satisfactory
P007703	ENVIRON/NATURL RESOU	4/14/1992	1992	19.5	Moderately Unsatisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007648	MEDIUM CITIES TRANSP	2/16/1993	1993	177.0				Satisfactory	Satisfactory
P007694	TRNSPRT AIR POLL CON	12/15/1992	1993	91.8	Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007716	INITIAL EDUCATION	9/8/1992	1993	28.4	Satisfactory	Likely	Modest	Satisfactory	Satisfactory
P007723	HWY RHB & SAFETY	6/24/1993	1993	480.0				Satisfactory	Highly Satisfactory
P007724	LABOR MARKET & PROD.	12/15/1992	1993	174.0	Satisfactory	Likely	Substantial	Satisfactory	Highly Satisfactory
P007612	SOLID WASTE II	6/9/1994	1994	6.9				Satisfactory	Satisfactory
P007701	ON-FARM & MINOR IRRI	2/17/1994	1994	170.0				Satisfactory	Satisfactory

Project ID	Project name	Approval date	Approval FY	Net comm amt	OED Rating			ARPP Rating*	
					Outcome	Sustainability	Institutional development impact	Latest DO**	Latest IP***
P007707	WATER/SANIT II	6/9/1994	1994	265.7				Unsatisfactory	Unsatisfactory
P007710	N. BORDER I ENVIRONM	6/9/1994	1994	54.6				Satisfactory	Satisfactory
P007725	MX: PRIMARY EDUC.II	3/31/1994	1994	372.0				Highly Satisfactory	Satisfactory
P034161	FINANCIAL SEC T.A.	1/24/1995	1995	37.4				Satisfactory	Satisfactory
P034490	MX: TECHNICAL EDUC/TRAINING	10/27/1994	1995	235.0				Satisfactory	Satisfactory
P007607	RAINFED AREAS DEVELO	7/12/1994	1995	85.0	Moderately Satisfactory	Likely	Negligible	Satisfactory	Satisfactory
P007702	SECOND DECENTRALZTN	9/13/1994	1995	470.7	Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P040462	ESSENTIAL SOCIAL SER	6/22/1995	1995	500.0	Moderately Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P040497	FINAN. SEC RESTRUCTU	6/22/1995	1995	1000.0	Unsatisfactory	Uncertain	Modest	Satisfactory	Satisfactory
P007689	MX: BASIC HEALTH II	9/26/1995	1996	310.0				Highly Satisfactory	Highly Satisfactory
P007713	WATER RESOURCES MANA	6/20/1996	1996	186.5				Satisfactory	Satisfactory
P040685	INFRA. PRIVATZTN TA	8/29/1995	1996	12.1	Satisfactory	Likely	Substantial	Satisfactory	Satisfactory
P007700	COMMUNITY FORESTRY	2/18/1997	1997	15.0				Satisfactory	Satisfactory
P007726	AQUACULTURE	5/1/1997	1997	0.8	Not Rated	Not Rated	Not Rated	Unsatisfactory	Unsatisfactory
P041820	CONTRACTUAL SAVINGS	12/17/1996	1997	400.0	Highly Satisfactory	Uncertain	Modest	Highly Satisfactory	Highly Satisfactory
P007732	RURAL FIN. MKTS T.A.	10/10/1996	1997	0.0				Unsatisfactory	Unsatisfactory
P007711	RURAL DEV. MARG.AREA	1/27/1998	1998	47.0				Satisfactory	Satisfactory
P046006	CONTRACT. SAVINGS II	6/11/1998	1998	400.0	Moderately Satisfactory	Uncertain	Modest	Satisfactory	Satisfactory
P007720	MX: HEALTH SYSTEM REFORM - SAL	6/30/1998	1998	700.0				Satisfactory	Satisfactory
P040199	MX: BASIC EDUC.DEVELOPMENT PHASE I	6/4/1998	1998	115.0				Satisfactory	Satisfactory
P043163	FEDERAL ROADS MODZTN	6/25/1997	1998	0	Not Rated	Not Applicable	Not Rated	Highly Unsatisfactory	Unsatisfactory
P044531	KNOWLEDGE & INNOV.	6/16/1998	1998	300.0				Satisfactory	Satisfactory
P049895	MX: HIGHER ED. FINANCING	6/4/1998	1998	180.2				Satisfactory	Satisfactory
P055061	MX: HEALTH SYSTEM REFORM TA	6/30/1998	1998	25.0				Satisfactory	Satisfactory
P007610	FOVI RESTRUCTURING	3/4/1999	1999	505.0				Satisfactory	Unsatisfactory
P048505	AGRICULTURAL PRODUCT	12/22/1998	1999	444.4				Satisfactory	Satisfactory
P057530	RURAL DEV.MARG.ARII	12/15/1999	2000	55.0				Satisfactory	Satisfactory
P066867	MX DECENTRALIZATION SAL	12/14/1999	2000	606.1				Satisfactory	Satisfactory
P066938	MX GENDER (LIL)	6/16/2000	2000	3.1				Satisfactory	Satisfactory
P067491	BANK RESTRUCTURING FACILITY	12/14/1999	2000	505.1				Highly Satisfactory	Highly Satisfactory
P064887	DISASTER MANAGEMENT	12/7/2000	2001	404.0				Not assigned	Not assigned
P065779	FEDERAL HIGHWAY MAINTENANCE PROJECT	12/14/2000	2001	218.0				Satisfactory	Satisfactory
P070479	EDO DE MEXICO STRUCTURAL ADJUSTMENT LOAN	12/14/2000	2001	505.1				Satisfactory	Satisfactory

* Annual Review of Portfolio Performance

** Development Objective

*** Implementation Progress

Source: Business Warehouse and OED database as of May 14, 2001.

Annex Table 8. Costs of Bank Programs for Mexico and Comparator Countries, FY91-99

Costs

Region and Countries	*Operating Costs ($US million)*				*Distribution (percent)*			
	Total	*Lending*	*Supervision*	*Analytical work*	*Total*	*Lending*	*Supervision*	*Analytical work*
Bankwide	2,292	757.7	897.9	415.1	100%	33%	39%	18%
LCR	381	129.8	152.1	65.6	100%	34%	40%	17%
Argentina	40.9	16.6	16.4	5.1	100%	41%	40%	12%
Brazil	61.0	18.1	28.1	8.8	100%	30%	46%	14%
Poland	34.1	10.4	11.3	6.2	100%	30%	33%	18%
Portugal	0.2	0.0	0.2	0.0	100%	0%	100%	0%
Mexico	47.3	17.9	16.6	9.2	100%	38%	35%	19%

Efficiency

Regions and Countries	*Total Costs ($million)*	*Number of projects*	*Net commitment ($ million)*	*Net commitment for satisfactory and non-risky projects ($million)*	*Costs per project (thousand dollars)*	*Costs per $1000 of net commitment (dollars)*	*Costs per $1000 of net commitment for satisfactory and nonrisky projects (dollars)*	*Project size ($million)*
Bankwide	2,292	2,229	197,103	144,120	1,028	11.6	15.9	88
LCR	381	465	46,957	37,413	819	8.1	10.2	101
Argentina	40.9	64	11,870	10,531	639	3.4	3.9	185
Brazil	61.0	64	9,052	7,248	953	6.7	8.4	141
Poland	34.1	25	3,694	3,374	1,364	9.2	10.1	148
Portugal	0.2	…	…	…	…	…	…	…
Mexico	47.3	46	11,029	8,725	1,028	4.3	5.4	240

Source: World Bank CRM database as of April 24, 2001.
* The amount of total costs includes lending completion costs, supervision, scheduled and unscheduled ESW, and dropped project costs.
** The amount of lending completion costs includes lending completion costs and dropped project costs.
*** The amount of ESW preparation costs includes unscheduled and scheduled ESW preparation costs.

Annex Table 9. International Development Goals

Goal	*Indicator*	*Mexico*			*Most Recent Comparative Data*				
		1990	*1993*	*1997*	*Argentina*	*Brazil*	*Poland*	*Portugal*	*Region*
1. Reduce the proportion of people living in extreme poverty by half between 1990 and 2015	Incidence of extreme poverty: people living on less than $2 a day (%)		40*			43.5	15.1	…	…
2. Enroll all children in primary school by 2015	School enrollment, primary (% net)	99.9	99.9	99.9	99.9	97.1	99.4	99.9	95.2
3. Make progress towards gender equality and empowering women, by eliminating gender disparities in primary and secondary education by 2005	a. Ratio of girls to boys in primary and secondary school	…	…	…	…	…	…	…	…
	b. Ratio of literate females to literate males (15-24 year olds)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
4. Reduce infant and child mortality rates by two-thirds between 1990 and 2015	Mortality rate, infant (per 1,000 live births)	36.4	..	31.0	18.8	34.0	10.2	6.4	31.6
5. Reduce maternal mortality ratios by three-quarters between 1990 and 2015	Maternal mortality ratio (per 100,000 live births)	..	..	..	38.0	..	..	..	..
6. Provide access for all who need reproductive health services by 2015	Contraceptive prevalence (% of women 15-49)	..	..	..	..	..	..	..	64.4
7. Implement national strategies for sustainable development by 2005 so as to reverse the loss of environmental resources by 2015	a. Biodiversity: protected land area	..	..	..	..	..	..	..	..
	b. Energy efficiency: GDP per unit of energy use	4.2	4.7	5.1	6.9	6.5	2.7	7.1	..
	c. CO2 emissions, industrial (kg per PPP$ of GDP)	0.6	0.5	..	..	..	..	..	..

* Survey Year: 1992

Source: World Bank SIMA database.

Annex Table 10. Mexico: Bank's Senior Management, CY89-00

Year	*Vice President*	*Country Director*	*Chief/Resident Representative*
1989	S. Shahid Husain	Rainer Steckhan	Marco Voljc
1990	S. Shahid Husain	Rainer Steckhan	Marco Voljc
1991	S. Shahid Husain	Rainer Steckhan	Eugene D. McCarthy
1992	S. Shahid Husain	Rainer Steckhan	Eugene D. McCarthy
1993	S. Shahid Husain	Rainer Steckhan	Eugene D. McCarthy
1994	Shahid Javed Burki	Rainer Steckhan	Eugene D. McCarthy
1995	Shahid Javed Burki	Edilberto L. Segura	Carl Dahlman
1996	Shahid Javed Burki	Carl Dahlman	Carl Dahlman
1997	Shahid Javed Burki	Oliver Lafourcade	Oliver Lafourcade
1998	Shahid Javed Burki	Oliver Lafourcade	Oliver Lafourcade
1999	David de Ferranti	Oliver Lafourcade	Oliver Lafourcade
2000	David de Ferranti	Oliver Lafourcade	Oliver Lafourcade

(Note: This is a translation of the comments received from Mexico Ministry of Finance and Public Credit on the November 2000 Draft CAE.)

SECRETARIAT OF FINANCE AND PUBLIC CREDIT

DIRECTORATE-GENERAL OF PUBLIC CREDIT

Subdirectorate-General of International Financial Institutions

COMMENTS ON MEXICO COUNTRY ASSISTANCE EVALUATION

(1) It is a positive development that the Bank should carry out this type of evaluation, particularly when it seeks the opinion of its borrower countries. If memory serves correctly, this is the first time an exercise of this kind has been undertaken. It is important that evaluations of the Bank by its borrowers become an ongoing, permanent feature.

(2) The report recognizes that Bank assistance to Mexico is variable and has little impact, and that the institution needs to gear its intervention to conditions in Mexico. However, it is to be regretted that the report does not propose an innovative strategy or creative assistance mechanisms that respond to prevailing conditions and needs in Mexico and to the present context of the world financial system. Generally speaking, the proposals made for the years ahead are based on use of the same instruments employed over the past decade.

(3) In the operational arena, the report makes a commendable call for introduction of a range of realistic loan programs on a par with both the country's liquidity needs and the Bank's development objectives. However, the document does not include any recognition by the Bank that a link needs to be forged between its own role as a source of the liquidity that supports macroeconomic stability and the development processes of its borrower countries.

(4) Again in the operational arena, the proposal that the Bank continue with its means of support for the financial sector is regarded as appropriate. However, it is not clear that the suggestion made for greater use of adaptable lending instruments will solve the main problem affecting the project portfolio, although this instrument certainly offers some operational advantages.

(5) Even though the most beneficial part of the relationship with the World Bank is when it assigns high-quality, experienced personnel on a permanent basis, the report contains no specific proposals to senior management regarding the matter. On this score, the recent decision to merge the Mexico Country Unit with the Venezuela and Colombia Unit is surprising precisely because it does exactly the opposite of focusing additional attention on Mexico.

(6) The references (in paragraph 3.7) to corruption, although based on various sources, are not considered to be properly supported, owing to lack of information on the nature of

this documentation. For that reason, it is believed these comments should be removed from the document.

(7) Although the report recognizes that the Bank needs to work with subnational government entities on a cautious, selective basis, it contains no specific recommendation on the need to develop criteria and procedures as a foundation for this work.

(8) The report notes that, though there is no evidence of this to date, the closer relationship between Bank staff and government officials, one of the results of the Bank's relocation of its Country Director to Mexico City, may reduce the Bank tendency to take positions different from those of the Government (paragraph 3.22). Given the acknowledged lack of evidence so far that this has actually occurred, such a statement is merely theoretical, and is therefore unnecessary in this document. Furthermore, the report does not examine the contribution this decentralization might have made to reestablishing a solid lending program.

(9) The explanation given for IFC's low participation in Mexico (paragraph 2.24) is too general and simplistic. A country the size of Mexico offers a very broad field for IFC participation in a number of sectors (and not only energy).

(10) The report carries its detailed analysis as far as 1998, and deals only superficially with 1999. In fact, it was in 1999 that some of the first results were seen of the work begun in 1997 to shape a more solid program of loans. On this same subject, the report states that one of the difficulties facing the Bank is the Government's limited openness to NGO participation in Bank projects. However, it fails to recognize that there have been major advances in this area over the last few years.

(11) The reference made (in paragraph 1.5) to the increase in extreme poverty is based on a comparison between 1984 and 1996. This is an inappropriate basis for the comparison, however, since 1996 was a particularly critical year. It would be more revealing to take 1999 as the comparator, since by then the reversal of the effects of the crisis on poverty levels had become clear.

December 2000

Attachment 1

Mexico: Country Assistance Evaluation

Management Action Record

Major OED Recommendations	***Management Response***
1. The Bank and the government should reach a common understanding about a reasonable range for Bank lending commitments and disbursements in the coming years that is consistent with the Mexican desires to manage its external debt and the opportunities for the Bank to have non-financial value added in terms of development impact. Two scenarios should be considered: reducing the debt stock to the Bank in order to create additional "surge capacity" for large-scale lending in the event that Mexico faces more limited access to capital markets; or maintaining a robust program of new lending that at least maintains the current debt stock or may use fully the available headroom for Bank exposure to Mexico. Under either scenario, the Bank and government may find that Adaptable Program Loans (APLs) or other programmatic lending instruments could be effective in achieving both value added from Bank involvement and stable disbursements.	Agreed on the need to make full use of the available instruments, especially APLs and Programmatic Lending. The two scenarios however should not necessarily be mutually exclusive, i.e., the Bank should continue lending at the present level of commitments which does leave some "headroom" in case of a crisis (in such case, the relative size of our additional lending is bound to be minimal anyway), but at the same time responds well to the country's need for investment and for well-balanced debt management.
2. The Bank can hope to have non-financial value added in Mexico only if it carefully manages its own human capital. As demonstrated by the successes at the beginning and again at the end of the 1990s and by the problems during the middle years of the decade, efficacy requires that the Bank assign very experienced and capable staff to work on the country for extended periods of time. Furthermore, rotation of staff should be managed carefully to prevent sharp discontinuities in the Bank's collective knowledge of the country.	Fully agreed.
3. Making an intellectual contribution to policy debate and decision-making in Mexico requires a serious and sustained engagement in carefully chosen areas. The Bank will need to be quite selective in defining its program of non-lending and lending services. Given its institutional mandates, priority in selection should be given to targeted poverty reduction policies and programs and to environmental issues, which remain pressing developmental challenges for Mexico.	Agreed. We should, however, not neglect the possibilities of Bank support to further fundamental structural policy changes which may not have an immediate but rather longer term poverty reduction impact, e.g., in the area of energy or labor reform.

Attachment 2

June 14, 2001

CODE2001-0062

Report from CODE

Informal Subcommittee of the Committee on Development Effectiveness

Mexico Country Assistance Evaluation

1. The Informal Subcommittee of the Committee on Development Effectiveness (SC) met on June 6, 2001 to discuss the Country Assistance Evaluation (CAE) for Mexico (CODE2001-0052). OED remarked that the CAE covered an 11-year period starting in 1989 (FY89-00). OED noted that Mexico had always been firmly "in the driver's seat" in its relationship with the Bank and the CAE, therefore, focused on sectoral issues and areas where the Bank's role was significant. The CAE found that the Bank had positive impact in primary education and health services, the transport sector, and reforms in contractual savings. However, it also found that there were significant lapses in the Bank's effective engagement, for example in the financial sector during FY92-94 and on environmental issues in FY96-99. In many cases, these lapses were due to the apparent inability of the Bank to mobilize the right staff and maintain their focus on Mexico. Also, the CAE found that Bank lending had the most impact at times of crisis, when Mexico's access to capital markets was curtailed. The CAE stressed that the Bank's experience since FY89 showed that, due primarily to the quality of human capital available to the Government and the changing nature of the country's development tasks, it was increasingly challenging for the Bank to have non-financial value added in Mexico. The evaluation concluded that on balance the Bank's program over the past 11 years had been relevant to Mexico's developmental needs, but the efficacy of assistance had been varied over the period. The record since FY92 had been mixed and was considered only partially satisfactory. However, OED stressed that the beginning of a new administration in Mexico presents important opportunities for the Bank to contribute more effectively to Mexico's development agenda. Looking forward to the next 3 to 5 years, the CAE recommended that the Bank and the Government reach a common understanding about a reasonable range for Bank lending consistent with the management of Mexico's external debt and the opportunities for the Bank to have non-financial value added in terms of development impact. The CAE noted two alternative scenarios of either reducing Mexico's debt stock to the Bank in order to create space for large scale lending should Mexico face limited access to capital markets in the future; or maintaining a robust program of new lending that maintains the current debt stock or uses fully the available headroom for Bank exposure to Mexico. The CAE emphasized that the Bank could only have value added in Mexico if it carefully managed its own human capital, assigning experienced staff and better managing staff rotation; and selectively focused its program in Mexico, giving priority to targeted poverty reduction policies and environmental issues.

2. Management welcomed the CAE noting it had been an extremely useful exercise. They stressed that the CAE had been prepared in close collaboration with them and had been helpful in CAS preparation. Management noted that the CAE covered a long time period that also included changes in the Mexican Government. Current conditions in Mexico were quite different due to the new administration and many of the lessons learned in the CAE were, therefore, not as relevant. Some of the OED findings on CAS lending targets and outcomes did not fully reflect the flexibility Management asked for and received in recent CASs to respond to the uncertain political, economic, and financial climate.

3. The Chair representing Mexico also welcomed the CAE and remarked that the authorities had found it to be a very useful document. He noted that the Bank's budgetary restrictions had limited the

extent and flexibility of its program in Mexico and he stressed the importance of having high quality Bank staff resident in Mexico. Regarding the two future alternatives mentioned in the CAE, he stressed that his authorities were discussing a relationship involving continued policy dialogue and a non-financial advisory relationship with the Bank with an option to borrow should the situation so require. Mexico was potentially interested, therefore, in the proposed deferred drawdown option.

4. The SC welcomed the CAE and found it to be a well-written and comprehensive analysis of the Bank's program during the time period. Among the specific issues raised by the SC were:

5. **Role of the Bank in MICs.** The SC noted that the case of Mexico raised many relevant questions about the Bank's assistance to Middle Income Countries (MICs) in general. For example, members commented that Mexico already had access locally to high quality human capital, well developed institutions of its own, and access to capital markets and questioned the role of the Bank in this regard. In particular, some members noted that the CAE found that there was limited value added from the Bank's ESW and policy dialogue and, therefore, wondered whether the Bank should continue to engage in activities not well received or used by the Government. Given the large number of countries that could benefit from Bank programs, the SC asked whether the Bank should tie up resources in more advanced countries that seemed not to require Bank assistance. OED responded that the CAE had not found the impact of ESW to be low in every case, but highly variable. Management noted that it was too soon to see the outcome and impact of the Bank's program, thus more time was needed to assess the success of the Bank's ESW and other products. Furthermore, the new administration had proven to be much more open to the Bank's assistance and this would change the nature of the relationship with Mexico going forward.

6. **Country Ownership.** Some members stressed that the CAE supported the notion that the Bank should only engage in programs that had country ownership or they were not likely to have sustainable impact. Others emphasized, however, that Mexico had refused the Bank's assistance in core priority areas such as targeted poverty programs, financial sector, governance, and the environment, and the Bank should perhaps have questioned its own strategy in Mexico, regardless of ownership, in such a case. Members also expressed concern that the Bank's basic diagnostic work in Mexico was dated, noting that the last poverty assessment had been carried out in 1991, and there were no current PERs, CPARs, and financial assessments. Members asked about the lessons learned from these experiences and how the Bank could engage the country more constructively on areas it thought were critically important without jeopardizing country ownership. Management responded that poverty work had been updated regularly and that a poverty assessment had recently been prepared and was being discussed with the new administration. Management further noted that the CAE had found that the authorities highly valued informal policy notes provided by the Bank as part of its ESW program. In addition, Management noted that, while not directly involved in targeted poverty programs, work supported by the Bank in the health sector provided the basis for the most important program in this sector.

7. **Role of IFC/OEG.** The SC stressed that the CAE would have been more useful had it included an OEG evaluation of IFC's program given the challenges IFC had faced in the country and the importance of the private sector in Mexico.

8. **Adjustment Lending.** Members noted that the evaluation methodology for adjustment lending remained problematic and issues such as the appropriate time to evaluate the impact of the Bank's adjustment program were particularly relevant in cases like Mexico. OED responded that they were in the process of reviewing adjustment lending methodology, looking at issues such as time frame and appropriate criteria, and Management noted they were also involved in this exercise.

9. **State Lending.** A member noted that the CAE suggested that state-level lending may be difficult in Mexico and wondered about the potential for the Bank's decentralized, state level approaches if they did not work in even sophisticated Borrowers like Mexico. Management responded that state level lending is new in Mexico, but the first experience has been a positive one.

10. **Staffing.** The SC expressed concern about the staffing problems reported in the CAE and stressed that it was very important that the Bank maintain high quality, consistent staffing for large and important Borrowers. Management responded that the situation had improved and the same Country Team had been in Mexico for over three years. They noted, however, that the next few years could prove challenging as many senior staff were likely to be up for rotation Bank-wide.

11. **Decentralization.** Members discussed the costs and benefits of decentralization of Bank staff and asked about the experience in Mexico, noting the tensions between having close contact with the client and maintaining neutrality and connections to Headquarters.

12. **Future Options.** The SC noted that the CAE outlined two alternatives for the Bank's future program and suggested that the "surge capacity" scenario seemed to be appropriate, but wondered how this could be reconciled with the request by many Mexican officials, particularly in line ministries, for an expanded Bank program. The SC stressed the importance of coordinating with the IMF on any future scenarios for Mexico. Management responded that they were in the process of discussing alternative support mechanisms with Mexico, one of which would allow the Bank to continue providing non-financial services with an option for borrowing should the situation so warrant.

Matthias Meyer, Chairman
CODE Subcommittee

<u>Distribution</u>
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA