

MEXICO

IDB COUNTRY STRATEGY WITH MEXICO

NOVEMBER 2010 – DECEMBER 2012

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ABBREVIATIONS

BCS-ME	The Bank's country strategy with Mexico
CDM	Clean Development Mechanism
MSME	Micro, small, and medium-sized enterprises
PECC	Programa Especial de Cambio Climático [Special Climate Change Program]
PNI	Programa Nacional de Infraestructura [National Infrastructure Program]
SAGARPA	Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación [Department of Agriculture, Rural Development, Fishing, and Food]
SCF	Structured and Corporate Financing Department
SEDESOL	Department of Social Development
SEP	Secretaría de Educación Pública [Department of Public Education]
SHF	Sociedad Hipotecaria Federal S.N.C.
SFP	Secretaría de la Función Pública [Civil Service Department]
SHCP	Department of Finance
SOFOLs	Sociedades financieras de objeto limitado [limited-purpose financial institutions that issue mortgage loans]

EXECUTIVE SUMMARY

Mexico has made notable progress in managing public policies and its fiscal and macroeconomic framework, yet still faces the challenge of stimulating inclusive, sustainable growth to improve the welfare of its population. The recent external shocks led to a significant economic contraction, loss of jobs, and increased informality and poverty. Economic activity can be expected to remain below potential over the next two years. The program adopted by the Mexican government therefore seeks to maintain balance between countercyclical stimulus and the need for sustainability in public finances. The government's external financing needs, including borrowing from multilateral agencies, will subside as the economic environment improves.

The Bank's country strategy with Mexico (BCS-ME) will span the last two years of President Felipe Calderon's administration and will serve as a transition to a new strategy that will guide the Bank's relationship with Mexico from 2013 onward. As such, the strategy comprises a two-pronged action plan, to address the challenges of improving medium- and long-term economic growth and those of the current economic climate. Moreover, separate and apart from the country's financing requirements, demand for technical assistance will remain high, so the knowledge agenda will be an important part of the Bank's work over the course of this strategy period.

Accordingly, the BCS-ME will have four areas of major focus encompassing 10 priority sectors in which the Bank has broad experience and can add value to the government's program: (1) in the social area, the strategy will support improvements in the design and efficiency of *social protection* programs targeting the poor population; improved quality of, and access to, *education* and more years of schooling; and improved placement in *labor markets*; (2) in the productive area, it will target sectors with great impact on the real economy, through investments in *water and sanitation* and *transportation* infrastructure; access to financing in the *housing* and *MSME* sectors; and greater productivity in the *agriculture sector*; (3) strengthening of *public finance* at the federal, state, and municipal levels; and (4) support for the *climate change* adaptation and mitigation agenda at both the federal and subnational levels.

The development of states and municipios and private-sector participation will be key components and crosscutting elements of the BCS-ME. As global financial markets normalize and developed countries' public borrowing declines, Mexico will be able to access private debt markets once again on competitive conditions, reducing the demand for sovereign-window resources. Thus, the subnational and private-sector dimensions are of vital importance for the medium-term strategy in Mexico.

The strategy implementation risks include macroeconomic factors that will reduce fiscal leeway and the Bank will address through lending; risks associated with weaknesses in institutional capacity, which the Bank will mitigate by strengthening public management at the federal and subnational levels; risks associated with the fact that the current administration lacks a majority in the Congress, which could dilute the scope of needed reforms; and fiduciary risks that the Bank would address by strengthening Mexico's country systems.

RESULTS MATRIX

2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source,* base year)	Indicative targets** (Target year)
Significantly reduce the number of Mexicans living in poverty through public policies that go beyond providing relief.	A. Social Protection	Improve the design and efficiency of social protection targeting the poor.	Expanded coverage of social protection programs in urban areas.	Percentage of poor urban households covered by social assistance programs.	19.8% (Encuesta Nacional de Ingresos y Gastos de los Hogares [National Survey of Household Income and Spending] (ENIGH) 2008, IDB calculations)	23% (2012)
			Reduced prevalence of chronic malnutrition in children under age five.	Rate of chronic malnutrition in children.	12.7% (Encuesta Nacional de Salud y Nutrición [National Health and Nutrition Survey] (ENSANUT) 2006)	10% (2012)
			Greater access on the part of beneficiaries of social protection programs to the formal financial system.	Number of social protection program beneficiary families receiving transfers through bank accounts.	375,434 (Secretaría de Desarrollo Social [Department of Social Development] (SEDESOL), 2010)	2 million (2012)
Improve the quality, relevance, and equity of educational programs.	B. Education	Improve the quality of educational services.	Improved outcomes on standardized tests.	Grades on Evaluación Nacional de Logro Académico en Centros Escolares [National Assessment of Academic Achievement in Schools] (ENLACE) mathematics and reading comprehension tests in the 125 municipios with the lowest Human Development Index scores.	Spanish: 393.6 Mathematics: 392.3 (Secretaría de Educación Pública [Department of Public Education] (SEP), 2009)	Spanish: 413.6 Mathematics: 402 (2012)
			Improved educational infrastructure	Number of schools with inadequate drinking water supply and sanitation infrastructure, excluding Consejo Nacional de Fomento Educativo [National Council on Promotion of Education] (CONAFE) (Census of educational infrastructure, 2007)	23,860 (Census of Educational Infrastructure, SEP, 2007)	8,000 (2012)
		Improve access to education and increase the number of years of study.	Increased basic education coverage in the eight states with highest rates of poverty (Oaxaca, Chiapas, Durango, San Luis Potosí, Puebla, Guerrero, Veracruz, and Tabasco).	Percent of the population from ages 4 to 15 enrolled in basic education in those states.	94.3% (Programa Sectorial de Educación [Education Sector Program] (PROSEDU), 2006)	99% (2012)
				Secondary school dropout rate in those states.	7.62% (SEP, 2007-2008 school year)	7.4% (2012-2013 school year)

* The numeric indicators reported are currently monitored by different country agencies, and periodically updated.

** The indicative targets will be revised or replaced, as applicable, through the country programming documents to be prepared during the strategy period.

2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
			Increased middle school completion rates for low-income youths.	Secondary school completion rates for children from families classified as very poor (“poverty of capacities”).	58% (ENIGH 2008, IDB calculations)	65% (2012)
			Increased high school coverage.	High school enrollment rate for population between ages 16 and 18.	60.9% (SEP, 2007-2008 school year)	65% (2012-2013 school year)
				High school dropout rate.	15.3% (SEP, 2007-2008 school year)	13.7% (2012-2013 school year)
Promote public policies that help create the labor market conditions to encourage creation of high-quality jobs in the formal sector.	C. Labor Market	Promote better job placement.	Improved labor intermediation services.	Number of job seekers served through various windows (Internet, counselors, training grants) operated by the Servicio Nacional de Empleo e Intermediación Laboral [National Employment and Labor Intermediation Service] (SNE).	3,945,942 (SNE records, 2009)	5,837,826 (2012)
				Placement rate among beneficiaries of the Programa de Apoyo al Empleo [Job Support Program].	55% (Instituto Nacional de Estadística y Geografía [National Statistics and Geographic Institute] (INEGI), Encuesta Nacional de Ocupación y Empleo [National Occupational and Employment Survey] (ENCOPE), 2009)	62.5% (2012)
			Improved job prospects for graduates of technical high schools.	Percentage of technical school graduates who join the labor market within three months of graduation.	25% (INEGI, Encuesta Nacional de Inserción Laboral de los Egresados de la Educación Media Superior [National High School Graduate Employment Survey] (ENILEMS), 2009)	40% (2012)

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
Promote the creation, development, and strengthening of micro, small, and medium-sized enterprises (MSMEs).	D. MSMEs	Increase MSMEs' access to financing.	Increased MSME access to financing.	Percentage of MSMEs among all Mexican enterprises receiving commercial bank credit.	17.8% (Sector Economy Program, 2006)	20.8% (2012)
Expand access to home purchase and construction financing for the most disadvantaged.	E. Housing	Increase housing sector access to financing.	Greater availability of mortgage loans.	Mortgage loans to households earning less than seven times the minimum wage as a percentage of all mortgage loans.	21% (Sociedad Hipotecaria Federal (SHF), 2009)	30% (2012)
				Number of mortgage loans to households earning on average seven times the minimum wage.	2,900 (SHF, 2009)	9,300 (2012)
				Percentage of mortgages financed by the private sector.	18% (Asociación Hipotecaria Mexicana, 2010)	40% (2012)
			Increased availability of construction financing.	Total bridge loans made by SHF.	MXP 1,500 million (SHF, 2009)	MXP 5,000 million (2012)
				Number of financial intermediaries making bridge loans.	5 (SHF, 2009)	13 (2012)
Increase coverage of drinking water and sanitation; implement integrated, sustainable management of water resources.	F. Water and sanitation	Increase coverage and improve management of drinking water and sanitation services.	Increased coverage of drinking water and sanitation services.	National coverage for drinking water. ¹	90.3% (Comisión Nacional del Agua [National Water Commission] (CONAGUA), 2008)	92% (2012)
				Urban coverage, water. ¹	94.3%	96%
				Rural coverage, water. ¹	76.8%	78%
				National coverage for sewers. ²	86.4% (CONAGUA, 2008)	88% (2012)

¹ Number of dwellings (national, urban or rural, as applicable) connected to the drinking water system / total number of dwellings (national, urban or rural, as applicable).

² Number of dwellings (national, urban or rural, as applicable) connected to the sanitary sewer system / total number of dwellings (national, urban or rural, as applicable).

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
				Urban coverage, sewers. ²	93.9%	95.6%
				Rural coverage, sewers. ²	61.8%	63%
			Increased efficiency of operators, with emphasis on cities of 10,000 to 250,000 inhabitants.	Índice de Eficiencia Global [Overall Efficiency Index] (m ³ collected / m ³ produced)	42.2% (CONAGUA, 2008)	50% (2012)
			Increased volumes of wastewater treated, with emphasis on urban areas.	Coverage of municipal wastewater treatment. ³	40.2% (CONAGUA, 2008)	60% (2012)
Ensure access to, and expand coverage of, transportation infrastructure and services.	G. Transportation	Expand the road system and improve urban transportation services.	Expanded coverage of national road system.	Density of the highway system (km of highways / thousand km ² of surface area).	0.0622 (PNI, 2010)	0.0712 (2012)
			Improved urban transportation services.	Average travel time for passengers on urban public transportation systems.	To be determined ⁴	28% reduction ⁵
Increase incomes of rural producers through increased presence in global markets and the incorporation of value-added processes and biofuel production.	H. Agriculture sector	Improve efficiency and effectiveness of agricultural health and research systems.	Improved technical capacity of the Servicio Nacional de Sanidad, Inocuidad y Calidad Agroalimentaria [National Agriculture and Food Safety Service] (SENASICA) to promote animal and plant health.	International certification of absence of Mediterranean fruit fly infestation.	Available (Department of Agriculture (SAGARPA), 2010)	Maintained (2012)
				SENASICA technical capacity index for animal and plant health	65.7% (SENASICA, 2010)	81.4% (2014)
			Strengthened Sistema Nacional de Investigación y Transferencia Agraria [National Agrarian Research and Transfer System].	Number of publications in peer-reviewed journals.	0.14 (SAGARPA, 2009)	0.20 (2012)
				Number of improved varieties delivered to producers in a five-year cycle.	61 (SAGARPA, 2009)	67 (2014)
		Increase lending to the agriculture sector.	Increased lending for agricultural production.	Total banking system lending to the agriculture, forestry, and fishing sector (balance at end-of-period in millions of pesos).	28,500 (Banco de México, 2009)	31,000 (2012)

³ Volume of municipal wastewater delivered for treatment / total volume of wastewater produced at the municipal level.

⁴ The baseline will vary with the specific local conditions of the target areas of the Bank operations, and so will be determined on a case-by-case basis.

⁵ The performance information available on various bus rapid transit (BRT) systems suggests that the average reduction in travel times is around 28%.

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
		Improve efficiency and equity in rural public expenditure.	SAGARPA provides timely assistance to rural producers.	Wait time for payment of benefits (days/hours).	Over 60 days (SAGARPA, 2010)	8 hours (2012)
				Number of beneficiaries served online.	0 (SAGARPA, 2010)	Over 6 million (2012)
			The Programa de Apoyos Directos al Campo [Farmers' Compensation Program] (PROCAMPO) is more equitable.	Transfers to eligible producers operating farms of up to 10 hectares (percentage of total)	56% (SAGARPA, 2008)	66% (2013)
				PROCAMPO operations are more efficient.	Number of days to process, generate, distribute, and collect payments.	66 days per transfer (SAGARPA, 2009)
			Establishment of an impact analysis tool.		Not available (SAGARPA, 2010)	Evaluation report. (2012)
			Diagnostic assessment of current public policy for the rural sector, particularly in regard to the Ingreso Objetivo [Target Income] and Activos Productivos [Productive Assets] programs and marketing support.	Presentation of proposals for reform of rural sector public policy instruments.	Not available (SAGARPA, 2010)	Proposed reform. (2012)
<p>Provide for public finance that promotes development in an environment of macroeconomic stability and is more efficient, transparent, and accountable in regard to public expenditure.</p> <p>Assist subnational governments in strengthening institutional capacities to improve actions at all levels of government.</p>	I. Public Finance	Increase revenue-generating capacities at the federal and subnational level.	Increased nonoil tax receipts.	Nonoil revenues (% GDP)	9.4% (Department of Finance (SHCP), 2009)	10.9% (2012)
			Reduced evasion of federal taxes.	Aggregate evasion of VAT, income tax and Impuesto Especial sobre Producción y Servicios [Special Tax on Production and Services] (IEPS) (nonoil)	23.36% (Tax Administration (SAT), 2008)	22% (2012)
			Increased subnational government revenues.	Locally-generated taxes as a percentage of total state revenues.	10% (SHCP, 2009)	12% (2012)
		Improve the effectiveness and efficiency of public expenditure at the federal and subnational level.	Greater transparency and control of public expenditure.	Percentage of state governments using harmonized classifiers established by the National Accounting Harmonization Board in state budget preparation.	0% (SHCP, 2010)	100% (2012)
			Improved composition of subnational government expenditure, with higher levels of investment.	Investment expenditures as a percentage of total state government expenditures (national average).	13% (SHCP, 2005)	18% (2012)

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
(i) Reduce emissions of greenhouse gases (GHG). (ii) Promote measures to adapt to the effects of climate change.	J. Climate Change	Support implementation of the climate change adaptation and mitigation agenda at the federal and subnational level.	Strengthened federal and subnational institutional capacities to implement climate change mitigation and adaptation programs.	Number of federal government entities with mitigation and/or adaptation programs. ⁶	4 ⁷ (SEMARNAT, 2009)	8 (2012)
				Number of states with Programas Estatales de Acción ante el Cambio Climático [State Climate Change Action Plans] (PEACCs). ⁸	2 ⁹ (SEMARNAT, 2009)	6 (2012)
			Reduced GHG emissions.	Volume of annual reductions in GHG emissions through programs to fund low-carbon projects. ¹⁰	0 (SEMARNAT, 2009)	2.0 million tons of CO ₂ equivalent (MtCO ₂ e) (2012) ¹¹
				Volume of annual reductions in GHG emissions through the achievement of PECC targets set by the federal government.	18 MtCO ₂ e/year (PECC, 2009)	129.03 MtCO ₂ e ¹² /year (2012)
				Volume of annual reductions in GHG emissions through greater access to the carbon market. ¹³	9 MtCO ₂ e/year (SEMARNAT, 2009)	13 MtCO ₂ e/year (2012)
			Contribution to the first phase (2008-2012) of the Mexican government's Marco de Políticas de Adaptación al	National and subnational analyses and studies of adaptation to climate change under the Sistema Integral	0 (SEMARNAT, 2009)	2 reports / publications / risk atlas (2012)

⁶ The entities must be engaged in development banking and active in the following sectors: Power generation and use; agriculture and forestry; waste; and risk management and adaptation.

⁷ Secretaría de Medio Ambiente y Recursos Naturales [Department of the Environment and Natural Resources] (SEMARNAT), Instituto Nacional de Ecología [National Ecology Institute] (INE), Department of Energy (SENER), and Nacional Financiera (Nafinsa). The planned activities will be carried out in entities including Banco Nacional de Obras y Servicios Públicos (BANOBRAS), Fondo Nacional de Infraestructura [National Infrastructure Fund] (FONADIN), Fideicomisos Instituidos en Relación con la Agricultura [Agricultural Trust Funds] (FIRA), Fideicomiso de Riesgo Compartido [Shared Risk Trust Fund] (FIRCO), SAGARPA, Comisión Nacional Forestal [National Forest Commission] (CONAFOR), and the Department of Social Development (SEDESOL).

⁸ To be considered, the published PEACCs must include a GHG inventory and a vulnerability analysis and strategy, and identify priority areas for mitigation and adaptation projects.

⁹ Federal District: Programa de Acción Climática de la Ciudad de México 2008-2012 [2008-2012 Mexico City Climate Action Program] (PACCM), May 2008. Veracruz: Programa Veracruzano Ante el Cambio Climático [Veracruz Climate Change Program] (PVCC), June 2009.

¹⁰ To be considered, the projects must relate to the areas of renewable energy, housing, energy efficiency, biofuels and REDD+ (Reducing Emissions from Deforestation and Forest Degradation).

¹¹ Comprises 1.6MtCO₂e/year from the renewable energy program and 0.4 MtCO₂e/year from the energy efficiency program.

¹² PECC target (cumulative) for the period 2008-2012.

¹³ Greater access to the carbon market will take the form of registration of projects in the CDM and other markets reflected in a reduction of certified GHG emissions by the public and private sectors.

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, [*] base year)	Indicative targets ^{**} (Target year)
			Cambio Climático [Policy Framework for Adaptation to Climate Change] relating to the evaluation of Mexico's vulnerabilities and the economic costs of priority measures.	de Adaptación [Integrated Adaptation System]. ¹⁴		

¹⁴ The analyses and studies must focus on areas related to integrated risk management; water resources; agriculture and livestock, forestry and fishing; ecosystems; energy, industry and services; transportation and communication infrastructure; regional planning and urban development; and public health.

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2007-2012 National Development Plan	IDB area of intervention	IDB strategic objectives	Expected outcomes of strategy	Indicators	Baseline (Source, base year)	Indicative targets** (Target year)
<p>Improve the management and quality of public expenditure as a means to strengthen the design and effectiveness of public policies at all levels of government.</p>	<p>K. Financial Management and Public Procurement</p>	Financial Management System				
		<p>Increase the use of reports from the Sistema Integrado de Contabilidad y Presupuesto [Integrated Accounting and Budget System] (SICOP) in reporting expenditures to the IDB.</p>	<p>SICOP is used to report expenditures to the IDB.</p>	<p>Percentage of executed portfolio for which expenditures are reported using SICOP reports.</p>	<p>6% (2010)</p>	<p>12% (2012)</p>
		Public Procurement System				
		<p>Strengthen the structure and operations of Mexico's public procurement system.</p>	<p>An action plan is prepared to improve policies and regulations for the consulting services industry.</p>	<p>OCDE indicator, on scale of 0 to 3 [subindicator 2(d).- Legislative Framework].¹⁵</p>	<p>Level 1 (2010)</p>	<p>Level 2 (2012)</p>
		<p>Use of those country procurement subsystems that are validated.</p>	<p>Utilization of certain country subsystems in the execution of Bank projects (to be identified, based on validation).¹⁶</p>	<p>Only 1 subsystem used for publicity of solicitations (2010)</p>	<p>Utilization of new subsystems (2012)</p>	

¹⁵ Subindicator 2(d). Effective procedures for the contracting of services or other cases where technical capacity is a key factor: if technical capacity and quality is a factor for the selection of consulting or other services, the law must clearly specify how the factor is to be considered. Whereas technical qualifications may be evaluated on a satisfactory/unsatisfactory basis, in many cases an evaluation of technical qualifications on the basis of preestablished criteria is deemed necessary, to select the most qualified proposal, including consideration of price and other factors. For consultants and other professional services, selection based solely on technical qualifications must also be authorized.

¹⁶ The procurement subsystems correspond to the various selection methods or electronic systems specified in Mexico's public contracting laws.

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I. COUNTRY CONTEXT

- 1.1 *Mexico has built a solid macroeconomic framework and pursued reforms that have improved its economic and social indicators.* Mexico has built a solid macroeconomic framework and pioneered the design of social programs that have contributed to reducing poverty, from 47% of the total population in 1996 to 25% in 2008. Mexico also has played an active role in international discussions on climate change.
- 1.2 *Nevertheless, Mexico faces the challenge of stimulating inclusive, sustainable growth to improve the welfare of its population.* The economy has expanded only moderately in recent decades. According to official figures (2008), 27 million of Mexico's inhabitants live in poverty, and poverty is becoming urbanized. From a social perspective, profound inequalities exist between socioeconomic groups and between regions of the country. This is due to factors including lower tax revenue collection, weaknesses in the quality of public expenditure; poor quality education; social policies that encourage informality; restrictions on access to financing; and low productivity owing to poor allocation of factors of production. In addition, climate change threatens Mexico's potential growth, with an estimated potential economic cost of 4 to 5% of gross domestic product (GDP) by 2050.
- 1.3 *Mexico has withstood a series of shocks in the last three years that have seriously affected economic activity and social welfare:* the worst international financial crisis of the postwar period, a sudden drop in oil production and associated public revenues; the influenza A/H1N1 epidemic; and increased violence associated with organized crime. In particular, the financial crisis provoked the worst contraction in Mexico's economy since 1932, the loss of 180,000 formal jobs in 2009, and an increase in poverty to over 30% of the total population in 2010.
- 1.4 *Despite this, sound macroeconomic fundamentals have enabled Mexico to adopt various measures to bolster the economy.* In 2008 and 2009 the government adopted stimulus measures equivalent to 2.5% of GDP, such as countercyclical spending policies, increased transfers to disadvantaged families and communities, increased investment, and measures to contain financial volatility and inject liquidity into credit markets. However, the recession reduced public revenues at the federal and subnational level; this, coupled with the decline in oil revenues, limits the government's leeway to deepen countercyclical measures without impacting the country's credit rating.
- 1.5 *The Government of Mexico has adopted a program for 2010-12 that seeks to maintain balance between countercyclical stimulus and the need for sustainability in public finance.* In parallel, the government is pursuing an agenda of reforms to increase the economy's growth potential and improve citizens' welfare. To do so, it will be necessary to improve the efficiency of public expenditure, attract private participation in infrastructure development, target programs to promote sectors with the most impact on jobs and production, and accelerate the agenda for climate change mitigation and adaptation.

II. THE IDB IN MEXICO

- 2.1 *The Bank's positioning in Mexico is based on six factors:* (i) a programmatic focus on such areas as social protection and agriculture; (ii) participation in programs with well-defined results frameworks and evaluation processes, which transcend the political cycle; (iii) development of sector knowledge to support the design, implementation, and evaluation of public policies; (iv) origination and support in formulating public investment projects with federal and subnational governments and the private sector; (v) fast and timely response in periods of crisis; and (vi) a business model that can deliver financing via more appropriate vehicles, in parallel with a knowledge agenda targeted to high-priority areas.
- 2.2 *At the same time, the Bank has been testing new intervention modalities that could become important avenues of development support to Mexico.* The Bank has begun developing strategic partnerships with financial intermediaries that have enabled it to leverage its contribution in new segments such as infrastructure, climate change, housing, micro, small, and medium-sized enterprises (MSMEs), and microlending, as well as capital market development. It has also begun working with subnational governments, supporting the development of planning, administration, and fiscal management capabilities in states including Yucatán, Tabasco, and Michoacán.
- 2.3 Coordination with other international financial institutions has led to the creation of a program and project cofinancing process with a single execution and evaluation design, which improves quality, increases channeling of resources to priority programs, and simplifies program execution. The IDB's closest coordination has been with the World Bank Group, working together in such areas as housing finance, climate change, and social protection (the "Oportunidades" program).

III. PRIORITY SECTORS 2010-2012

- 3.1 *The aftermath of the financial crisis will continue in 2010-2012.* Considering the economic environment and the Bank's experience in key sectors to boost growth and mitigate the effects of the crisis, the Bank's country strategy with Mexico (BCS-ME) will have four areas of major focus encompassing 10 priority sectors: (1) in the social arena, the strategy will support improvements in the design and efficiency of *social protection* programs targeting the poor population; improved quality of, and access to, *education* and more years of schooling; and improved placement in *labor markets*; (2) in the productive area, it will target sectors with great impact on the real economy, through investments in *water and sanitation* and *transportation* infrastructure; access to financing in the *housing* and *MSME* sectors; and greater productivity in the *agriculture sector*; (3) strengthening of *public finance* at the federal, state, and municipal levels; and (4) support for the *climate change* adaptation and mitigation agenda at both the federal and subnational levels.
- 3.2 The Bank will support its work in those sectors with state and municipal initiatives, weighing the possibility of supporting subnational development through the Bank's

- nonsovereign windows (e.g., development of efficient local lending vehicles), in addition to traditional assistance in the form of sovereign lending.
- 3.3 Support for private-sector participation will be an essential part of the BCS-ME. Increased private lending is a central pillar of the government's program. The private dimension will be present in strategic sectors, building on the Bank's experience in the specific sectors mentioned above. The Structured and Corporate Financing Department (SCF), the Multilateral Investment Fund (MIF), and the Opportunities for the Majority Sector (OMJ) will participate actively in housing, MSMEs, water and sanitation, transportation, the agriculture sector, and climate change. There will be ongoing coordination of this work with the Government of Mexico.
- 3.4 Lastly, the operations to be programmed in each one of the BCS-ME sectors can contribute to meeting the lending targets set in the "Ninth General Increase in Resources of the Inter-American Development Bank" (GCI-9). Specifically, actions in Social Protection, Education, Labor Markets, Housing, MSMEs, Water and Sanitation, and the Agriculture Sector can contribute to the targets of poverty reduction and increased equity; whereas actions in the Water and Sanitation, Transportation, and Climate Change sectors can support the target for sustainable energy and environmental sustainability, as well as for regional cooperation and integration.
- A. Social protection**
- 3.5 The economic contraction has increased poverty. According to official figures, "poverty of capacities," a measure of the population without enough income to simultaneously satisfy their needs for food, health and education, increased from 20.7% in 2006 to 25.1% in 2008, and is expected to encompass over 30% of the population in 2010. At the same time, poverty has become urbanized over the past decade (urban poverty increased from 33% in 2000 to 38% in 2008), and may have been accentuated by the crisis, given urban families' greater dependency on wages than their rural peers. The concern with the crisis is that low-income households may have been forced to use adaptive strategies detrimental to their future income-earning capacity, such as forgoing proper nutrition. Moreover, for many households the eventual economic recovery may be insufficient to lift them out of poverty in the short term. To address this structural situation, since 1997 the Government of Mexico has employed the "Oportunidades" human development program as the principal tool of social protection, which is intended to strengthen households' ability to climb out of poverty on their own in the medium term. Although this was not its original purpose, the Oportunidades program has played a key role in cushioning the social impact of the crisis. However, Oportunidades faces significant challenges in improving its effectiveness, particularly in terms of better linkage with the supply of social services for which it stimulates demand, and expansion of the program in urban areas, accompanied by improved design and relevance for poor urban families.

- 3.6 To improve the design and efficiency of the Oportunidades program and overcome some of the challenges it faces in mitigating the impact of extreme poverty, the Bank will provide support through: (i) consolidating the model of urban intervention to eliminate gaps in coverage and enhance the program's relevance; (ii) improving the quality of early childhood development, education, and health programs and adapting the Oportunidades program to make it more relevant to the poor while creating the necessary incentives to ensure quality in the delivery of basic services; and (iii) bringing unbanked beneficiaries into the formal banking system, to reduce the costs of participating in the program.
- 3.7 The main risk to execution of the BCS-ME lies in the lack of incentives to encourage subnational governments and central government agencies to coordinate the execution of health and education expenditures with the interventions necessary to improve the effectiveness of Oportunidades. The Bank's technical assistance will allow these risks to be identified more clearly, and appropriate mitigation actions proposed.

B. Education

- 3.8 Mexico ranks near the bottom on the OECD indicators of educational coverage and quality. Problems of coverage and dropout become accentuated in junior high school (educación secundaria) and high school (educación media superior), where coverage is barely 94.2% and 60.9%, and dropout rates are high (6.8% and 15.3%, respectively). In terms of quality, results in national tests (Evaluación Nacional de Logro Académico en Centros Escolares [National Assessment of Academic Achievement in Schools], ENLACE) and international tests (Program for International Student Assessment, PISA) indicate very low performance. In 2009, 67.2% and 68.9% of elementary school students received unsatisfactory or rudimentary scores in Spanish and mathematics, respectively (ENLACE). Problems of coverage and quality are particularly acute in highly disadvantaged communities. In 2005, in communities of under 2,500 inhabitants, 6.5% of children aged 8 to 14 could not read or write, and students demonstrated minimal educational achievement. Furthermore, a large number of schools lack basic water, electricity, and sanitation services or adequate infrastructure. In 2007, the infrastructure conditions of 33,445 schools were rated poor or very poor; 85% of those schools were located in rural communities, and 67% were located in highly or very highly disadvantaged communities.
- 3.9 To address these problems, the Bank's strategic objectives for education are to (i) improve the quality of services; and (ii) increase access to the educational system and the length of time spent in it. To this end, the Bank will provide financing and technical assistance in the coming years to support the efforts of the Department of Public Education to reduce lags in access, number of years of schooling, and academic achievement in highly marginalized areas, and improve health and safety conditions in elementary schools. The Bank will also support other programs under the strategy objectives of coverage, quality, and equity.

- 3.10 The economics of the sector make it difficult to advance an agenda of thoroughgoing reform. To mitigate this risk, all IDB actions in the sector will include consensus-building and strengthening of participatory processes within a decentralized framework.

C. Labor markets

- 3.11 Four major trends are observed in the labor market: (i) insufficient creation of well-paying jobs—55% of workers earn less than three times the minimum wage (US\$15/day); (ii) low labor productivity—in the industrial sector, labor productivity fell relative to the United States by 80% in the last four decades; (iii) low educational level of the workforce—the economically active population has an average of only nine years of schooling; and (iv) growth of the informal sector, where two thirds of workers lack access to the health services provided by formal employment.
- 3.12 The strategic objective in this sector is to promote greater employment. The Bank will support the targeting of policies so as to focus labor intermediation on improved placement in well-paying jobs in the formal sector. To this end, it will support programs for the unemployed and first-time job seekers; labor intermediation, job placement, and training services; training programs to increase workers' skills; and MIF support. Supporting the Mexican government in developing effective technical education systems will be a priority, with emphasis on improved employment prospects for technical school graduates.
- 3.13 The principal risks in the sector concern the political will of social and government stakeholders—reflected, for instance, in the willingness to reform labor laws—and companies' interest in participating in job programs. The Bank will mitigate these risks through technical assistance for the design of effective policies.

D. Micro, small, and medium-sized enterprises (MSMEs)

- 3.14 MSMEs represent 99% of Mexican businesses, account for more than 50% of GDP, and employ 75% of workers. However, only 60% of them access supplier financing—at high interest rates and short maturities—and the banking system's share of MSME lending was only 12.7% in 2007. The financial crisis aggravated the situation, curtailing bank lending to businesses by 4% in 2009. As a result, access to financing is both a cyclical and a structural obstacle to the growth and survival of MSMEs.
- 3.15 The Bank's strategic objective will be to improve MSME access to financing through (i) lending and technical assistance to development banks to implement, develop, and/or expand their programs; (ii) use of new financial instruments (e.g., guarantees); and (iii) development of private financial intermediaries to serve the needs of these businesses. Through its nonsovereign window (SCF), the Bank will also promote alternative financing for regulated and unregulated financial institutions to increase lending to MSMEs.

- 3.16 The effects of the crisis may spread further than expected, prolonging liquidity shortages in markets, reducing MSMEs' profitability, and limiting their borrowing capacity. The Bank lending will mitigate any tightening of credit that could arise under such a scenario.

E. Housing

- 3.17 After a decade (1996-2008) of recovery and buoyancy, when the Mexican mortgage market grew by an average of 5.2% each year, the sector now faces significant challenges. While the current housing shortage is estimated at 8.9 million families, construction lending was sharply curtailed in 2009, with a 17% year-on-year decline, which reduced the supply of housing by 39% in 2009. At the same time, the financial crisis revealed the fragility of the sector constituted by the limited-purpose financial institutions known as SOFOLs, which originated the most private mortgage loans between 1995 and 2007. The portfolios of certain SOFOLs lost close to 18% of their value, forcing financial authorities to inject liquidity to maintain the flow of housing finance and sustain the pace of growth in the sector.
- 3.18 The Bank will work through the sovereign and nonsovereign windows (SCF, MIF) in channeling resources to promote access to housing finance, with special emphasis on low-income sectors. It will provide liquidity for mortgage loans and new home construction through the primary mortgage markets by utilizing financial intermediaries, and through the secondary markets by supporting the capital market for bonds backed by mortgages or other real assets.
- 3.19 The principal risk is the persistent lack of liquidity and uncertainty in financial markets, which creates further complications for private-sector entity funding and mortgage lending activities. The Bank's actions will mitigate this lack of liquidity.

F. Water and sanitation

- 3.20 Ten million of Mexico's inhabitants are without piped water, and 14 million have no sewer service connection. Only 40% of municipal and 18% of industrial wastewater is treated in any way. The estimated economic costs associated with environmental degradation of water resources is 0.3% of domestic GDP, and the annual cost of water pollution is US\$6 billion. Operators in the sector are characterized by low technical and business efficiency, high operating costs, and insufficient revenue collection, which limits their self-sufficiency and ability to expand and improve services.
- 3.21 The Bank's strategic objective in the sector will be to increase coverage and improve management of water and sanitation services. To that end, the Bank, working with the nonsovereign window (SCF), will provide assistance to promote: (i) self-supporting services and low-cost solutions in rural and urban communities; (ii) efficiency on the part of operators through conditional urban investment programs; (iii) greater private-sector participation; and (iv) development of wastewater treatment programs.

- 3.22 The effectiveness of the Bank's interventions in the sector may be limited by complicated institutional arrangements, multiple stakeholders, and weak management capacities at the various levels of government. The assistance to the sector will take the institutional context into account to mitigate this risk.

G. Transportation

- 3.23 The transportation infrastructure reflects weaknesses vis-à-vis comparable countries. Mexico's infrastructure ranks forty-ninth worldwide and sixth in Latin America, due to poor quality, and is slightly above the international average of 3.7 (on a scale of 1 through 7). Its ratio of kilometers of road per square kilometer of territory is low, slightly below that of Brazil (0.19) and far below that of Spain (1.32). Urban transportation is inefficient and unsafe. Although it serves 52 million users in 31 metropolitan areas, its density of 175,000 inhabitants per kilometer is nearly 10 times that of urban transportation systems in developed countries. The involvement of the federal, state, and municipal governments in the development of transportation infrastructure projects and lack of institutional capacity, particularly at the subnational level, make it difficult to address these weaknesses.
- 3.24 The IDB's objectives in the sector will be to support the expansion of Mexico's road system and improve urban transportation services. To do so, the Bank and its nonsovereign window (SCF) will work simultaneously in three areas: (i) supporting the development of an efficient, safe logistics system, connecting regions with limited access to the principal road system; (ii) developing bus rapid transport (BRT) urban transportation systems, which are recognized as modern, clean, efficient, and safe mass transit systems; (iii) strengthening the technical and institutional capacities of subnational governments to implement the portfolio of transportation infrastructure projects included in the Programa Nacional de Infraestructura [National Infrastructure Program] (PNI); and (iv) providing financing for federal and subnational transportation infrastructure projects.
- 3.25 The risks in the sector stem from the institutional structure and political tensions that may hamper the performance of decentralized programs supporting implementation of the PNI. The technical assistance that the Bank offers to the central and subnational governments reduces the likelihood that these risks will materialize.

H. Agriculture sector

- 3.26 Although Mexico has adopted significant changes in its agricultural policy, sector performance indicators are unsatisfactory. Factors limiting the productivity of production units as well as the sector as a whole include underinvestment in food safety, research, and technological development (0.45% of GDP versus 2% for the OECD); and lack of access to financing, which hinders crop conversion and limits investment and the availability of working capital. Although public spending for agriculture in Mexico is comparable to that of the United States (14.2% of gross sales value) spending serves to provide private goods (24% of the total) and transfer income (64%) rather than to create public goods (8%). Added to this are problems

- of efficiency and inequity. Efficiency losses of the Programa Ingreso Objetivo [Target Income Program] represent 33% of its budget and at the same time perpetuate inequity by depressing the price of grains, which affects producers that are not program beneficiaries. There are also programs working at cross-purposes, such as programs promoting food self-sufficiency coexisting with programs highlighting Mexico's comparative advantages.
- 3.27 The objectives of the BCS-ME are to: (i) make agricultural research and health systems more efficient and effective, supporting the production of rural public goods—reduction of animal and plant disease and improvement of the agricultural research and transfer system; (ii) increase lending to the agricultural sector, including forestry activities. The nonsovereign window (SCF, MIF) will promote access to financing for rural producers through projects to make agribusinesses more competitive; and (iii) increase the efficiency and equity of rural public spending by strengthening mechanisms to support rural producers, improving the Programa de Apoyos Directos al Campo [Farmers' Compensation Program] (PROCAMPO), conducting a detailed analysis of existing programs, and formulating proposals for sector policy reforms.
- 3.28 The interests created by the programs' existence for long periods limit the viability of reforms in the sector. To mitigate this risk, it is important to analyze the sequence of reforms and make enough information available to the public. In addition, increased public spending in priority areas in a context of fiscal constraint may require the Department of Agriculture, Rural Development, Fishing, and Food (SAGARPA) to reallocate resources internally among programs.

I. Public finance

- 3.29 Public finances have been impacted recently by two factors: a structural factor linked to the 23% drop in oil production between 2004 and 2009, which will have a lasting impact on government revenues; and a cyclical factor linked to reduced nonoil revenues (which declined by 11.5% in 2009) due to the crisis. The crisis has also revealed the vulnerability of subnational finances, characterized by limited local revenue collection (less than 10% of state revenues on average) and resultant heavy dependence on federal transfers. At the same time, the authorities have enacted a number of regulations, executive orders, and laws to modernize public management, improve the quality of expenditure, evaluate ongoing investments and programs, and provide transparency as to the use of public funds. This wide-ranging modernization has yet to materialize. Subnational governments in particular are hampered by weaknesses in areas such as strategic planning, procurement, financial management, collection of locally raised revenues, capacities to develop viable investment projects, monitoring, and dissemination of outcomes.
- 3.30 The objectives for public finance at the federal and subnational levels are to build capacity to generate revenues and make public spending more effective and efficient. For the first objective, the Bank will support the tax reforms recently adopted by the central government and strengthen the federal tax and customs

administration to reduce tax evasion. It will provide consulting services to subnational governments to: build capacity to increase state and municipal revenues through improved revenue management and modernization of tax rolls; implement measures to increase state tax receipts; and improve efficiency and effectiveness in the capture and use of federal transfers. For the second objective, the Bank will promote greater transparency and control of expenditure by supporting a standardized public accounting system, as well as promote more effective subnational public spending by creating and/or strengthening state investment systems and identifying and implementing subnational projects that have high socioeconomic impact and are technically, financially, and environmentally sustainable. No activities supported through the nonsovereign window are contemplated.

- 3.31 The strengthening of federal public finances is subject to a political consensus in favor of thoroughgoing fiscal reform. Also, the political and economic linkages between the different levels of government will determine the extent of progress achieved in fiscal management at the state and municipal level. The technical assistance and knowledge contributed by the Bank will help build consensus among the various political stakeholders.

J. Climate change

- 3.32 The key instrument in Mexico's climate change agenda is the Programa Especial de Cambio Climático [Special Climate Change Program] (PECC). The PECC proposes a comprehensive policy based on the target of reducing emissions of greenhouse gases (GHGs) by 50% (with respect to 2000 levels) by the year 2050. It also promotes mitigation and adaptation measures, as well as crosscutting coordination of sector, institutional, and national and subnational government policies. However, implementation of the PECC adaptation and mitigation agenda faces challenges: (i) the majority of federal government entities lack the institutional capacity to adopt mitigation and adaptation programs (only four entities are currently involved in meeting the PECC targets). The limitations are even greater among subnational governments, only two of which have adopted state climate change action plans; (ii) there are only a few financing programs for low-carbon projects, the result of lack of technical capacity to structure projects of this type and limited involvement of public development banks or commercial banks in priority sectors; (iii) access to carbon markets through voluntary markets or project registration with the Clean Development Mechanism is limited, particularly for state-run enterprises; (iv) knowledge is lacking to evaluate vulnerability and estimate the costs of priority adaptation measures.
- 3.33 The Bank's strategic objective is to support implementation of the climate change adaptation and mitigation agenda. To that end, it will provide assistance to the Government of Mexico and subnational governments through the sovereign and nonsovereign windows (SCF, MIF), to: (i) strengthen institutional capacity to implement mitigation and adaptation programs through training and technical assistance for federal and subnational government agencies; (ii) reduce GHGs

through public- and private-sector financing for low-carbon projects and technical assistance to increase access to carbon markets; (iii) build knowledge by developing scientific and technological tools to evaluate and reduce vulnerability in priority sectors and improve decision-making in regard to adaptation. Such support will include technical assistance for the development and use of mechanisms to cover against natural disasters and reconstruction work.

- 3.34 Weak implementation of new laws and regulations promoting renewable energy and energy efficiency would impact the ability to attract investment in low-carbon projects. The technical assistance provided by the Bank will mitigate this risk.

IV. LENDING FRAMEWORK

- 4.1 *The fiscal measures adopted by the government have improved the sustainability of public finances in the medium term.* Fiscal deficits of 0.7% and 0.3% of GDP are projected for 2010 and 2011, respectively, with a return to a balanced position in 2012. Although public sector debt will remain above levels observed in 2007 (38.2% of GDP), it will stabilize at 44.4% between 2011 and 2013 and decline to 43.3% in 2015. The debt is sustainable under various growth, interest rate, and oil revenue scenarios.
- 4.2 *Net public sector demand for external financing is expected to decline gradually.* In a base scenario, the Government of Mexico will gradually reduce the demand for multilateral financing as the fiscal deficit subsides, capital market conditions become more favorable, and the government deepens its strategy to promote the development and use of domestic financial markets. Bank approvals for Mexico in this period are projected to be US\$5.8 billion: US\$2.8 billion in 2010, US\$1.5 billion in 2011, and US\$1.5 billion in 2012 (see Table 1). Importantly, financing requirements would be even lower, if the output gap narrows faster than expected, in which case demand for IDB resources would be less, although such a scenario is regarded as unlikely for now. In contrast, under a high scenario of slow economic recovery and less favorable market conditions, borrowing with the IDB could increase substantially (see Annex B). Design and execution of the planned program will be supported with nonreimbursable technical assistance funding of around US\$15 million annually.

Table 1: Financial Flows – Base Scenario

(in US\$ millions)

	2010	2011	2012	Annual average during the period 2010-2012
Portfolio and financial flows				
Base scenario				
Portfolio available for disbursement at start of period	1,700.0	2,500.0	2,500.0	2,233.3
Approvals	2,800.0	1,500.0	1,500.0	1,933.3
Disbursements	2,000.0	1,500.0	1,500.0	1,666.7
Repayments	480.8	461.2	432.5	458.2
Memo:				
Public-sector debt (% of GDP)	43.1%	42.7%	41.8%	
Total external debt / Public-sector debt	29.8%	28.7%	27.8%	
Debt with multilaterals / Total external debt	21.4%	23.4%	24.2%	
Debt with IDB / Debt with multilaterals	37.2%	37.3%	38.4%	

Note: Based on information available as of 29 October 2010.

V. COUNTRY SYSTEMS IN MEXICO

- 5.1 Mexico has made progress in the use of country financial management and procurement systems to manage Bank projects (see electronic link, “Fiduciary Note”). The country’s outlook for moving from a traditionally fragmented management approach to integrated management is good. In particular, the Ley General de Contabilidad Gubernamental [General Government Accounting Law] (December 2008) provides for harmonized accounting systems at all levels of government by 2012. In Bank-financed projects, the country systems used are the budget, cash management, accounting, and internal control systems.
- 5.2 Government oversight functions are performed by: (i) the Secretaría de la Función Pública [Civil Service Department] (SFP), which establishes the internal control system and performs the internal audit function; (ii) the Auditoría Superior de la Federación [Federal Audit Office] (ASF), which performs the external independent audit function; and (iii) a standing transparency and anticorruption committee whose members are drawn from the various federal government departments. Bank-financed projects are audited by private firms commissioned by the SFP; the ASF performs audits on certain specific projects. During the strategy period, greater coordination with the World Bank and the SFP is anticipated to harmonize the terms of reference, eligibility criteria, and appointment of external auditors currently done by the SFP.
- 5.3 In regard to procurement systems, a diagnostic assessment of the Sistema Federal de Compras Públicas [Federal Public Procurement System] conducted by the IDB and the World Bank in 2007 identified areas of improvement, such as the

contracting of consulting services. As of 2009, significant progress has been made with the reform of two federal procurement laws and their implementing regulations, which provide for new selection methods such as reverse auctions, consolidated purchases, and framework contracts; selection of consulting engagements; and improvements in the public e-procurement system (COMPRANET), among other changes. These innovations are largely consistent with the Bank's procurement policies and add value to the use of resources in a framework of efficiency and transparency. In addition, five standard documents used for the selection and contracting of works, goods, and consulting assignments and a model contract for individual consultants have been harmonized between the SFP, the World Bank, and the IDB. These documents were updated in 2010 and are used for all procurements financed with IDB funds. A study is also being conducted for the SFP in 2010, and will produce an action agenda to improve policies and regulations for the consulting industry. The Bank will continue the process of identifying systems and subsystems that may be used, in accordance with the "Strategy for Strengthening and Use of Country Systems" (document GN-2538). As a result of the process of harmonization of the terms of reference and formats of post reviews of procurements were agreed upon with the SSP for audits, the Bank may gradually come to rely on external auditor reports, as well as on the work of internal control units for post reviews of procurement processes. This will reduce the costs of external audits and of post reviews of procurements conducted by the executing agency, financial agents, and the IDB. The Bank is supporting development of a training plan and the tools to prepare the internal control units and/or external auditors to apply and review Bank procurement policies.

VI. RISKS¹⁷

- 6.1 *Risks associated with the macroeconomic environment.* Public finances will continue to be affected by the economic climate and reduced petroleum production. The Bank's resources will partially mitigate Mexico's financing needs. However, the impact on development indicators will depend, above all, on the political consensus as to fiscal management and support for a sound macroeconomic policy framework.
- 6.2 *Political risks.* The viability of the government's reform agenda will depend on the ability of political actors to build consensus. The Bank's status of honest broker will mitigate this type of risk in its interventions.
- 6.3 *Risks associated with institutional management.* Technical weaknesses in institutional management frameworks may impact fulfillment of the strategy objectives. Consequently, the BCS-ME provides for actions to strengthen public management at the federal and subnational levels. The intervention model developed with various states will assist in identifying actions and programs to

¹⁷ Risks and mitigation measures will be subject to monitoring throughout the BCS-ME period.

support efficient and transparent management of the resources administered by subnational governments.

- 6.4 *Fiduciary risks.* In 2009, the Government of Mexico announced that the SFP would be disestablished. Although the restructuring has not been implemented, the Bank will monitor the process, since it could impact progress in the adoption of country systems. It will also verify that the reforms of laws, regulations, and procedures are consistent with international standards and Bank policies.

ANNEX A. MACROECONOMIC AND SOCIAL INDICATORS

	2007 ^a	2008	2009	2010e	2011e	2012e
REAL SECTOR						
GDP (% change) ^(a)	3.3	1.4	-6.5	4.3	3.5	4.2
Inflation (end of period, % change) ^(a)	3.8	6.5	3.6	4.9	3.9	3.5
PUBLIC FINANCE						
Traditional public sector balance (% GDP) ^(b)	0	-0.1	-2.3	-2.7	-2.3	-2
Budgetary revenue (% GDP) ^(b)	22.2	23.6	23.6	22.0	21.8	21.7
Net budgetary expenditure (% GDP) ^(b)	22.2	23.7	25.9	24.7	24	23.7
Total public sector gross debt (% GDP) ^(b)	38.2	43.3	44.6	44.6	44.2	43.4
Total public sector domestic debt (% total debt) ^(b)	73.0	70.3	73.1	75.5	77.3	79.0
Total public sector external debt (% total debt) ^(b)	27.0	29.7	26.9	24.5	22.7	21.0
Petroleum production (thousands of barrelsday) ^(c)	3,076	2,792	2,601	2,507	2,500	n.d
EXTERNAL SECTOR						
Exchange rate (end of period, MX\$/US\$) ^(a)	10.9	13.8	13.1	12.5	12.7	13.2
Current account (% GDP) ^(a)	-1.7	-0.3	-0.3	-0.2	-1.1	-1.7
FDI (US\$ billions) ^(c)	27.3	23.2	11.4	16.6	18.9	n.d
Total exports (% change) ^(a)	8.8	7.2	-21.1	19.2	5.8	6.3
Imports (% change) ^(a)	10.1	9.5	-24.0	20.0	8.3	7.3
Remittances (US\$ millions) ^(d)	26,069	25,137	21,181	21,164	20,997	25,179
Remittances (% change) ^(d)	2.0	-3.6	-15.7	-0.1	-0.8	19.9
International reserves (US\$ billions) ^(a)	78.0	85.3	90.8	106.5	117.6	124.7
SOCIAL INDICATORS						
Population (millions) ^(e)	105.8	106.7	107.6	108.4	109.2	110.0
Unemployment rate (% of EAP, end of period) ^(a)	3.4	4.3	4.8	5.1	5.0	4.6
Households in "poverty of food" category (%) ^(g)		18.2		24.3		
Households in "poverty of capacities" category (%) ^(h)		25.1		30.6		
Households in "poverty of assets" category (%)		47.4		52.8		
Literacy rate among population aged 15 to 24 ^(f)	98.2	98.4				
Literacy rate among population aged 15 and over ^(f)	92.8	92.9				
Primary school completion rate (% of relevant age group) ^(f)	103.8					
Under-5 mortality rate (per 1,000) ^(f)	18.5	17.5				
Maternal mortality rate (per 100,000 births) ^(f)	60.0					
Infant mortality rate (per 1,000 births) ^(f)	16.1	15.3				
Life expectancy at birth (years) ^(f) ⁱ	74.9	75.1				
Percentage of population using improved sources of water ^(f)	95.0					
Percentage of population using improved sanitation infrastructure ^(f)	81.0					
Proportion of women in the Chamber of Deputies ^(f)	22.6	23.2	28.2			
Energy usage per US\$1,000 GDP (energy intensity) ^(f)	131.5					
Number of Internet users per 100 inhabitants ^(f)	21.2	22.2				

Sources:

- ^(a) Latin Focus Consensus Forecast (July 2010).
- ^(b) IMF (March 2010).
- ^(c) Survey of Private Sector Economist Expectations (July 2010).
- ^(d) Economist Intelligence Unit (June 2010).
- ^(e) Precriterios 2011 (April 2010)
- ^(f) Consejo Nacional de Población y Vivienda [National Population and Housing Board].
- ^(g) "Poverty of food": inability to obtain a basic food basket, even if all available household income is used only to purchase items in that basket.
- ^(h) "Poverty of capacities": available income is insufficient to cover the price of the food basket and pay necessary health and educational costs, even if all available household income is used for no other purposes.

- ① “Poverty of assets”: available income is insufficient to purchase the food basket and pay necessary health, clothing, housing, transportation, and educational costs, even if all available household income is used for no other purposes. The 2010 poverty projections are from the Chamber of Deputies Centro de Estudios para el Desarrollo Rural Sustentable y la Soberanía Alimentaria [Center for Sustainable Rural Development and Food Sovereignty Studies], and do not represent official estimates.
- ① Millennium Development Goals Indicators, United Nations Statistics Division.
- * Reporting periods are as follows: maternal mortality rate, 2005; percentages of population using improved water and sanitation infrastructure, 2006.

ANNEX B. LENDING FRAMEWORK

1. *The country's net external borrowing for 2010-2012 was projected, using the financial programming model developed for Mexico.* Two scenarios were projected: one with low external demand for financing (base scenario), based on the assumptions in the General Economic Policy Criteria 2011; and one with high external demand for financing (high scenario), which assumed a slower recovery of the economy and international capital markets than in the low scenario.
2. *In the base scenario, the country's net external financing requirements during the 2010-2012 period will be an annual average of around US\$5.7875 billion.* This scenario assumes an annual average growth rate for the period of 4.2%, and an oil production level and price of 2,559 thousands of barrels/day and US\$64.40 per barrel, annual average, as well as domestic borrowing of 75.9% of the total in 2010, and 84.1% in 2011-2012. The assumption as to multilateral banks' share of total external borrowing, based on discussions with the finance authorities, starts at 75% in 2010 and declines to 44% in 2012.
3. *In the high scenario, which assumes a slower recovery of the economy and international capital markets, the country's net external financing requirements during the 2010-2012 period will be an annual average of around US\$7.3641 billion.* This scenario assumes a decline in the growth rate and in the oil production level of one standard deviation, equivalent to 1.61 percentage points and 158 thousands of barrels/day, respectively. Domestic borrowing starts at 75.9% of the total in 2010, rising to 80% in 2011-2012. The assumption as to multilateral banks' share of total external borrowing starts at 75% in 2010 and declines to 65% in 2012.

Table B.1

Financial Scenarios

(in US\$ millions)

	2010	2011	2012	Annual average during the period 2010-2012
Net external financing requirements of the public sector				
Low scenario				
Net external borrowing, Total	7,846.3	4,849.6	4,666.6	5,787.5
- Net external borrowing, Multilaterals	5,884.7	2,727.9	2,041.6	3,551.4
High scenario				
Net external borrowing, Total	7,846.3	7,252.8	6,993.4	7,364.1
- Net external borrowing, Multilaterals	5,884.7	5,076.9	4,545.7	5,169.1
Portfolio and financial flows				
Base scenario				
Portfolio available for disbursement at start of period	1,700.0	2,500.0	2,500.0	2,233.3
Approvals	2,800.0	1,500.0	1,500.0	1,933.3
Disbursements	2,000.0	1,500.0	1,500.0	1,666.7
Repayments	480.8	461.2	432.5	458.2
High scenario				
Portfolio available for disbursement at start of period	1,700.0	2,500.0	2,500.0	2,233.3
Approvals	2,800.0	2,500.0	2,500.0	2,600.0
Disbursements	2,000.0	2,500.0	2,500.0	2,333.3
Repayments	480.8	461.2	432.5	458.2
Memo:				
Base scenario:				
Public-sector debt (% of GDP)	43.1%	42.7%	41.8%	
Total external debt / Public-sector debt	29.8%	28.7%	27.8%	
Debt with multilaterals / Total external debt	21.4%	23.4%	24.2%	
Debt with IDB / Debt with multilaterals	37.2%	37.3%	38.4%	
High scenario:				
Public-sector debt (% of GDP)	43.1%	43.9%	44.1%	
Total external debt / Public-sector debt	29.8%	28.9%	28.1%	
Debt with multilaterals / Total external debt	21.4%	25.0%	27.3%	
Debt with IDB / Debt with multilaterals	37.2%	37.7%	38.8%	

Nota: Based on information available as of 29 October 2010.

ANNEX C. DEVELOPMENT EFFECTIVENESS MATRIX

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX	
<p>In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluability of all Bank development products.</p> <p>The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."</p> <p>The DEM-CS is a yes/no system with a partial score for each of the four evaluation criteria.</p>	
	SCORE
I. RELEVANCE	10.0
A. Ownership and Alignment: establishing consistency of CS objectives with government's plans & priorities	10.0
B. Coherence: establishing (i) the definition of Country Strategy focus in terms of anticipated results and (ii) the integration across Bank instruments/products	10.0
II. EFFECTIVENESS	8.5
A. Strategy Results Framework	9.5
B. Financial Transfers	10.0
C. Build up and use of Country systems	4.0
III. EFFICIENCY	
IV. RISKS	10.0