Office of Evaluation and Oversight

Country Program Evaluation

México

2013-2018

IDB | IDB Invest

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RE-536
June 2019

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PREFACE

As part of its 2019 annual work plan, the Office of Evaluation and Oversight (OVE) has prepared the evaluation of the country program of the Inter-American Development Bank Group (IDBG)[1] with Mexico during 2013-2018. According to the Bank's Protocol for Country Program Evaluations (CPEs) (RE-348-3), the main goal of this evaluation is "to provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's overall strategy and program of country assistance." This CPE was prepared during 2018 and the first half of 2019 in time to inform the process of elaborating the new Country Strategy (CS), which is expected to be finalized during the second half of 2019. It focuses on evaluating the Bank's assistance to the country, in particular on the financial and non-financial relevance of the CS and country program and on the implementation, effectiveness, efficiency, and sustainability of the program.

This is the fourth independent evaluation of the Bank's country program with Mexico. Each of the first three CPEs covered periods of economic crisis and subsequent recovery. The first (RE-259-3) spanned 1990-2000, a transformative period for Mexico during which the North American Free Trade Agreement entered into force, followed by the "tequila" currency and economic crisis; the second (RE-339) covered 2001-2006, at the start of which the U.S. "dot-com" crisis spilled over to Mexico; and the third (RE-424-1) covered 2007-2011, a period marked by a deep recession originating in the U.S. subprime mortgage crisis. The present evaluation period (2013-2018), the first with positive if modest economic growth throughout all years, saw the introduction of broad structural reforms. This CPE is also the first for Mexico that covers operations of the former Inter-American Development Corporation (IIC), because OVE's oversight mandate has been extended to IIC (now IDB Invest) since the 2016 consolidation of IDBG's non-sovereign-guaranteed windows (AG-9/15).

[1] In this document, IDBG refers to the IDB and IDB Invest.

ACRONYMS AND ABBREVIATIONS

BANCOMEXT	Banco Nacional de Comercio Exterior
BANJERCITO	Banco Nacional del Ejército, Fuerza Aérea y Armada
BANOBRAS	Banco Nacional de Obras y Servicios Públicos
BANSEFI	Banco del Ahorro Nacional y Servicios Financieros
CCLIP	Conditional credit lines for investment projects
CONEVAL	Consejo Nacional de Evaluación de la Política de Desarrollo Social
CPD	Country Program Document
CPE	Country Program Evaluation
CS	Country Strategy
DB	Development Bank
EE	Energy efficiency
FFS	Fee for service
FI	Financial Intermediaries
FIRA	Fideicomisos Instituidos en Relación con la Agricultura
FND	Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero
GDP	Gross domestic product
GNI	Gross national income
ESCI	Emerging and Sustainable Cities Initiative
IDB(G)	Inter-American Development Bank (Group)
IIC	Inter-American Investment Corporation (now IDB Invest)
IL	Investment loan
LAC	Latin America and the Caribbean
MICI	Independent Consultation and Investigation Mechanism
MIF	Multilateral Investment Fund (now IDB Lab)
MSMEs	Micro, small and medium-sized enterprises
NAFIN	Nacional Financiera
NAFTA	North American Free Trade Agreement
NSG	Non-sovereign-guaranteed
OECD	Organisation for Economic Co-operation and Development
OMJ	Opportunities for the Majority Initiative
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PBP	Programmatic policy-based loan
PEMEX	Petróleos Mexicanos
PND	National Development Plan
PPP	Public-private partnerships
PROCAMPO	Programa de Apoyos Directos al Campo
PROFORHCOM	Programa de Formación de Recursos Humanos Basados en Competencias

PROSSAPYS	Programa para la Sostenibilidad de los Servicios de Agua Potable y Saneamiento en Comunidades Rurales
SCF	Structured and Corporate Finance Department
SG	Sovereign-guaranteed
SHF	Sociedad Hipotecaria Federal
SMEs	Small and medium-sized enterprises
SMSXXI	“Siglo XXI” fund
SP	Seguro Popular
TC	Technical cooperation
TFFP	Trade Finance Facilitation Program
TFP	Total factor productivity
UN	United Nations
XSR	Expanded Supervision Report

Executive Summary

Context

Mexico is the second-largest economy in Latin American and the Caribbean (LAC) and the 15th-largest in the world. Its per capita gross domestic product places it among the upper-middle-income countries, is higher than the LAC average, and ranks sixth among IDB's borrowing member countries. The economy is dominated by services, followed by industry (including energy) and agriculture. Mexico is one of the few LAC countries to have successfully diversified away from primary exports, and as most of its exports go to the United States, Mexico's economy is highly reliant on the country's main trading partner.

While economic growth was positive throughout the evaluation period, Mexico continues to face development challenges. In recent years, Mexico's economic growth has been too modest for meaningful rises in per capita incomes. Improved tax collection and other fiscal reforms have helped stop the rise in fiscal deficits and public sector debt, but structural challenges such as high economic informality and low productivity growth remain. Although the country has made progress in recent years, it is still very unequal in terms of socioeconomic outcomes and opportunities. Mexico's financial sector is solid and well-capitalized, but at the same time does not provide sufficient access to finance for smaller companies. Moreover, high levels of violence and corruption continue to affect the country.

The evaluation period was marked by the introduction of wide-ranging structural reforms. The need for reforms was driven by long-standing and worsening problems in numerous areas. In line with Mexico's 2013-2018 Plan Nacional de Desarrollo (PND) and its general objective to "achieve Mexico's maximum potential," the reforms sought, among other things, to decrease costs and improve services in the energy, telecommunications, and financial sectors, strengthen public finances at the federal and subnational levels, improve education quality and outcomes and increase labor market flexibility.

The Bank's program

IDBG's CS was aligned with Mexico's PND. The 2013-2018 CS (GN-2749) proposed to work toward nine strategic objectives under three main pillars: productivity, social development, and regional development (Table i.1). Additionally, the CS established energy, education, and citizen security as dialogue areas and set out various areas of cross-cutting action: gender, diversity, and integration. While identifying significant regional disparities in socioeconomic outcomes and opportunities, the CS stopped short of an explicit focus on Mexico's poorer states.

Table i.1. Strategic objectives of Country Strategy results matrix 2013-2018

Priority area	Sectors	IDBG strategic objectives
Productivity	Public management	Support the strengthening of public management at the federal and subnational levels.
	Financial system	Increase the level of finance to the real economy.
	Labor markets	Promote better job placement.
	Business competitiveness	Support the development of logistics and telecommunications systems and promote innovation and entrepreneurship.
Social development	Social protection	Help break the intergenerational cycle of poverty by fostering the building of capacities associated with nutrition, health, and education.
	Health	Strengthen and integrate health promotion and prevention, and disease control actions, and make universal access to health services a reality.
Regional development	Urban development	Promote the orderly, safe, and sustainable growth of cities.
	Rural development	Raise productivity in the agriculture sector and improve the coverage of water services for people living in rural areas.
	Climate change	Support the implementation of national climate change policy mechanisms fostering adaptation measures, taking a long-term approach.

Source: GN-2749 IDB Country Strategy with Mexico, 2013-2018.

The evaluation period was characterized by large-scale sovereign-guaranteed lending for policy reforms and through national development banks (DBs). Between 2013 and 2018, IDB and IDB Invest approved a total of US$13 billion through 218 new sovereign-guaranteed (SG) and non-sovereign-guaranteed (NSG) financing and technical cooperation (TC) operations. Of the total amount of SG loans approved between 2013 and 2018, 42% was for policy-based loans and 25% for financing for national DBs. Of the three CS pillars, productivity and regional development received the most funding. Relatively few operations included gender, integration or diversity aspects.

IDBG operations are necessarily limited in scope because of the size of Mexico's development needs and certain limitations to IDBG's work in Mexico. Besides the fact that IDBG is very small compared to Mexico's development financing needs, a number of key factors have influenced IDBG's mode of engagement in Mexico, particularly on the SG side. On the financing side, these factors include the facts that (i) Mexico has had ample access to competitive capital market financing; (ii) IDB SG loans to the Government fund Mexico's general budget and do not provide additional financial resources to line ministries engaged in IDB-supported operations; and (iii) IDB can provide SG financing to Mexico's DBs, but it cannot lend directly to subnational entities. On the non-financial side, Mexico generally seeks specific and limited technical support to help fill knowledge gaps and ensure program monitoring and evaluation rather than broader advice on overall policy formulation.

IDBG's 2013-2018 program has been largely relevant. IDBG lending and TC operations provided highly relevant support to key reforms in the energy, financial, fiscal and competitiveness areas, while IDB was not significantly engaged in education sector reforms. IDBG also continued its support to several long-standing Government programs, although in some cases IDB's relevance was affected by changing Government priorities, budget cuts and IDB's declining financial competitiveness. Other IDBG operations filled specific needs aligned with CS strategic objectives, but again some were affected by budget cuts. TCs supported a variety of activities (often monitoring and evaluation of IDB-supported programs) and were more valued and used in some sectors than in others. Despite the CS's lack of an explicit geographic focus, direct TCs and indirect financing for subnational entities predominantly benefited poorer Mexican states. NSG operations supported a wide range of mostly relevant activities, such as investments in renewable energy and telecommunications infrastructure.

IDBG financing continues to be financially competitive for the Government of Mexico but became less attractive to national DBs during the period. While Mexico increasingly finances itself in international capital markets, it continues to be one of the IDBG's largest borrowers. However, IDB's late-2015 increase in lending charges contributed in large part to Mexico's US$832 million in DB loan cancellations during 2016-2018 (compared to US$29 million in 2012-2015, and US$230 million during the entire 2007-2012 strategy period). While the majority of NSG financing has been financially relevant, IDB Invest recently introduced a new short-term supply chain financing product of less clear financial additionality to date.

Mexico's implemented program was highly efficient in terms of times and costs, although average costs were affected by high cancellations during the second half of the period. The preparation and execution times and costs of SG operations in Mexico continue to be considerably lower than IDB and peer country averages. The low project processing costs are partly due to the large average size of operations in Mexico, but they can also be explained by Mexico's efficient use of investment loans: disbursements are often used for expense reimbursement, IDB continues to support long-standing government programs, operations use country systems, and DBs are cost-conscious in their loan use. However, efficiency was affected by very high (US$1.6 billion) cancellations, prompted in large part by budget cuts and a loss of IDB financial competitiveness after 2015. NSG operations in Mexico showed higher rates of cancellations and prepayments than those in peer countries during the period, but lower rates of impairments and write-offs.

Effectiveness

Overall, IDBG effectively supported Mexico in its efforts to create an environment that is more conducive to productivity growth. IDBG operations contributed to the promising results of key reform efforts in public management, telecommunications, and the financial sector, although the results of labor markets interventions were affected by budget cuts and priority changes. Available results for NSG operations in business competitiveness have been generally positive, although early indications raise questions about the development impact of IDB Invest's support to micro, small and medium-sized enterprises (MSMEs) through supply chains in Mexico. A majority of loans to financial intermediaries (FIs) have increased FI lending to the target segments, but for some operations there is insufficient information to assess effectiveness.

The results of IDBG support in social development (social protection, health and education) were mixed. IDBG support in social protection and health helped Mexico make partial progress toward the strategic objectives. Recent operations supported by IDBG in the education sector show some early promising results, but as in the other social development areas, uptake of technical inputs provided through Bank TCs was limited over the evaluation period.

IDBG support to regional development and energy has yielded some important results, although some areas were affected by budget cuts. Several pre- and post-reform IDBG operations in energy and climate change contributed to boosting cleaner and less costly energy generation, mostly supporting climate change mitigation despite the adaptation focus of the CS. Some IDBG operations in energy efficiency and geothermal energy have, however, been delayed and have not fully reached their objectives so far. Shifting Government priorities and budget cuts affected results for urban development operations. IDBG operations in rural development generally showed good results, such as the successful execution of complex international tenders for important investments.

Sustainability

Sustainability is a concern for some areas of IDBG's 2013-2018 country program, although it is too soon to draw definitive conclusions. The changed policy priorities and high staff turnover following the political transition have introduced uncertainty about reform implementation and the fate of some of long-standing Government programs that have been supported by IDBG. Given the recent transition and still-undefined policies in many areas, however, it is too soon to draw definitive sustainability conclusions. Unless market conditions change or a renewed need for funding long-term assets materializes, sustained lending of large amounts to DBs seems unlikely, at least in the short term. Some sustainability questions exist about NSG's MSME support through supply chains, certain NSG securitization operations, and the continuity of lending volumes for renewable energy.

Conclusions and recommendations

IDBG's 2013-2018 country program has in large part been relevant while more effective in some areas than in others, but the continuity of IDB's efficient mode of engagement is uncertain. While IDBG's role in Mexico is limited by institutional factors and IDBG's small size compared to Mexico's development needs, IDBG's program with the country has been largely relevant, efficient and effective. However, cancellations, budget cuts, and delays affected the execution and results of some programs, and IDBG operations were more clearly effective in some areas (such as support to reforms and operations in climate change/energy, public management and rural development) than others (such as certain labor markets and supply chain operations). While many IDBG TCs provided highly valued technical inputs, there is little evidence of counterpart use and uptake of other parts of the TC program. The political transition gives rise to sustainability concerns for parts of IDBG's 2013-2018 program. More generally, IDBG's traditionally efficient business model of supporting Mexico seems slated for change, in that reduced DB borrowing seems likely in the near future, some long-standing IDBG-supported Government programs are being eliminated or changed, and, with some exceptions, new areas of engagement are still undefined. A renewed push for finding solutions for more direct support to subnational entities could boost IDB's added value to the country but would also require significantly increased resources, given the larger support needs at that level.

In light of the evaluation findings, OVE recommends to Management:

For IDB:

1. **Seek avenues for IDB to stay relevant to Mexico's development needs.**
    - (a) **Actively engage in a dialogue to identify federal programs and policies where IDB can add value.** Given the likelihood of significant policy changes, the Bank should work with the Government to identify key policy areas where it can add value through technical inputs and financing, and subsequently ensure learning through robust monitoring and evaluation of IDB-supported programs.
    - (b) **Continue efforts to find solutions for more direct support to subnational entities while weighing needs and feasibility.** Given the stark inequalities within Mexico and the large development needs of some regions, IDB work with subnational entities can add significant value. When continuing its support to subnational governments through development banks, federal government programs and TCs, or exploring options to provide more direct financing, IDB should put particular emphasis on subnationals with important development needs while also taking into consideration trade-offs in terms of operational and financial implications, given the higher technical support needs at that level.

2. **Increase efforts to ensure strategic use and increased counterpart uptake of TC outputs, and improve documentation of results.** TCs can be an important tool to inform a policy dialogue with the new authorities and to use in program preparation. In light of limited IDBG TC resources, and in line with the previous CPE's findings, OVE recommends that Management take measures (such as strategic planning within the country programming exercise and with key Government counterparts) to increase the likelihood that TC products will be useful to, and used by, counterparts. Given the lack of evidence about the use of many client support and knowledge and dissemination TCs, improve IDB follow-up with clients and documentation of results and use.

For IDB Invest:

3. **Strengthen the effectiveness and additionality of IDB Invest's business model of supporting SMEs through value chains.** Since Mexico is the first country to which IDB Invest has rolled out its new supply chain finance product, it serves as an important test case from which to draw early lessons that can inform the implementation of this product going forward in Mexico and elsewhere. Given early indications of limited financial additionality and development impact of the supply chain finance product as implemented in Mexico to date, OVE recommends that IDB Invest tailor the instrument mix (funded vs. unfunded support, senior debt vs. other instruments, technical cooperation, etc.) to each market to ensure financial and/or non-financial additionality. Moreover, clearly document development results, which at a minimum requires tracking the evolution in the number and size of all suppliers to IDB Invest's anchor clients financed through the partner platforms (not just suppliers financed under the IDB Invest lines, or all suppliers served by the platforms). For vertical integration operations, further study the direction and distribution of impacts on supply chain companies, to clearly represent and document development results.

I. COUNTRY CONTEXT AND DEVELOPMENT CHALLENGES[1]

1.1 **With a population of 122 million, Mexico is the second-largest economy in LAC and the 15th in the world.** Its per capita gross domestic product (GDP) of US$17,331 places it among the upper-middle-income countries, is higher than the LAC average (US$14,551), and ranks sixth among IDB's borrowing member countries. The economy is dominated by services (63% of GDP), followed by industry, including energy (29% of GDP), and agriculture (3%). With exports accounting for 38% of GDP, and with 81% of non-oil exports going to the United States, Mexico's economy is highly reliant on the country's main trading partner. Mexico is one of the few LAC countries to have successfully diversified away from primary exports, with manufactured goods representing 89% of exports in 2018, followed by oil (6% of exports in 2017).

1.2 **The evaluation period was marked by the introduction of wide-ranging structural reforms.** The need for reform, driven by long-standing and worsening problems in numerous areas, had become urgent by 2012. In the energy sector, electricity prices were high and oil production was declining as a result of insufficient investment and the natural depletion of existing oil fields.[2] Falling oil production also reduced fiscal income, heightening the need for tax reforms. In the telecommunications market, expensive and low-quality services, and insufficient infrastructure were thought to dampen GDP growth.[3] In education, high primary school enrollment (95%) was in contrast to low graduation rates from secondary education (48% of 25- to 34-year-olds in 2017) and scores on international standardized tests that are far below the Organisation for Economic Co-operation and Development (OECD) average.[4] The financial sector provided affordable access to finance to only limited parts of the economy, and the labor market was marked by a lack of incentives to work in the formal sector, weak compliance with tax and social security obligations, rigid contract rules restricting formal employment growth and the absence of a comprehensive strategy to boost productivity.

1.3 **In a historic agreement, *Pacto por México*, signed in December 2012, Mexico's main political parties joined forces to pass 85 major reform initiatives during the previous Government's first 18 months in office.** An energy reform created new regulatory agencies and eliminated the state's monopoly in the oil industry and on electricity generation. A fiscal reform increased consumption taxes, eliminated loopholes, and limited corporate deductions. A telecommunications reform allowed foreign companies to invest in the sector and ordered the creation of new wholesale internet and television networks. An education reform aimed to improve the quality of teaching and learning through improved teacher training, introduction of teacher evaluations, curriculum reform, infrastructure investments, and expanded parent and community involvement in basic education. A financial sector reform sought to decrease transaction costs in the recovery of outstanding debt, encourage competition, and boost access to finance through DBs. A labor reform included

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1 For sources and further details, refer to the Approach Paper for this evaluation (*Approach Paper: Country Program Evaluation Mexico 2013-2018, RE-536*).

2 According to PEMEX estimates, developing the potential of the national exploration and extraction industry would require approximately $US60 billion per year, far exceeding PEMEX' annual budget.

3 Inefficiencies in the telecom market were estimated to produce an annual economic loss of 1.8% of GDP (OECD, 2012).

4 See OECD (2018a and 2018b) for secondary graduation rates and performance on standardized tests, and the World Bank's World Development Indicators for primary school enrollment data.

changes in contract modalities and reduced hiring and firing costs. An economic competition reform created agencies that were in charge of monitoring new market rules. Other initiatives approved during the period included a political-electoral reform, a transparency reform, a social security reform, and the reform of the National Code for Criminal Proceedings.

1.4 **Mexico's 2013-2018 PND was aligned with the *Pacto por México* and its general objective was to "achieve Mexico's maximum potential."** The PND's goals were grouped into five areas: (i) Mexico at peace; (ii) inclusive Mexico; (iii) Mexico with quality education; (iv) prosperous Mexico; and (v) Mexico with global responsibility.[5] It also included cross-cutting strategies to grow productivity, modernize government and bring it closer to the people, and introduce a gender perspective. The PND goals were to be reached in part through the *Pacto por México* reforms.

1.5 **While Mexico has avoided recessions in recent years, economic growth has not only been lower than what was expected at the outset of the reforms, but also too modest for meaningful rises in per capita incomes.** At 2.43%, the country's average annual growth during 2013-2017 was higher than average growth in LAC (1.07%) and in its major trading partners (1.92-2.32%) during the same period. Economic studies suggest that Mexico achieved this relatively positive result because its generally sound macroeconomic policies and policy frameworks counteracted low total factor productivity (TFP) and falling investment that was attributable to uncertainty about the future of North America Free Trade Agreement (NAFTA), recent interest rate hikes, and public spending cuts triggered by collapsing oil revenue. However, 2018 growth, which the International Monetary Fund (IMF) estimated at 2.2%, is well below the rates of more than 5% projected by the Government at the outset of the reforms.

1.6 **Improved tax collection and other fiscal reforms have helped stop the rise in fiscal deficits and public sector debt, but structural challenges remain.** During the evaluation period, the federal deficit averaged 3.1% of GDP, compared to 3.2% during 2008-2012. After the federal deficit reached a high of 4.5% of GDP in 2014, improved tax collection, fiscal consolidation, and one-off factors contributed to the first primary surplus since 2008 and thus to lowering the deficit to 1.1% of GDP in 2017 and 2.3% in 2018. Following fiscal reforms and improved tax collection, non-oil tax revenues rose to 12% of GDP on average during the evaluation period (compared to 8.8% on average during 2007-2012), but this proportion remains the lowest among OECD countries, largely because of Mexico's limited tax base and high levels of economic informality. Outstanding public sector debt reached a high of 50.1% of GDP in 2016 and then fell to 44.8% of GDP by 2018, but it remains considerably higher than the 35% average during the six years preceding the evaluation period.

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5 "Mexico at peace" comprises the areas of governance, citizen security and rights, and judicial reform. "Inclusive Mexico" covers social cohesion, inclusiveness, reduced inequality, access to health services, and social security. "Mexico with quality education" includes human capital development, teacher evaluations and merit-based promotions, inclusiveness and equity in education, and incorporation of culture, sports, technology, and innovation in curriculums. "Prosperous Mexico" spans eliminating barriers to productivity, promoting formal employment, reforms of the telecom and energy sectors, increasing competition and competitiveness, improving transport infrastructure, ensuring food safety through a productive agriculture sector, and exploiting the tourism potential. "Mexico with global responsibility" consists of strengthening Mexico's global presence, reaffirming commitment to free trade and the movement of capital, and protecting the rights of Mexicans abroad and of foreigners in Mexico.

1.7 **Although Mexico has made progress in recent years, it is still a very unequal country.** While Mexico's Gini coefficient experienced a marked drop during the evaluation period,[6] it is still the highest among OECD countries. Low and falling real wages over the last 15 years have prevented a majority of the population from improving their living standards. Moreover, Mexico's tax and transfer system has proven relatively ineffective at redistributing wealth, partly due to the low tax base. Mexico's rank in the United Nations Human Development Index fell from 61 (of 186) to 74 (of 189) during the evaluation period, with eight other IDB member countries ranking higher. During the evaluation period, official national poverty levels (CONEVAL) fell slightly (overall from 45.4% to 43.6%, and extreme poverty from 9.8% to 7.6%), but the country has stark regional inequalities: rural poverty and poverty among the indigenous population are considerably higher than the national average, and the highest poverty levels are recorded in Mexico's southernmost states. Differences in formal employment opportunities between states and, therefore, in affiliation to Mexico's social security institutions, perpetuate disparities in access to health care and income through contributory pensions in old age.[7] Opportunities for escaping poverty are also affected by disparities in the length and quality of education across states. In terms of gender equality, Mexico has made progress on schooling and political representation. However, gross national income per capita (on purchasing power parity terms) for males (US$22,873) is still estimated to be more than double that of females (US$11,065), and the female labor force participation rate is only 44.1% (compared to men's 79%) and therefore considerably lower than both the LAC average (51.6%) and the rates in peer countries such as Brazil (53.2%) and Colombia (58.8%).

1.8 **Despite the recent reforms, one of Mexico's major structural challenges has been the low productivity growth**. While the structural reforms implemented during the evaluation period are estimated to have had a slight positive effect, Mexico's TFP performance compares unfavorably with that of the OECD and other LAC countries. Small, relatively unproductive companies make up the vast majority of Mexico's productive sector, and there are economic disincentives to enterprise growth and formality. Studies suggest that this misallocation of resources is in large part caused by distortions in the tax system, labor market regulations, and the social security system, as well as an environment of weak contract enforcement. Low labor productivity is also thought to be a function of insufficient human capital resulting from failures in the education, health and social protection systems. Over the evaluation period, Mexico's overall global competitiveness ranking stayed about the same, whereas the sub-ranking on the quality of its institutions worsened from 96 to 123 and the ranking on labor market efficiency fell from 96 to 105, illustrating the ongoing challenges in these areas.

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6 After staying around 45-46 during 2008-2014, Mexico's Gini coefficient fell to 43.4 (its lowest level recorded in World Bank measurements starting in the 1980s) between 2014 and 2016. In Latin America, only Argentina, Uruguay and El Salvador record lower levels of inequality than Mexico according to the latest available data. (Source: World Bank Group)

7 The 2004 introduction of the *Seguro Popular* (SP) has led to some improvements in health care, but the SP provides access to only a limited range of health care services. Non-contributory pensions (introduced federally in 2013) have reduced extreme poverty in old age, but they have been much lower than contributory pensions.

1.9 **Mexico's financial sector is solid and well-capitalized, but it does not provide smaller companies with sufficient access to finance.** The banking sector shows high levels of capitalization and profitability, and adequate liquidity to face shocks. At the same time, it is concentrated, with the five major financial groups accounting for around 70% of bank assets. Banking penetration has been growing strongly since 2000 but is still limited, with credit to the private sector at 35.5% of GDP in 2017- lower than not only the OECD average (58%), but also than levels in other countries of similar GDP per capita, such as Brazil (58%), Chile (80%), and Colombia (47%). Of companies captured by Mexico's 2014 economic census, only 7% reported having obtained bank financing. As a result of the reforms aimed at promoting financial inclusion, an increasing part of the population 15 years or older now has a bank account (37% in 2017 compared to 27% in 2011); however, this share is still well below the OECD (95%) and overall LAC (55%) averages.

1.10 **High levels of violence and corruption also continue to present challenges for Mexico.** Crime and a lack of public safety were seen as the most important problems facing the country throughout all years of the evaluation period.[8] Since 1997, when the country began keeping records, 2017 and 2018 were the years with the most murders. There were large regional disparities but an overall rise in the homicide rate during the evaluation period; several Mexican states, such as Baja California and Colima, experienced sharp increases in homicide rates. Another important issue is corruption: Mexico ranks 138th of 180 countries on Transparency International's Corruption Perception Index, with only Guatemala (144), Nicaragua (152), Haiti (161), and Venezuela (168) faring worse among LAC countries. Widespread illegal fuel pipeline tapping became an increasing problem during the evaluation period, and the new government has attempted to crack down on this activity by transporting fuel by truck instead.

1.11 **Going forward, Mexico's generally resilient economy is expected to provide stability, while there is some uncertainty about the extent to which the expected benefits of recent reforms will materialize.** In addition to challenges to reform implementation due to institutional weaknesses especially at the local level, the new Government has already announced its disagreement with the education reform and at least parts of the energy sector reform. Uncertainty around government finances recently prompted Fitch to downgrade Mexico's sovereign credit rating from BBB+ to BBB and Standard & Poor's to change its rating outlook to negative. Nevertheless, the new Government enjoys high levels of popular support, economic uncertainty has been reduced by the October 2018 agreement on a renegotiated NAFTA (now the United States-Mexico-Canada Agreement, or USMCA), and Mexico's rating would need to fall by a full two to three notches for the sovereign to lose its investment grade status.

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8 About a third of survey respondents mentioned these issues as the most important problem facing the country, more than any other issue (Latinobarometro online data, available at http://www.latinobarometro.org/latOnline.jsp).

II. THE BANK'S 2013-2018 PROGRAM

2.1 **The 2013-2018 Country Strategy (GN-2749) proposed to work towards nine strategic objectives under three main pillars: productivity, social development, and regional development** (Table 2.1). Additionally, the CS established various areas of cross-cutting action—gender, diversity, and integration—as well as the dialogue areas of energy, education, and citizen security. NSG operations would complement SG interventions in the CS priority areas. The strategy included various activities to enable IDBG to make more use of country systems to reduce transaction costs and increase program efficiency. It also mentioned the necessity to provide technical support through TC and potentially through the new "fee-for-service" (FFS) model, and it expressed IDBG's commitment to coordinate with other multilateral and bilateral agencies to exchange views and ideas and to explore opportunities for joint work.

Table 2.1. Strategic objectives of Country Strategy results matrix 2013-2018

Priority area	Sectors	IDBG strategic objectives
Productivity	Public management	Support the strengthening of public management at the federal and subnational levels.
	Financial system	Increase the level of finance to the real economy.
	Labor markets	Promote better job placement.
	Business competitiveness	Support the development of logistics and telecommunications systems and promote innovation and entrepreneurship.
Social development	Social protection	Help break the intergenerational cycle of poverty by fostering the building of capacities associated with nutrition, health, and education.
	Health	Strengthen and integrate health promotion and prevention, and disease control actions, and make universal access to health services a reality.
Regional development	Urban development	Promote the orderly, safe, and sustainable growth of cities.
	Rural development	Raise productivity in the agriculture sector and improve the coverage of water services for people living in rural areas.
	Climate change	Support the implementation of national climate change policy mechanisms fostering adaptation measures, taking a long-term approach.

Source: GN-2749 IDB Country Strategy with Mexico, 2013-2018.

2.2 **The previous CPE for Mexico (RE-424-1), covering 2007-2011,[9] highlighted that although the Bank lost some of its relevance with Mexico's access to capital markets and its increasing sophistication, Mexico continued to appreciate value of the Bank's technical support and competitive financial terms.** OVE made five recommendations: (i) strengthen the relevance of the Bank's future program to the country's structural challenges (including the fiscal challenges presented by an aging population); (ii) redefine and specify the criteria for the Bank's private sector work and monitor investments in the sector to guarantee results and the Bank's value-added; (iii) reduce transaction costs by making more use of country systems and exploring ways to provide local currency without swaps; (iv) explore effective ways of working with the subnational governments (either directly or through Mexico's state-owned DB Banco Nacional de Obras y Servicios Públicos - BANOBRAS, but reducing transaction costs); and (v) adopt a more strategic focus in developing the TC program.[10]

9 During the first four years of this period, there was no new CS but rather four updates of the 2001-2006 CS (GN-2181-1). In late 2010, a new CS (GN-2595-1) was approved to cover the end of the evaluation period.

10 See Annex I, Table I.10 for an update on the implementation of OVE's recommendations.

A. Relevance

2.3 **The objectives of the 2013-2018 CS aimed to address important country development constraints in line with parts of Mexico's PND, but they stopped short of explicitly targeting regional disparities.** On the public sector side, most areas were very well aligned with Mexico's PND and development challenges more broadly, and IDB actions were forecast to support important reform efforts. Given the expectation that Mexico's Government would not invite substantial IDBG participation on education, energy, and citizen security issues, these areas were largely[11] included as dialogue areas only, despite a significant pending reform agenda. The CS correctly identified significant socioeconomic disparities between Mexican states as a key challenge, but the proposed priority action areas did not develop a concrete geographic focus other than differentiating between rural and urban areas more generally.[12] The anticipated activities for private sector operations[13] were very specific in some sectors,[14] yet the CS and its associated sector notes failed to provide any rationale for them. Because IDBG financing is only a small share of Mexico's funding sources, the attribution of developments in the chosen macro-level Results Matrix indicators to IDBG interventions is necessarily tenuous. At the same time, some of the chosen indicators were not fully adequate to measure progress toward the projected objectives and outcomes.[15]

1. Description of IDBG's country program 2013-2018

2.4 **Between 2013 and 2018, IDB and IDB Invest approved a total of US$13 billion through 218 new SG and NSG financing and TC operations.**[16] On the SG side, 31 loans for US$11 billion and 5 investment grants for US$43 million were approved, complemented by 96 TC operations totaling US$34 million, and 3 FFS operations.[17] NSG operations consisted of 57 loans for US$1.7 billion,[18] 4 equity investments for

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11 A small aspect of citizen security was included under the urban development. Renewable energy and energy efficiency investments were included in the "climate change" sector.

12 This approach can be partially explained by IDB's inability to finance subnational entities directly, hence IDB's financial support is has to be channeled through federal government programs and development banks. However, through IDB's support to federal social development programs targeting the poor, as well as its support to rural development (with the poorest states being also among the most rural), IDBG program had an indirect focus on poor areas.

13 Note that since the CS dates to 2012, it covered only the former SCF and OMJ, not the IIC.

14 In the health sector, NSG financing was to very specifically focus on "investments in health facilities, including hospitals and diagnostic clinics subcontracted by public insurers" – an activity that did not materialize. In rural development, the private sector was to integrate agricultural value chains.

15 Examples are the health sector indicator that captures the uninsured population but fails to measure access to health care, health promotion actions, and other aspects of the strategic objective; the urban development indicator of "% of public subsidies assigned for housing in existing urban areas", which by itself is inadequate to measure progress towards the projected outcome of "the biggest cities become denser"; and the social protection indicator of the average number of deficiencies among the extremely poor, which measures all extremely poor (and not just those covered by the IDB-supported PROSPERA) and fails to capture the intergenerational aspect of the objective.

16 See Annex I for summary tables and detailed lists.

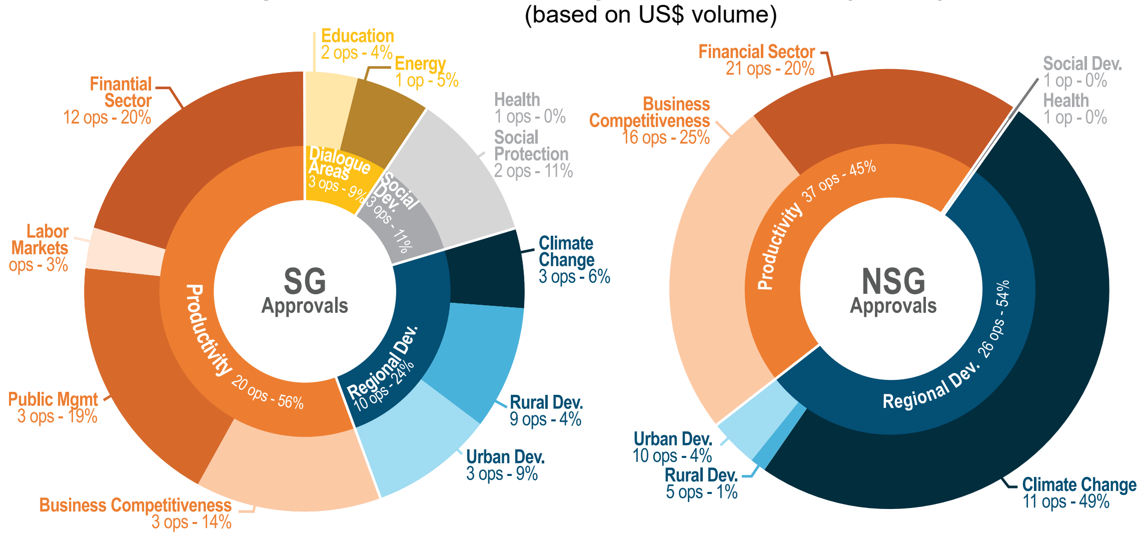
17 IDB was to receive US$1.8 million under the FFS operations (of which US$91,000 was cancelled).

18 These include one Trade Finance Facilitation Program (TFFP) operation for US$100 million.

US$44 million, and 12 guarantees[19] for US$300 million,[20] in addition to 16 TCs amounting to US$1.4 million. During this period, MIF (now IDB Lab) approved 50 operations for US$53 million: 36 TCs (US$25 million), 8 loans (US$16 million), 4 equity investments (US$11 million), and 2 investment grants (US$1 million).

2.5 **Of the three CS pillars, productivity and regional development received considerably more funding than social development.** Productivity areas accounted for 56% of SG financing, and NSG funds mostly supported regional development.[21] Social development obtained only 11% of SG, and less than 1% of NSG, financing (see Figure 2.1 for sector distribution[22]). SG TC funds mostly supported urban development (24% of approved amounts), public management (13%), and climate change (12%), but were also used in citizen security (6 TCs). NSG TCs focused mainly on business competitiveness (69%). The three FFS operations supported subnational governments in urban development, public management, and social development.

Figure 2.1. 2013-2018 loan and guarantee approvals by priority area
(based on US$ volume)



Notes: Does not include TC or TFFP operations. Classifications in all but four cases are based on Country Program Documents (CPDs), whenever available. Ten double-classified operations are included as follows: (i) financial sector if they supported financial intermediaries (nine cases), and (ii) 'main' area of intervention based on project descriptions (one case). See Annexes I and XII for details.
Source: OVE, based on internal documents and databases.

19 Six of these are part of operations that also include loans. When several lending instruments are part of the same operation, the operation is counted only once. Two of the guarantees, for US$4.7 million total, were issued under the TFFP program.

20 Third-party funds (under IDBG administration) accounted for US$251.1 million in these operations.

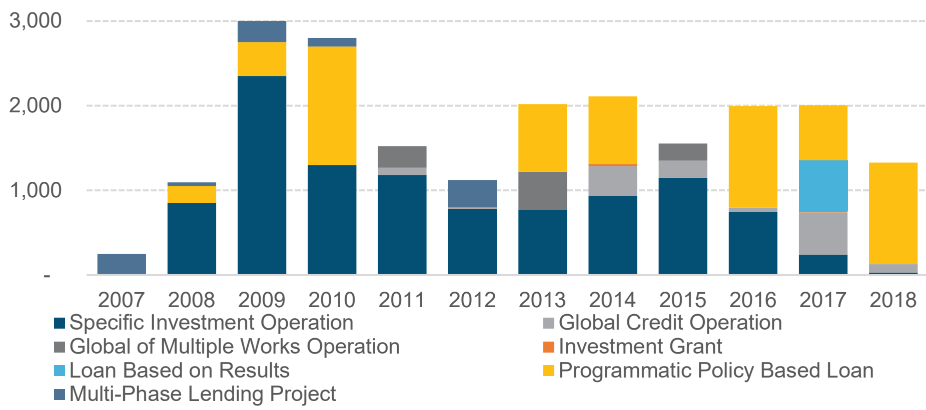
21 NSG refers to IDB Invest and its predecessors SCF, OMJ, and the former IIC. MIF (now IDB Lab) operations are not included unless specifically mentioned. NSG percentages are based on the total excluding TFFP.

22 Operations classified as "climate change" in Figure 2.1 do not include many other operations which are primarily classified in a different sector but are also climate-change-related (Annex X lists all climate finance operations). Moreover, some operations classified as "climate change" were, due to their energy-related nature, evaluated in the Energy Sector Note, which also includes energy-related financial sector operations. Operations classified as "financial sector" were evaluated as part of both the financial sector portfolio, and the sector to which the FI on-lent under the IDBG operation. Similarly, operations that were not classified as financial sector by CPDs but were channeled through FIs or included financial sector components, were also analyzed as part of a financial sector evaluation portfolio. See Annex 1 for a detailed classification.

2.6 **Slightly less than a quarter of operations included at least some gender aspect, but diversity and integration topics were even less prominent.** OVE's review[23] found that 22% of SG and NSG loan, guarantee, or investment grant operations of the evaluated portfolio included indicators, components, or activities related to gender issues. In addition, IDBG also provided five stand-alone TCs in this area.[24] Diversity and integration aspects were part of only 6% and 5% of reviewed operations, respectively.[25]

2.7 **The evaluation period is characterized by the use of SG loans to support policy reforms and large-scale lending through national DBs.** Of the total amount of SG loans approved between 2013 and 2018 (Figure 2.2), 42% corresponded to seven policy-based loans for US$4.65 billion in the areas of public management (3), business competitiveness (2), urban development, and energy. Investment loans represented 57% of total approved resources (24 operations for US$6.3 billion), including one results-based loan (US$600 million). Financing for national DBs[26] accounted for US$2.8 billion, or 25% of the total approved amount, through 12 loans and 3 investment grants.[27] DBs made heavy use of conditional credit lines for investment projects (CCLIPs): nine of their loan operations (amounting to US$2.1 billion) were part of a CCLIP.[28]

Figure 2.2. 2013-2018 SG financing approvals by instrument (US$ million)[29]



Source: OVE, based on internal databases.

23 OVE could not use classifications in IDB databases since these were only available for the most recent part of the evaluation portfolio. OVE classified projects as having a gender aspect whenever document review and interviews revealed that there were specific gender-related indicators, components or activities, either in the operation itself or an associated TC.

24 This represents 4.5% of the 112 stand-alone TCs, and includes the "Cuidad de las Mujeres" initiative to integrate services for women, a platform for collecting and disseminating data on violence against women, and an intervention designed to increase female participation in non-traditional careers (see also para. 3.13).

25 In addition, there was one stand-alone TC with diversity aspects. The integration topic was not well defined by the CS. OVE classified operations as relevant to integration whenever they included integration of supply or distribution chains or involved cross-border integration/trade-related operations.

26 Including BANOBRAS, BANCOMEXT (Banco Nacional de Comercio Exterior), FND (Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero), FIRA (Fideicomisos Instituidos en Relación con la Agricultura), NAFIN (Nacional Financiera), and SHF (Sociedad Hipotecaria Federal).

27 During 2007-2012, lending to DBs had accounted for 31% of total approved amounts.

28 For more detail about Mexico's portfolio by recipient and instrument, see Annex I, Figures I.7 and I.8 and Table I.9.

29 Specific investment, multiple works, multi-phase lending and global credit operations are all investment loans.

2.8 **The legacy portfolio was composed of 97 operations for $5.4 billion that were approved before 2013 but were active or evaluated during the CPE period.** [30] On the SG side, it included 20 investment loans (for US$4.7 billion), three investment grants, and 41 TCs.[31] On the NSG side, the legacy portfolio included 25 loans (US$597 million), 4 guarantees[32] (US$32 million), 3 equity investments (US$12 million),[33] and 3 TCs (US$2 million). Regional development areas accounted for 40% of the SG legacy volume, and productivity and social development areas followed with 25% each. For NSG lending, productivity areas accounted for more than two thirds of approvals.[34]

2. Relevance of IDBG's 2013-2018 country program

2.9 **A number of factors have influenced IDBG's mode of engagement in Mexico, particularly on the SG side (see Box 2.1).** On the financing side, these factors include the facts that (i) Mexico has had ample access to competitive capital market financing; (ii) IDB SG loans to the Government must be included in the federal budget and do not provide additional financial resources to line ministries engaged in IDB-supported operations, with the Ministry of Finance often seeking regular and predictable SG disbursements for debt management purposes (see also Box 2.3); and (iii) IDB can provide SG financing to Mexico's DBs, but it cannot lend directly to subnational entities. On the non-financial side, Mexico generally seeks limited and specific technical support to help fill knowledge gaps and ensure program monitoring and evaluation rather than broader advice on overall policy formulation. Together these factors have motivated a mode of engagement wherein IDB SG funding has been focused on areas where it can add value through specific technical inputs while ensuring, on the one hand, sizable and predictable disbursements through policy-based loans (PBLs) or support to large national programs such as PROSPERA, and on the other hand direct funding to DBs.

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30 Given that NSG operations, unlike SG operations, are often fully disbursed up front, OVE considered the Expanded Supervision Report (XSR)—prepared at early operating maturity—an appropriate milestone for substantial implementation. Because during the evaluation period there was a gap in the production of XSRs around the merge-out, OVE also considered non-TFFP NSG operations with 2011 and 2012 disbursements as part of the legacy portfolio.

31 Legacy SG loans and investment grants include US$144 million from third-party funds administered by the Bank.

32 Two of these are part of larger operations that also include loans. When several lending instruments are part of the same operation, the operation is counted only once.

33 Including US$2 million from the China Equity Investment Fund administered by the IIC/IDB Invest.

34 One industry operation (Etileno XXI) represented almost half the amount of legacy NSG approvals.

Box 2.1. Factors influencing IDBG's mode of engagement in Mexico

- **No "budget additionality".** As in a few other borrowing member countries (Chile, Colombia), IDB funds lent to the Government become part of the funding for the general budget, and do not constitute additional extra-budgetary resources for programs and activities supported by IDB. Line ministries and other Government executing agencies do not receive IDB funding directly, but IDB funds are instead paid to the Mexican Finance Ministry (Hacienda), which decides on the mix between domestic and external funds with which to finance the line ministries. While considered good practice as policy and investment decisions are made independently of the financing source, this can result in a disconnect between the executing agencies and IDB, in that the former assume much of the transaction cost of working with IDB, but *a priori* do not perceive a financial benefit – compared to other sources of financing – from IDB participation. IDB support is therefore usually requested in areas where IDB can provide clear non-financial additionality. However, counterparts across various sectors (labor markets, rural development, education, health) highlighted that, despite the resources not constituting additional financing, having IDB involved has sometimes helped them protect resource allocation in the face of budget cuts.
- **Demand for punctual technical support and monitoring and evaluation (M&E) activities.** Given the high capacity of experts in most of the federal agencies, Mexico typically does not seek wholesale policy advice, but rather external technical support to fill knowledge gaps in limited yet key specific areas. Mexico's government also appreciates IDB undertaking TC-financed M&E of supported programs, in part because these activities tend to not be consistently and predictably funded within Mexico's Government budget.
- **Financing for public sector DBs and trust funds.** Six national DBs[a] and numerous public trust funds and other organisms[b] are part of Mexico's public sector and provide financing to various parts of Mexico's economy. By working with these entities, IDB's SG financing can reach Mexico's private sector in addition to its public sector. Borrowing by DBs has also enabled Mexico to use much more IDB funding than it could within the limited direct IDB financing needs of the Federal Government itself.
- **Constitutional and other limitations to funding subnational governments.** Given large disparities in institutional capacities among Mexico's subnational entities, IDBG support could be very relevant at that level. However, Mexico's Constitution prohibits subnational governments from taking loans from external entities, including multilateral development banks. While IDBG has in the past provided financing to subnational entities through BANOBRAS, OVE's previous CPE (RE-424-1) found that the high transaction costs and lack of a more direct connection between IDB and the relevant governments have limited the benefits of this arrangement. Furthermore, a financial responsibility law enacted in 2016 has, among other measures to avoid unsustainable debt at the subnational level, introduced a requirement for subnational entities to take the lowest-cost debt offered regardless of non-financial value added, further reducing BANOBRAS' competitiveness when using longer-term IDB funding.
- **Access to competitive capital market and other financing.** Because Mexico has an investment-grade credit rating, the Government and large Mexican companies have access to ample competitive financing from international and domestic markets. In 2017, only 8% of Mexico's public and private external medium- and-long-term debt stock (87% of Mexico's total) was held by official creditors, while the rest was held by private creditors such as bondholders and commercial banks. Moreover, Mexico's Government can obtain domestic local currency financing at lower rates than IDBG can offer; therefore, IDBG's MXN treasury, while an attractive and frequently used funding source for NSG operations, has not been used for SG loans (although swaps have been). For DBs, the pricing of IDB's local currency offering (via swaps or MXN treasury) is not competitive at anything but long tenors, limiting the attractiveness of IDB funding for anything but US dollar-linked or very long-term local currency assets.
- **Regular delays in annual budget allocation.** While the general budget is approved before the end of each year for the following year, executing agencies report that the allocation of approved budget to specific spending items often takes the first few months of each year, creating inertia in decisions and actions, including for IDB-financed projects. These inefficiencies are especially important in sectors in which the fiscal year does not coincide with spending cycles—as in education, in which the school year stretches from one year into the next.

[a] *Banco del Ahorro Nacional y Servicios Financieros (BANSEFI); Banco Nacional del Ejército, Fuerza Aérea y Armada (BANJERCITO); SHF; NAFIN; BANCOMEXT; BANOBRAS*
[b] *For example, FIRA; FND*
Source: OVE, based on analysis and interviews.

2.10 **A large majority of IDBG operations were relevant, albeit necessarily limited in size and scope compared to Mexico's development needs.** Most operations were well-aligned with the strategic objectives set out in the CS (Table 2.1). IDBG supported important CS-aligned new reforms (see para. 2.11), continued its support to long-standing programs (see para. 2.12), and financed other relevant initiatives (see para. 2.13), although some activities were affected by budget cuts,[35] Government priority changes and IDBG's reduced financial competitiveness during the period. While IDBG support was somewhat marginal in certain sectors, this is understandable given the small share IDBG can contribute to Mexico's various and large development financing needs.[36]

2.11 **IDBG lending and TC operations provided highly relevant support to key reforms in the energy, financial, fiscal and competitiveness areas, but IDB was not significantly engaged in education sector reforms.** In the energy sector, TC support helped prepare the renewable energy contract auctions resulting from the energy reform, and IDBG NSG lending to winning solar projects helped spark rapid growth in Mexico's renewable energy market (see Box 2.2). A subsequent programmatic policy-based loan (PBP) supported the implementation of key parts of the energy reform, and SG loans through DBs helped finance a large gas pipeline public-private partnership (PPP) made possible by the reforms. IDB also supported, through DBs, the development of geothermal energy generation, but the relevance of this support was affected by the lack of competitiveness of this energy source compared to others. In public management, TCs and lending operations supported aspects of the fiscal and financial sector reforms that have helped increase tax revenue and credit to the private sector. In business competitiveness, TCs and SG and NSG loans supported reform efforts to increase productivity through investments in broadband infrastructure (see Box 2.2), enhanced competition, and increased access to finance. In urban development, TCs and SG loans supported the government's goal of urban densification and the implementation of a new general sector law.[37] Aside from a few TC-financed pilots and studies that enjoyed limited uptake, IDB was not directly involved in the important education sector reforms the Government launched during the period.

2.12 **IDBG also continued its support to several existing Government programs, but in some areas IDB's relevance was affected by changing Government priorities, budget cuts, and falling IDB financial competitiveness.** In social protection, IDB continued to provide loans and TCs to the Government program PROSPERA,[38] with more limited Bank-supported design adjustments than in previous periods. In rural development, IDB continued its support to the rural water and sanitation program PROSSAPYS, over time focusing on smaller communities[39] and introducing gender aspects. In urban development, IDB continued its support to

35 Budget cuts, in effect each year during 2015-2018, were made necessary mainly by falling tax revenues that were due to collapsing oil production and prices.

36 As of 2018, Mexico's outstanding SG debt with IDB was equivalent to about 1.3% of GDP and represented only about 2.7% of Mexico's total public debt.

37 For more examples and details, refer to Chapter III and the attached sector notes.

38 PROSPERA provides cash transfers to poor households conditional on meeting certain health and education requirements.

39 IDB loans were complemented by a small investment grant operation which piloted a new water and sanitation provision model in dispersed rural communities.

low-income housing financing through SHF while introducing environmental sustainability aspects. However, a number of loan cancellations reflect a loss of IDB relevance in certain areas during the period. In rural development, IDB's large-scale support to the farm subsidy program PROCAMPO did not continue as expected, since Mexico's agriculture ministry saw limited value in Bank support for subsequent phases of the program, and the last loan to PROSSAPYS was partially cancelled because of budget cuts. In labor markets, the budget for the supported program PROFORHCOM[40] was severely reduced toward the end of the period, also resulting in a partial loan cancellation. A changed funding strategy also prompted the cancellation of most of IDB's second loan to support school infrastructure. IDB loans in urban development were similarly affected: IDB's latest urban development loan to HABITAT[41] was fully cancelled because of changed Government priorities, and IDB's housing finance loans through SHF became smaller during the period because of IDB's falling financial competitiveness, with a partial cancellation of the last loan.

2.13 **Other IDBG operations filled specific needs aligned with CS strategic objectives—and again, some were affected by budget cuts.** In energy, IDBG SG (through DBs) and NSG loans provided crucial long-term financing to add cleaner wind, solar and gas power generation capacity. In the health sector, an IDB loan (and evaluation TC) supported the "Siglo XXI" fund (SMSXXI), which finances certain health interventions for children under the age of 5 outside the social security system. Additionally, two grant-funded Mesoamerica operations supported improvements in maternal and child health services in the state of Chiapas. In the education sector, IDBG continued its support to a community school program benefiting students living in marginal areas, and to student loans, the latter through NSG operations. In rural development, IDB loan and technical support helped ensure the transparent and successful execution of international procurement processes for several complex and sensitive investments of national importance. IDB also provided a series of loans and TCs to help FND and FIRA extend financing to existing and new rural productive activities and introduce climate change, environmental and gender aspects in their lending.[42] However, the last loans of both series were partially cancelled because of budget cuts. Similarly, cuts to counterpart funds for an IDB-supported urban development program for improved water and sanitation services in medium-sized cities reflected shifting Government priorities in the sector.

2.14 **TCs supported a variety of activities across sectors, varied in relevance, and were often used to conduct monitoring and evaluation of IDB-supported programs.** Of the 137 SG and 18 NSG TCs approved or implemented during the period, 28% were classified as operational support, 55% as client support, and 9% as research and dissemination, while 8% (all NSG) were not classified. A large majority of TCs[43] were executed by IDBG; although this practice results in costs for IDB, Government counterparts reported valuing IDB execution greatly because of the obstacles to implementing evaluation activities, in particular, in line ministries, given the short budget horizons and insufficient resources allocated for such activities (an

40 Programa de Formación de Recursos Humanos Basada en Competencias.

41 IDB had supported this neighborhood improvement program since 2004.

42 During the evaluation period, FND also concluded an IDB-supported program to finance low carbon strategies in the forest areas in states with the highest net forest loss forest areas.

43 Of all TCs in OVE's evaluation portfolio for which relevant information was available in IDB's databases, 89% were executed by IDB and only 11% by the recipient.

issue that was exacerbated by budget cuts during the period). Counterparts across several sectors (e.g., rural development, energy, citizen security and public management) assigned high value and usefulness to many TCs, especially whenever the technical inputs provided filled crucial knowledge needs that helped clients innovate, improve their operations,[44] or put policy into practice. IDBG also used TCs to ensure that supported activities are evaluated, and several TCs stepped in to finance evaluation activities when IDB loan funds originally earmarked for this purpose (e.g., in social protection, rural development and labor market programs) were cancelled or reallocated because of budget cuts or otherwise shifting priorities. However, in certain sectors (e.g., health, education, business competitiveness), several TCs were disconnected from lending operations and supported some topics of limited Government focus; the lack of evidence about uptake or other use[45] (some of which was partly due to insufficient IDB follow-up) calls their relevance into question.

2.15 **Support to subnational entities through lending operations to the federal government and through TCs benefited mostly poorer Mexican states.** While Management has maintained an active dialogue with Mexico to explore possible financing structures, IDBG has thus far not found an effective solution to allow more direct subnational lending. A loan to BANOBRAS for subnational investments was only partially executed during the evaluation period because of the loss of attractiveness of IDB funding combined with competitive pressures on BANOBRAS after the introduction of the financial discipline law. However, five other SG loans approved during the period benefited subnational entities through loans to the Federal Government: a public management PBL to improve subnational financial management, two water and sanitation loans (one for urban, one for rural areas), and two productivity PBLs that included components for regional development and convergence. In addition, IDB provided a wide range of technical support activities to subnational entities with its own administrative resources[46] and through 16 TCs, 2 investment grants and 2 fee-for-service operations[47] approved during the period. Additionally, IDB continued to implement two legacy loans, 10 TCs and one investment grant approved before 2013 that indirectly supported subnationals. A large majority of the subnational entities directly or indirectly supported by IDB were located in Mexico's poorer states.[48]

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44 For example, NAFIN, BANCOMEXT, FIRA and FND appreciated IDBG's support in incorporating environmental and social aspects into their lending operations.

45 The issue is especially marked for the 112 approved client support and knowledge and dissemination TCs. Of the 77 partially or fully implemented TCs (another 16 are still in progress), OVE found evidence of at least partial client use (i.e. further use of at least some of the outputs produced by the TC) for 51 (of which 31 led to changes in policies and practices), with another 20 not being used, and no information found for the remainder. OVE's review was based on the desk review of relevant TC documentation and interviews, as not all TCs of the evaluation portfolio are recorded in IDB's new TC Monitoring System, which moreover does not consistently document results and use of TCs.

46 An example is the application of the Emerging and Sustainable Cities Initiative (ESCI) methodology of identifying and prioritizing climate change-relevant investments to the cities of Xalapa, Campeche and La Paz.

47 One FFS helped the Puebla government document and disseminate its social investment strategy. Another FFS has helped BANOBRAS apply the ESC methodology to four cities. A third approved FFS to help public management in the government of Jalisco was cancelled in its initial stage due to a change in the main counterpart.

48 Two-thirds of direct or indirect interventions with subnationals (excluding operations benefiting all states equally) supported entities located in poor states (defined as the poorer half of Mexican states, all of which exhibit poverty rates above 40% based on 2016 CONEVAL data). The rural water and sanitation loan benefited almost all Mexican states, but 10 of the 11 top recipient states by amount were among the poorer half of states.

2.16 **NSG operations supported a wide range of activities of varying relevance.** During the period, IDBG NSG operations supported investments of national importance such as the Manzanillo port expansion, investments in crucial telecom and renewable energy infrastructure (see Box 2.2), and the Etileno XXI petrochemical plant. Moreover, IDBG contributed to pioneering innovative funding structures in the areas of energy efficiency, education, urban development, and general business competitiveness. Numerous older and smaller operations supported companies (mostly small and medium-sized companies, or SMEs) through FIs or directly across various sectors; however, few of these clearly established expected development results or positive externalities beyond the client itself. In line with the findings of OVE's Evaluation of Direct Support to SMEs by the IIC (CII/RE-23-3), the direct SME support operations were also not suitable for creating more durable financing solutions because of their small scale, their one-off nature and their financial unsustainability for IDB Invest. NSG support to supply chains during the period also raises some relevance questions (see paras. 2.22 and 3.4 below). However, Mexico's program included some compelling examples of synergies between the work of the private and public sector sides of IDBG (Box 2.2).

Box 2.2. Examples of SG-NSG synergies in Mexico's 2013-2018 program

- **Renewable energy.** While IDBG had already financed several Mexican self-supply wind projects since 2009[a] and SG TCs and concessional resources had helped generate knowledge about exploiting Mexico's renewable energy potential, three SG TCs (ME-T1291, ME-T1302, ME-T1308) provided critical support to Mexico's energy ministry. They ensured, among other activities, the timely delivery of the auctions of renewable energy supply contracts (one of the 2013 energy reform's key components), whose structure and transparency helped attract strong competition and resulted in the lowest offered solar energy prices in the world, to the future benefit of the Mexican economy. Subsequently, IDBG deployed its resources and risk absorption capacity to help meet the large financing needs of this newly emerging market by supporting the construction and ongoing sustainability of several auction-winning solar energy plants through NSG loans.[b]
- **Red Compartida.** Three SG TCs (ME-T1236, ME-1267, ME-T1268) provided inputs for the reform of the telecommunication sector, including the strengthening of the regulator and valuing a part of the radioelectric spectrum for high-speed mobile internet. Foregoing immediate potential large fiscal revenues from auctioning off the spectrum directly (at a time when oil revenues were falling), Mexico's Government decided to invest in Mexico's future growth potential by using an innovative PPP structure to create a wholesale broadband network (Red Compartida) that ensures equal access for service providers and maximum network coverage in the shortest amount of time possible. Because of the large financing amounts needed and the limited capacity of commercial lenders to take on the risks involved in this untested structure, IDBG approved an NSG loan directly to the winning network-building consortium through IDB Invest (ME-L1285, 12088-01), as well as a CCLIP operation (ME-L1284) to finance part of BANCOMEXT's funding for the project.

[a] *ME-L1076, ME-L1081, ME-L1099, ME-L1107, ME-L1109, ME-L1119*
[b] *ME- L1271, ME-L1272, ME-L1281, 12083-01, 12197-01, 11894-04, 11894-03, 11894-02*
Source: OVE, based on analysis and interviews.

2.17 **A few of the operations approved during the period, while relevant in addressing development challenges, diverged from what had been contemplated under the CS.** While operational mainstreaming of climate change topics saw an important increase, a large majority of IDBG climate change operations during the evaluation period supported climate change mitigation rather than adaptation activities,[49] despite the CS climate change sector note's focus on the latter.

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49 Adaptation activities represented 15% of climate change operations in terms of number, and only 2% in terms of amount. However, this represents an improvement over the last period, during which no climate change adaptation operations were approved. Some of the most important examples of climate change adaptation operations approved during the period are action plans to improve adaptation measures and capacity at the local level, and support to the development and implementation of the National Water Reserves Program.

Although energy and education had been designated as dialogue areas only, IDB approved several SG and NSG loans in these sectors during the period. In the health sector, one small NSG operation helped a company introduce a new hypertension drug in the Mexican market, but IDBG's NSG windows did not get involved in financing private service providers, as the CS had foreseen. In addition to the intervention areas contemplated in the CS, IDB also provided several fast-disbursing TCs for relief efforts after natural disasters Mexico suffered during the period.

2.18 **Coordination with other official multilateral and bilateral agencies was limited yet adequate for the Mexican context.** Various areas (urban and rural development, health, social protection) of IDBG interventions have received support from both IDB and the World Bank Group, as well as from some bilateral lenders, while coordination activities appear to have been limited. However, Hacienda, which leads the relationships with bilateral and multilateral organizations, is strategic about where to work with which partner to avoid overlaps, somewhat reducing the need for direct coordination among organizations.

3. Financial competitiveness

2.19 **While Mexico increasingly finances itself in international capital markets (Figure 2.3), it continues to be one of the IDB Group's largest borrowers.** Mexico has continued to borrow from IDB[50] and the World Bank,[51] maintaining its exposure levels with IDB consistently close to the established limits. Mexico received net IDB financing flows of US$5.96 billion between 2013 and 2018 (excluding interest payments and fees), compared to US$6.4 billion in 2007-2012. Over the evaluation period, Mexico's SG debt balance with IDB grew from US$10.7 billion in 2012 to US$15.3 billion at the end of 2018[52] (17.4% of the Bank's total stock of SG debt), now surpassing Brazil as IDB's largest SG borrower. IDB Invest's outstanding exposure to Mexico's private sector was US$124.4 million at the end of 2018 (7% of its total portfolio), up from US$84.6 million at the end of 2012.[53]

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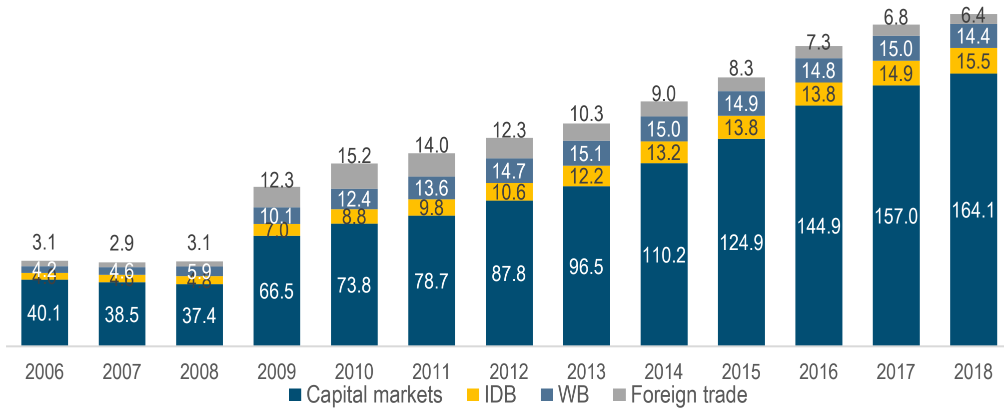
50 This can be partially explained by the continued financial competitiveness of IDB SG long-term financing (according to analysis by IDB's Finance Department based on Bloomberg data and its own calculations, IDB's fixed-rate equivalents have been consistently lower than trading levels and coupons at issuance date of bonds of comparable tenors emitted by Mexico). Mexico's debt with IDB has represented an average of 8.3% of external public debt over the period (compared to the 6.6% expected in the CS) and 48.2% of external multilateral debt (compared to the 43.9% projected by the CS). Mexico drew average yearly IDB disbursements of about US$1.59 billion, roughly maintaining the US$1.61 billion average of 2007-2012 (a period that included the global financial crisis) and slightly exceeding what was expected under the CS (US$1.51 billion/year).

51 The World Bank's 2013-2018 approved commitments for Mexico (annual average of US$410 million) have fallen strongly compared to the 2007-2012 period (annual average US$2.5 billion), which had included lending in response to the financial crisis (see Annex, I, Figure I.6).

52 The outstanding NSG exposure on IDB's balance sheet stood at US$807.5 million at the end of 2018 (10.5% of total IDB NSG debt stock).

53 This represented 7.8% of the IIC portfolio in 2012. In 2018, the Mexican private sector was IDB Invest's fourth largest borrower in terms of outstanding portfolio, after Brazil, Argentina, and Chile.

Figure 2.3. Evolution of Mexico's public external debt stock (US$ billion)



Source: OVE, based on data from Mexico's Finance Ministry (2019).

2.20 **Mexico received substantial IDBG TC resources over the period, although less than other countries.** During 2013-2018, a total of US$62.5 million in IDBG[54] TC resources were approved for Mexico, of which US$34.3 million consisted of TCs from IDB's public sector side.[55] For each SG loan, Mexico received on average 2.6 SG TC operations during the evaluation period—below the IDB average (4.1), but above that of peer countries[56] (2.1). However, because of the large average size and total amount of Mexican loans, SG TC resources per thousand US dollars in SG loans for Mexico (US$3.11) were well below the average for IDB (US$23.77) and for peer countries (US$8.05). Mexico was the top recipient of IDB Lab TCs and grants during the period, with US$27.7 million approved for 40 operations.

2.21 **IDBG has lost some of its financial competitiveness with national DBs.** Mexico's major national DBs report that, while IDBG financing is still attractive at long tenors and especially in US dollars, it became less so during the evaluation period. DBs cancelled US$832 million in loans during 2016-2018 (compared to US$29 million in 2012-2015, and US$230 million during the entire 2007-2012 strategy period). IDB financing was initially attractive to NAFIN and BANCOMEXT, especially for their funding of renewable and other energy projects (which required long tenors and whose revenues were in many cases tied to the US dollar), but it became less so for both these institutions—and for BANOBRAS[57] and SHF[58]—

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54 This includes IDB Lab (former MIF) grants.

55 In terms of both total TC and SG TC resources, Mexico was the fifth-largest TC recipient after Colombia, Jamaica, Brazil and Peru.

56 The peer countries (Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, and Peru) were chosen because they are comparable in terms of per capita income—they are also upper-middle-income countries, i.e. have a Gross National Income (GNI) per capita of at least US$3,896 (on purchasing power parity terms)—and size of the economy (GNI of at least US$150 billion, on purchasing power parity terms).

57 BANOBRAS has not requested loan disbursements from IDB since 2015, despite US$100 million being approved and still undisbursed under ME-L1111. The most recently approved loan (ME-L1158, for US$100 million as por of a CCLIP operation for US$1 billion) dates to 2015 but was never signed, and then finally cancelled but kept the CCLIP line open. According to interviews, BANOBRAS, under pressure to compete on pricing with commercial banks for financing to subnational governments since the introduction of the Financial Responsibility Law, has funded its relatively long-term assets mainly with short-term liabilities, which it can obtain at lower rates than IDB financing.

58 The amounts of approved operations under the CCLIP with SHF declined from US$500 million for the first two CCLIP operations approved in 2009/2010, to just US$100 million for the last (ME-L1163, approved in 2015, 70% was then cancelled), citing local alternative financing sources among other reasons.

after IDB's 2015 SG lending margin hike in late 2015.[59] FND and FIRA, whose access to alternative funding sources is more limited than that of the DBs, continued to borrow from IDB during the period, however 60% of the most recent FND loan was also cancelled due to budget cuts.[60]

2.22 **While the majority of NSG financing has been financially relevant, IDB Invest has recently introduced a new product of less clear financial additionality to date.** IDB Invest[61] provided highly additional long-term funding to Mexico's nascent renewable energy market at a time when commercial lenders were still reluctant to finance this new industry, and it has in general assumed risks not covered by,[62] and extended tenors reportedly not available from, commercial funding sources. NSG operations have also provided loans or helped create innovative structures[63] to channel financial resources to other market segments that are underserved by Mexico's financial sector. The former IIC, through various small loans and equity operations, supported mostly SMEs for which access to commercial financing sources was generally insufficient at the needed terms. NSG operations mobilized US$251 million in concessional funds and US$66 million in B-loans to the Mexican private sector during the period, and helped clients avoid currency risk by providing US$1 billion of its financing in local currency. However, IDB Invest's recently[64] introduced supply chain finance product, which provides short-term financing to suppliers of large Mexican companies,[65] appears to directly compete with similar and ample commercial bank financing for a product that, at least in Mexico and in this particular format, is already widely available for suppliers to large companies.

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59 NAFIN has cancelled US$250 million (71%) of ME-L1151 (approved in 2014) and has not requested any IDB loan disbursements since 2015. BANCOMEXT, while it drew the full disbursement (US$200 million) under ME-L1172, has not yet signed ME-L1284. A new CCLIP operation for BANCOMEXT (ME-L1284) to provide financing for the Red Compartida project was approved in 2018 but is pending signature.

60 US$300 million of the originally approved US$500 million of ME-L1259, approved in 2017, has been cancelled.

61 Before the merge-out at the beginning of 2016, through the Inter-American Investment Corporation (IIC) and the IDB windows SCF (Structured and Corporate Finance Department) and OMJ (Opportunities for the Majority Initiative).

62 Examples are merchant risk (i.e. the risk of fluctuating spot prices affecting revenues after long-term supply contracts run out) in renewable energy operations, and various risks involved in the innovative Red Compartida project.

63 Such as funds for SME financing or securitization structures for various assets, including student loans, loans for educational material, energy efficiency investments, and mortgages.

64 Approval of the first operation of this type was in 2016, and operations stated in January 2018.

65 In this "reverse factoring" product, lenders take the risk of the large buyer and not that of the (typically SME) suppliers, enabling the provision of better financing terms than the suppliers would be able to obtain on their own. IDB Invest channels its financing through a third-party online platform that connects numerous lenders with large companies and their supply chains.

B. Program times and costs

2.23 **The preparation and execution times and costs of SG operations[66] in Mexico continue to be considerably lower than IDB and peer country averages.[67]** During the evaluation period, preparing Mexican investment loans (ILs) has cost, per US dollar approved, only about 41% of the IDB average, and 53% of the peer country average. For loan execution, Mexican operations cost only 44% of the IDB average per US dollar disbursed, and 67% of the peer country average. Per operation, Mexico's ILs also cost less than those of peers and the rest of IDB, although the differences are much less stark.[68] In addition to the variable costs of operations, the fixed costs (per US dollar approved and outstanding) of the Mexico country office have also been the lowest among peer countries during the period (see Annex I, Figures I.4 and I.5). In part, these differences are explained by operation size: the average Mexican IL during the period (at US$219.4 million) was larger than that of any other IDB borrowing member country, three times the IDB average size, and double the average operation size in peer countries.[69] Overall project processing times are short: the average life[70] of Mexican ILs was only 60% of the IDB average and 58% of that of peer countries. Despite a marked increase in the time between approval and signature,[71] Mexican preparation times overall have fallen by 33% compared to the previous period, and Mexican execution times by 38%.[72]

2.24 **Apart from the larger average size of its operations, the low project processing costs can also be explained by Mexico's specific use of its ILs.** The operational efficiency of Mexican operations can be partly explained by four factors: (i) Mexico's frequent use of IDB disbursements for expense reimbursement, (ii) IDB's continued support to existing Government programs, (iii) the efficient use of ILs by DBs, and (iv) Mexico's use of country systems and financial agents (Box 2.3).

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66 Unless otherwise stated, numbers refer to investment loans only. See Annex I, Tables I.6-I.8, for comparisons including PBLs and more detailed data.

67 See footnote 56 for definition of peer countries.

68 Per approved IL, Mexico's preparation costs were US$214,000 (US$227,000 for peers; US$247,000 for IDB on average) during the period. Per disbursed IL, Mexico's implementation costs were US$244,000 (US$302,000 for peers; US$294,000 for IDB on average).

69 Mexico's PBLs are also the largest on average among all countries. Including PBLs, Mexico's average SG operation size is US$305.9 million, compared to IDB's US$88.8 million, and peer countries' US$126.3 million.

70 Time between initial project registration and full disbursement of current approved amount (i.e. excluding cancelled amounts).

71 The average number of months between approval and signature for all operations (IL and PBLs) jumped from 3.4 to 5 compared to the last period, driven by increases from 3.6 to 5.4 months for IL, and from 1.6 to 3.4 months for PBLs. According to interviews, this is due to the fact that both the Government and DBs increasingly delay contract signature until all disbursement conditions are met, to avoid paying commitment fees on undisbursed balances.

72 IL preparation times are 30% lower than those in peer countries (23% lower than the IDB average), and execution times 58% lower than those of peers (60% lower than IDB average).

Box 2.3. Characteristics of Mexico's use of SG investment loans

- **Reimbursement of expenses.** Many Mexican loans disbursed against already-paid expenses, allowing for fast disbursements and low transaction costs for both IDB and the country. Moreover, IDB supported some large-scale government programs (such as PROSPERA and PROCAMPO) whose spending patterns were highly predictable, further reducing uncertainty and transaction costs around the timing and amounts of disbursements. This is reflected in the fact that Mexican total disbursement times (from first eligibility to full disbursement) for ILs are less than half of those of IDB and peer countries. The flexible use of ILs also allowed Hacienda to time and size disbursements according to general external debt management needs, more than being driven by underlying project schedules and financing needs.
- **Continuing support to existing government programs.** During the period, IDB continued to support certain long-standing Government programs (such as PROSPERA and PROFORHCOM), in some cases without implementing major changes (and with most studies for potential adjustments being financed by TCs), therefore enabling minor preparation times and costs.
- **Efficient use of ILs by DBs.** DBs are highly sensitive to cost, and therefore tend to use their ILs very efficiently. Since DB operations disburse within only 5.5 months on average (compared to 38 months for all other loans), the average life of DB operations is 47% shorter than that of the rest of Mexican operations (Figure I.2., Annex I). This is also reflected in low execution costs: disbursing US$1 million to DBs cost US$966 on average during the period, compared to US$2,553 for the rest of the portfolio.[a]
- **Use of country systems and financial agents:** In most areas (except reporting and certain parts of procurement), IDB operations make full use of Mexico's country systems (and use increased further during the period), facilitating project execution.[b] Moreover, two DBs (NAFIN and BANSEFI) act as financial agents in charge of processing disbursements and reporting for IDB loans, which can make disbursement processes more efficient because of the ample experience of the two financial agents with IDB procedures and requirements.

[a] *Average preparation costs are however a bit (by US$158, or 17%) higher for ILs with DBs.*

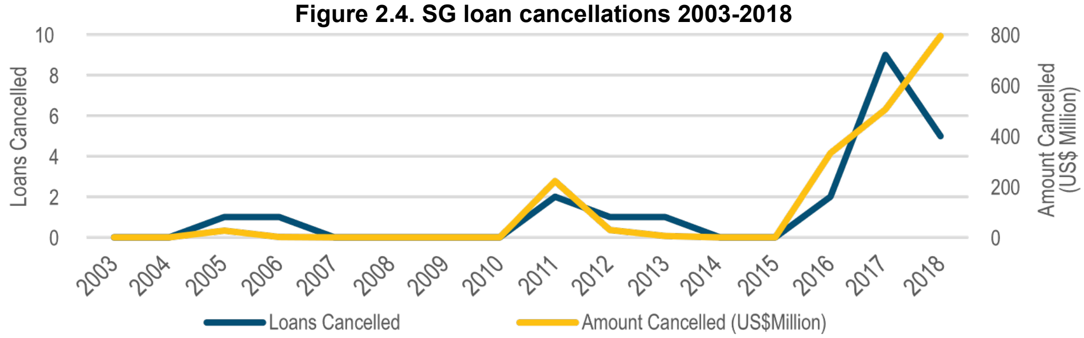
[b] *Country sub-systems can be used by IDB after a rigorous validation process (following GN-2538) to determine whether they conform to IDB standards.*

Source: OVE, based on analysis and interviews.

2.25 **However, costs were affected by high cancellations during the second half of the evaluation period (Figure 2.4).** Cancellations of approved Mexican SG operations have increased strongly since 2016, and most – according to interviews – were due to (i) cuts to the budget of Mexico's Federal Government, and/or (ii) IDB's reduced competitiveness following its late-2015 increase in loan charges.[73] US$1.6 billion was cancelled from 15 operations (three operations were cancelled in their entirety) during 2013-2018, a 5.5-fold increase over the last evaluation period in terms of cancelled amounts (and a four-fold increase in number of operations with cancellations). Cancellation amounts started to increase in 2016, reaching their highest level in 2018, when 30% of available balances were cancelled. Because of the cancellations, Mexico's average execution cost per US dollar disbursed for investment loans increased by 14% for Mexico compared to the 2007-2012 period, whereas it fell by 38% for IDB overall, and by 26% for peers during that time.

[73] Overall, 36% of cancelled SG amounts were due to Government budget cuts, 30% due to IDB's reduced competitiveness (all of which by DBs, where this reason contributed to 60% of cancellations), 23% due to changed Government priorities, and 21% for other reasons (percentages do not add to 100% as some operations were cancelled for more than one reason). The sector with the highest cancelled amounts was rural development, followed by climate change (energy), urban development, education, labor markets and public management (see Annex I, Table I.11).

Figure 2.4. SG loan cancellations 2003-2018



Source: OVE calculations based on internal databases

2.26 **NSG operations in Mexico had higher rates of cancellations and prepayments than those in peer countries[74] during the period, but lower rates of impairments and write-offs.[75]** Of all NSG operations approved during the evaluation period, 44% (56% in terms of approved amount) have since been cancelled or dropped, compared to 41% (33% in terms of amount) for similar countries. Of the NSG operations that were approved and had disbursed during the period, 15.9% (2.3% in terms of amount) have since been prepaid[76] and therefore generated lower revenues than initially expected, compared to 9.1% of operations (1.4% of amount) during the same period in peer countries. Only 1.5% of Mexican NSG operations (0.2% in terms of amount) approved and disbursed during the period suffered subsequent impairment or write-offs, compared to 2.7% of peer country operations (4.3% in terms of amount). These data are consistent with the relative maturity of Mexico's financial markets, in that alternative financing sources are typically more available, and credit quality is better on average than in other countries. Because of a lack of comparable time recording systems across IDBG's private sector windows during the period, no consistent and reliable data about NSG project processing times and costs are available. Client interviews point to general satisfaction with IDB Invest's responsiveness; however, several clients also reported that their operation was affected by turnover in their assigned IDB Invest counterparts during the period,[77] in that project timelines were delayed because of loss of knowledge, or some initially agreed-upon conditions were renegotiated.

74 The same group of peer countries was used for NSG as for SG (Argentina, Brazil, Colombia, Dominican Republic, Ecuador, Chile and Peru). Due to inconsistent availability of data on historic cancellations, prepayments and write-offs for the whole portfolio, comparisons are limited to peer countries.

75 All analysis is based on available information in IDB and IDB Invest systems, as well as additional research by OVE whenever data was incomplete or inconsistent.

76 Prepayment is defined as repayment before the original maturity date.

77 The evaluation period included the merge-out of IDB's private sector windows into the IIC (now IDB Invest).

III. Effectiveness of the Bank's Program

3.1 **This chapter analyzes the results of the IDBG's program during 2013-2018, grouped under the three pillars of the 2013-2018 CS (productivity, social development and regional development).** OVE also reviewed IDBG activities under the dialogue areas of energy, education and citizen security. Any important results on cross-cutting issues (gender, diversity and integration) are mentioned within the appropriate priority or dialogue areas. For assessing effectiveness, OVE considered those operations of the evaluation portfolio whose implementation was expected to make sufficient progress during the period to assess attainment of outputs and/or outcomes. Given the large portfolio size, this chapter presents results that are meant to illustrate the most important developments and contributions toward the CS strategic objectives, rather than discussing all operations.[78]

A. Productivity

3.2 **Overall, IDBG effectively supported Mexico in its efforts to create an environment that allows for more productivity growth**. As the paragraphs below describe, most IDBG operations in public management, business competitiveness and the financial system contributed to progress toward the CS strategic objectives (Table 2.1). However, IDBG's limited role in certain programs and reform initiatives makes attribution of some results to IDBG intervention difficult, budget cuts and reduced IDB competitiveness partially affected results in certain labor markets and public management operations, and certain new NSG operations raise early effectiveness questions.

3.3 **IDBG operations contributed to the results of key reform efforts for increased productivity (Box 3.1), while the results of other interventions were more mixed.** In public management, IDB made financial and technical contributions to the fiscal reform and the implementation of the financial discipline law, resulting in increased non-oil fiscal revenues and improved financing conditions for certain subnational entities. In addition, IDB investment lending and TC support helped improve results-based budgeting at the federal level (ME-L1047, ME-T1148), financed subnational investments (ME-L1059, ME-L1111), and strengthened financial planning and management capabilities for the government of Yucatán (ME-T1123, ME-T1124, ME-T1138, ME-T1139), although expected fiscal management improvements for other subnational governments did not materialize. In the financial sector, support for regulatory reforms led to increased banking penetration and improved credit access for the private sector. In business competitiveness, IDB PBLs and TCs provided marginal support to reforms that increased competition and enhanced regulation in key economic sectors such as telecommunications, but the attribution of promising early results to IDB intervention is tenuous. IDB support to labor market reforms did not result in the expected policy changes, and while support through investment and TC operations aimed at improving intermediation and job training services (ME-L1258, ME-T1190, ME-T1301, ME-T1333) saw some positive results, both these latter operations and others that intended to reduce the gap between education system outputs and labor market needs (ME-L1142, ME-L1039, ME-T1224, ME-T1174) failed to fully achieve their expected results because of budget cuts and some design shortfalls.

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78 For more detailed and comprehensive information, refer to the sector notes for this CPE. For a list of operations in each priority area and sector, refer to Annex I, Tables I.3 and I.4. For an updated status of the CS Results Matrix indicators, see Annex I, Table I.5.

Box 3.1. Results of IDBG support to reforms for increased productivity

- **Public management.** While two PBPs financially supported Mexico's tax reform, another PBP and two TCs provided substantial technical and financial support to the preparation and implementation of the 2016 Financial Discipline Law for Federal and Municipal Governments.[a] IDB was also engaged in ongoing dialogue in these areas. Among the results of the tax reform (which, however, are difficult to attribute to IDB support), Mexico's non-oil tax revenues rose from 15.5% (2013) to 18.8% (2017) and the promoted use of digital bills and receipts increased more than expected. Because of the financial discipline law and associated implementation actions, transparency around the financial situation of subnational governments has increased substantially, bringing improved financing options and conditions for certain subnational governments. Given IDBG's strong technical support to these initiatives (including best practice exchanges with other governments, law and rules drafting, development of a subnational debt registry and alert system, and training), at least some of the results in this area may be attributed to IDBG support.
- **Labor market.** In line with prior dialogue between IDB and Mexico in this area, IDB provided a TC (ME-T1222) to serve as technical input for the planned reform of the social security system, which would have ensured universal access to health care, unemployment insurance and pensions, regardless of employment status. This reform (excluding health care in the final bill), was passed by Mexico's Congress in 2013/2014 but did not pass Mexico's Senate, and has therefore not been implemented. Another TC (ME-T1278) financed a study on innovative approaches to reducing labor informality (another major reform area); however, its focus was limited, and the activities were not implemented beyond the study.
- **Business competitiveness and financial system.** SG PBLs (ME-L1141, ME-L1186) and TCs (ME-T1260, ME-T1334) supported an ambitious reform program to improve productivity through increased competition and enhanced regulation in key sectors (telecommunications, financial sector) and otherwise decreased transaction costs. The TCs supported specific studies on state-level productivity gaps and the establishment of state productivity commissions and special economic zones, but most reform activities were designed and implemented without IDBG technical input. Therefore, while the reforms have shown some promising results (lower prices and higher quality for telecommunication services, increased banking penetration and credit to the private sector, improved money-laundering and anti-terrorism finance controls in the financial sector), attributing specific results to IDBG support is difficult. Interviewed counterparts, however, highlighted the importance of the positive market signal provided by IDBG's "seal of approval" for the reforms more generally.

[a] *PBPs for tax reform: ME-L1144, ME-L1189. Fiscal management of subnationals: ME-L1253 (PBP); ME-T1276, ME-T1310 (TCs)*

Source: OVE, based on analysis and interviews.

3.4 **Available results of NSG operations in business competitiveness[79] have been generally positive, although there are concerns about the effectiveness of some operations.[80]** The expansion of the Manzanillo port (ME-L1152) has added significant additional port capacity, and a related TC (ME-T1239) produced a study about climate change mitigation and adaptation considerations for Manzanillo, which the port authority used in its planning activities. IDB Invest's financing to several debt and private equity funds has so far provided financing to at least 20 medium-sized companies in various sectors (education, health, renewable energy, manufacturing, hospitality, etc.) which would otherwise not have had access to similar financing products, some of which were offered for the first time in Mexico. The IDBG-supported petrochemical plant Etileno XXI (ME-L1110) has been built and is operating, and has created a significant number of jobs in a low-income area. The supply of its primary input ethane by Mexico's state-owned hydrocarbon company PEMEX has, however, been affected by lower-than-expected domestic production of this product. While too recent for fully assessing

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79 OVE classified NSG operations under business competitiveness whenever their objectives were broadly aligned with this area and no other, more explicit sector applied (such as education, energy, etc.), regardless of original classification. This includes operations by the former IIC that did not follow the same classifications as IDB. Several operations to provide finance through FIs to companies are included both under business competitiveness and financial sector.

80 Given the large NSG evaluation portfolio in this area and the limited results data available for smaller, older operations especially by the former IIC, this section focuses on the results of operations of at least US$10 million.

results, IDB Invest's support to supply chains through large anchor companies poses some early effectiveness questions:

- While the supported **vertical integration** of one large industrial client has the potential to significantly improve the direct borrower's productivity and competitiveness, the direction of net employment and income effects for SME companies in its existing and future supply chain is less clear-cut, and would warrant further study to properly set expectations about development impacts for this and future similar operations.
- Early result indications of IDB Invest's **supply chain finance operations** in Mexico point to limited development impacts, in that clients report that IDB Invest support has thus far resulted in slightly better pricing, but not in smaller or more suppliers having access to factoring solutions.[81] This is because for the moment, IDB Invest financing does not increase their total factoring amount but rather replaces part of existing commercial bank lines because of excess financing supply, especially in local currency, where there is ample commercial funding for this short-term product through the partner platform.

3.5 **A majority of loans to FIs have increased FI lending to the target segments, but for some operations there is insufficient information to assess effectiveness.[82]** While IDBG typically tracks well how the client FI reports using the specific IDBG loan itself, this information is not enough when IDBG supports existing activities, since it does not show whether the FI increased its financing to the target segment overall. It is necessary to know how the whole relevant outstanding portfolio evolved, not only what was on-lent with IDBG funds. However, when supporting activities that are new to the FI, usually knowing how much was deployed under the IDBG operation is sufficient as it can be considered an increment of lending to that specific segment. Of the 43 SG and NSG on-lending operations through FIs that had progressed sufficiently to show results during the period, the majority (30) targeted client segments that the FI was already financing on its own account as well, but OVE found relevant portfolio information for less than two-thirds (19) of them.[83] Of those, most (16) had increased their lending to the target segment by at least the size of the IDBG loan, whereas lending had contracted despite the IDBG operation for the remaining three. All of the other (13) operations that supported activities that were new for the FI showed evidence that they had reached or exceeded the FI's resource deployment targets. Profitability data for the relevant portfolio, to ascertain whether the increase was sustainable, were usually unavailable.[84]

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81 While IDB Invest requires its lines to be predominantly used for MSMEs, the overall number of MSME suppliers with access to financing is not known since IDB Invest tracks only the use of its own line, and not all suppliers of its anchor clients financed also by other banks through the e-platform. However, interviewed counterparts stated that IDB Invest has not had an impact on the number and size distribution of suppliers, and that thus far, most MSME suppliers financed by IDB Invest had been re-assigned from other bank lines on the same platform.

82 For more information about the evaluation approach and results, refer to Annex XII.

83 The finding of insufficient information is in line with results of OVE's 2016 Evaluation of IDB Group's Work Through Financial Intermediaries (RE-486-2).

84 Data on non-performing loans of the specific target portfolio was available in only five cases.

B. Social development (social protection, health and education)

3.6 **IDBG support in social protection and health helped make partial progress towards the strategic objectives.** IDB's main value-added to Mexico's flagship social protection program PROSPERA was knowledge created through studies, data collection and evaluations—which, however, led to only limited program adjustments. Some studies financed by IDB during the evaluation period generated relevant information to inform a dialogue around possible adjustments to PROSPERA's nutrition and education-related transfers. However, despite the positive results observed in some of the education-related pilot initiatives, they were not scaled up, so their possible impact was limited over the evaluation period[85] While there have been some improvements in educational attainment and nutritional outcomes among PROSPERA beneficiaries, the former can therefore not be attributed to IDB support over the evaluation period. The results of IDBG investment operations in health have been mostly positive, if limited in reach. IDB's support to the SMSXXI program (ME-L1028, ME-T1307) has helped strengthen the operations of the fund that contributed to reductions in child mortality and out-of-pocket payments among beneficiaries. In Chiapas, the Mesoamerica grants (ME-G1001, ME-G1004) helped improve access to maternal and child health services and make essential medical supplies more consistently available. However, dispersed TC activities that were largely disconnected from lending operations enjoyed variable ownership by the Government. As a result, the TCs did not significantly contribute to advances in the areas on which they had focused, partly because of insufficient Bank follow-up. The company supported by the one NSG operation in the sector successfully introduced a new hypertension drug to the Mexican market.

3.7 **Recent operations supported by IDBG in the education sector[86] show some promising early results, yet uptake of Bank technical support was limited.** IDB operations in education implemented during the period focused on improving school infrastructure (ME-L1086, ME-L1171) and on supporting the quality of education offered by community schools outside the traditional education system (ME-L1033, ME-L1162). While the first school infrastructure improvement operation reached its objectives, the second fell short because of the partial cancellation of the loan. IDB's support to community schools, provided in part through TCs, helped improve educator recruitment and training, and implement a new model of teaching and learning. IDB was largely at the margin of the government's broader education sector reforms, providing limited and specific support through various TC-funded studies and pilots, most of which do not appear to have made a significant and lasting contribution. On the NSG side, IDBG support contributed to the development of the nascent student loan market and supported the financing of teacher-bought school materials, although the results of some operations have fallen short of targets thus far because of overly optimistic expectations related to student loan uptake.

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85 The results of two evaluated pilots (financed under ME-L1091 and ME-T1335), showing a decrease in drop-out rates (albeit increased costs) when changing the recipient of high school scholarships from the mother to the student and/or when increasing the amount of transfers for middle and high school students are now reportedly drawn on to inform the design of the new government's national scholarship program that is slated to replace PROSPERA

86 Since education was a dialogue area under the CS, there were no established strategic objectives.

C. Regional development and energy[87]

3.8 **IDBG support to regional development and energy has yielded some important results, although the implemented program deviated from the CS strategic objectives (Table 2.1) in some areas, and was partially affected by budget cuts.** As the paragraphs below describe, IDBG support in climate change has helped make significant progress on climate change mitigation and mainstreaming[88] initiatives, but has not made significant inroads on the adaptation objective laid out in the CS. Operations in urban development, some affected by delays and cancellations, advanced the objective of orderly and sustainable urban growth, but did not address the citizen security aspect of the objective. In rural development, IDBG support was more aligned with the CS in that IDBG helped improve rural water and sanitation coverage, the creation of public goods, and the expansion of financing suitable for improving agricultural productivity. In energy, IDBG-supported results exceeded the CS expectations by providing financing in addition to inputs to the sector dialogue.

3.9 **Several pre- and post-reform IDBG operations in energy and climate change mitigation show significant results.** Through numerous SG and NSG operations relevant for both energy and climate change, IDBG helped implement specific yet crucial parts of the energy sector reform and spark strong growth in the provision of competitive renewable energy (see also Box 2.2). Through NAFIN and BANCOMEXT, as well as through NSG operations (directly and through a fund), IDBG has lent US$755 million of its own resources and mobilized US$142 million in concessional resources, contributing to financing 20 renewable energy projects[89] worth US$4.5 billion to build an additional 2.7 GW in clean energy capacity, of which 2.5 GW are already operating.[90] Additionally, TCs helped NAFIN (ME-T1168) build up its renewable energy finance area and enabled both NAFIN and BANCOMEXT (ME-T1204) to apply more rigorous environmental and social standards to their operations. The gas pipeline "Los Ramones," financed in part through IDB loans to NAFIN (ME-L1151) and BANCOMEXT (ME-L1172), has been built and is operating (albeit still below full capacity), and one of the two large combined-cycle gas power plants (for a total capacity of 2.4 GW) financed under the same loans is also up and running. Moreover, there has been progress in several results indicators (such as the length of the gas pipeline network, the share of clean energy generation and electricity network coverage) under the subsequently approved PBP operation (ME-L1264) for the implementation and strengthening of the energy sector reform, although there has been little improvement in technical and commercial losses in electricity distribution and transmission.

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87 Since a large part of IDBG interventions relevant to climate change were in renewable energy or energy efficiency, this section also covers the energy sector, although the sector was a dialogue area outside the regional development pillar in the CS. There were no CS strategic objectives for energy.

88 In line with the cross-cutting nature of climate change topics in IDBG's Institutional Strategy, the Climate Change Division considers 72 Mexican operations from 9 sector divisions (excluding IDB Lab and IDB Invest) to have contained climate change components during the evaluation period,

89 On the NSG part, this includes 10 solar power plants approved after the reforms (11894-02. 11894-03, 11894-04, 12197-01, 12083-01, ME-L1136) and two wind power plants (ME-1107, ME-L1125) approved before the reforms. On the SG side, this includes one solar, six wind and one hydro power plants financed through NAFIN (ME-L1109 and ME-L1119).

90 The 2.7 GW supported by IDBG correspond to 27.7% of the overall increase in Mexican installed renewable energy capacity between 2012 and 2018, which grew strongly from 14.4 GW to 24.1 GW during the period (source: Mexican Energy Ministry SENER).

3.10 **Some other IDBG-supported operations in energy and climate change have been delayed and have therefore fallen short of reaching their objectives.** SG operations supporting geothermal energy (ME-G1005, ME-L1148) have suffered long delays and required redesign, with no tangible results to date because geothermal energy prices are not competitive under current market circumstances. IDBG support to energy efficiency (EE) investments has also fallen short of expectations thus far. One SG operation (ME-L1267) that was intended to improve the EE of government buildings has not disbursed because of design challenges and unclear interest of counterparts, and NSG operations aiming to finance and securitize EE investments have faced delays because of design and other implementation issues. While one of the NSG-financed legacy Oaxacan wind farms in the evaluation portfolio has been operating well despite a 2017 earthquake, another operation was never implemented because of community opposition.[91] The only loan (ME-L1268) approved for climate change mitigation and adaptation during the evaluation period, structured as a results-based loan with an innovative design to reward reduced urban sprawl, deforestation and forest degradation, has not yet been signed in an effort to avoid commitment fees before disbursements. And while an FFS operation (ME-R1002) helped BANOBRAS apply the ESCI methodology to four Mexican cities, a 2017 ESCI investment grant (ME-G1012) to improve the mitigation and adaptation capacity of three Mexican cities (Xalapa, La Paz and Campeche) in the areas of clean energy, solid waste management and sanitation has not initiated disbursements becasue of delays caused by local counterpart turnover and lack of procurement capacity.

3.11 **Shifting Government priorities and budget cuts affected results for urban development operations.** A legacy SG operation for neighborhood improvements (ME-L1098) led to improved access to basic services and housing quality,[92] but a follow-on operation was cancelled because of shifting priorities. In an IDB-supported urban water and sanitation program (ME-L1176), severe budget cuts to the executing agency CONAGUA led to disbursement delays and lowered expected results, although the project has met the revised targets thus far. IDB's support to SHF (ME-L1103, ME-L1121)[93] for low-income housing finance has introduced innovative approaches to fostering environmental sustainability and climate change considerations, and has supported the primary and secondary mortgage markets. While the green housing finance operation with SHF (ME-L1121) has reached or exceeded most targets, other operations showed more mixed results (or did not track them), and 70% of the last operation was cancelled because of reduced demand and IDB competitiveness. NSG support for developing Mexico's secondary mortgage market through direct financing to INFONAVIT, as well as to the first mortgage trust fund to securitize INFONAVIT mortgages, has contributed to lowering the income threshold for the mortgages it securitizes, and the demonstration effect of IDBG financing has allowed the trust fund to now fund itself from commercial sources. IDB

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91 A compliance review into Energía Eolica del Sur (formerly Mareña Renovables) by IDB's Independent Consultation and Investigation Mechanism (MICI) found that IDB had failed to comply with several Bank policy provisions that are meant to provide for timely and appropriate community consultations and disclosure.

92 Since results for the originally established indicators could not be monitored, alternative indicators were used to assess outputs and outcomes, including an impact evaluation.

93 The most recent operation (ME-L1163) has not disbursed yet.

Invest's support to some housing developers was more clearly developmental (in benefiting largely lower-income segments) in some cases than in others.

3.12 **IDBG operations in rural development generally showed good results.** Apart from financing subsidies to rural producers, IDB's support to PROCAMPO through a legacy CCLIP operation (ME-L1041)[94] helped improve the program's focus on smaller farmers and introduce operational improvements that resulted in significantly lower administrative expenses and processing times. Another loan (ME-L1045) contributed to modernized systems and financial and technical support centers for farmers, and accompanied the successful international tenders for (i) a nuclear fly sterilization plant in Chiapas (construction is ongoing) that should help ensure that Mexico remains free of the devastating Mediterranean fly, and (ii) a marine research vessel that has already been successfully deployed to map marine wildlife on Mexico's Atlantic and Pacific coasts.[95] Notwithstanding these good results obtained in 3 of the 4 project components, counterparts attribute some delays and the cancellation of one component[96] in part to design flaws, in that the loan covered too many disconnected activities with four different responsible agencies under the same operation, which led to governance and coordination issues. IDB's support to rural water and sanitation (ME-L1147) was affected by a partial loan cancellation prompted by budget cuts, but increased subnational counterpart funding helped reach or exceed some of the coverage targets. IDB support to FND and FIRA[97] helped incorporate environmental and social aspects into, and otherwise improve, credit assessment methodologies, as well as extend financing for various rural productive activities. In most cases, the available data suggest that overall financing by FND and FIRA to target segments has met or exceeded targets. IDB also supported FND in an innovative project (ME-L1120/ME-G1002) to reduce deforestation and degradation, which – after initial delays prompting a redesign – has made progress towards most of the expected results. A majority of targets under a small IDB loan (ME-L1115) to a remittance-based investment program in rural communities were reached. The scarcity of information about the results of the various small direct or indirect (via FIs) NSG loans to rural producers makes an assessment of their effectiveness impossible in most cases.

D. Other areas of support

3.13 **Counterparts highly valued IDB's TCs for citizen security topics, and of the TCs not aligned with the CS, those used to provide quick support after natural disasters were the most noteworthy.** Through a series of TCs,[98] IDB supported capacity building and process improvements in crime data collection for various key actors in Mexico's justice system to complement the reforms to Mexico's judicial branch. Another TC (ME-T1275) supported the development of an internet platform to improve the collection, analysis and publication of data on violence against

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94 Since the executing agency SAGARPA did not agree to support the impact evaluation components required by IDB and generally saw limited financial value in IDBG participation, a second CCLIP operation did not materialize.

95 It is too early to assess the results of another investment supported by IDB (the construction of a secure laboratory to test for highly contagious animal diseases).

96 Investments in agricultural, fishing and forestry innovations.

97 FND: ME-L1055, ME-L1161, ME-L1170, ME-L1259, RG-T1779, RG-T1866, ME-T1199 ; FIRA: ME-L1145, ME-L1190, ME-T1265, ME-T1266, ME-G1006.

98 ME-T1352, ME-T1355, ME-T1381.

women; the platform is online, but dissemination and maintenance are a concern. Counterparts expressed a high degree of satisfaction with the technical support they received, which allowed them to learn from international and regional best practices, as well as with IDB's role as neutral intermediator, which helped give continuity to initiatives despite coordination issues among the many institutions involved. Seven TCs[99] not aligned with the CS provided fast financing for relief efforts after several tropical storms in 2013-2016 and two strong earthquakes in 2017, and another TC (ME-T1366) helped assess earthquake damage to water infrastructure.[100]

E. Sustainability

3.14 **The development results of a good part of IDBG's 2013-2018 country program appear sustainable.** Several of the reforms (for example in the tax, energy, productivity and telecom areas) supported by IDBG have already produced tangible development results, and some of the progress is anchored in long-term contracts and constitutional laws that would be politically and financially costly to reverse. Mexico now enjoys higher non-oil tax revenues, increased competition in various areas, more credit to the private sector and lower prices for telecom services of better quality. Numerous renewable energy plants are set to begin producing clean energy at record-low prices, and a large-scale nationwide mobile broadband network is being built to deliver high-speed internet to previously underserved regions.

3.15 **Given the political transition, however, sustainability is uncertain in various areas.** The severe budget cuts during the second half of the evaluation period resulted in cancellations and project execution below expectations, and there is uncertainty about the continuity of several long-standing Government programs supported by IDBG.[101] The incoming administration's stated disagreement with certain reforms approved under the previous administration,[102] its changed policy focus in many areas,[103] the high staff turnover during the transition, and additional budget cuts in many relevant executing agencies[104] pose additional challenges to sustainability. This is especially true for some operations which were approved toward the end of the previous period (such as the urban water and sanitation program) or other projects that have yet not been fully executed, but also for other operations whose

99 ME-T1241, ME-T1242, ME-T1272, ME-T1303, ME-T1324, ME-T1364, ME-T1365.

100 Three other non-aligned TCs supported activities in the local food/tourism industry (ME-T1289; not used), parenting strategies (ME-T1270; evaluation showed no impact) and services for women (ME-T1259; replicated but implementation affected by budget issues).

101 For example, the new Government has announced that PROSPERA will cease to exist in its current form, to be replaced only in part by a modified scholarships program. The continued existence of PROFORHCOM seems also unlikely, and general reorganizations seem likely in labor markets, health and social programs.

102 One example is the energy sector, in which the fourth auction for renewable energy contracts has been cancelled, along with a large transmission line.

103 One example is urban development, in which a new focus on informal peri-urban settlement appears to replace earlier priorities, such as urban densification, climate change/sustainability and other programs supported by IDBG. A reduction in certain housing subsidies may also affect the size and focus of IDBG's support to mortgage markets.

104 Examples are rural development, in which the budgets of some executing agencies were cut by almost 40%, and the elimination of budget for PROFORHCOM. However, a loss of personnel familiar with IDB-supported programs and budget cuts of various dimensions that affect program execution and use of technical inputs were reported across virtually all relevant Government areas.

development results may not materialize as expected because of changes in policy[105] or in the general market rules.[106] However, given the recent transition and still-undefined policies in many areas, it is too soon to draw definitive conclusions about the sustainability of development results, especially as the elimination of some Government program aspects may be compensated for by other, new policies.

3.16 **Unless market conditions change, sustained lending of large amounts to DBs for similar activities seems unlikely, at least in the short term.** During the second half of the evaluation period, SG loans to DBs did not disburse or were cancelled because of increases in IDB's loan charges at the end of 2015, and activity has not resumed since,[107] although the IDB subsequently lowered its spread again. In OVE interviews, most DBs reported that, while valuing IDB's technical support, they do not need IDBG financing under normal market circumstances,[108] except when they try to avoid asset-liability tenor mismatches for long-term assets. During the evaluation period, such DB assets were plentiful because of the strong growth in renewable energy and gas power projects prompted by the energy sector reform, and large one-off operations such as the Red Compartida and gas pipeline. Given the DBs' gradual withdrawal from financing many long-term renewable energy assets,[109] the cancellation of the new energy auction and the planned transmission line, and a general change in government priorities for DBs toward job creation and national production, it seems doubtful whether a similar amount of long-term DB assets will need IDB financing for the near future.[110] Given the highly efficient nature of lending to DBs during the evaluation period, a reduction in lending to DBs could also affect IDBG's overall cost of lending to Mexico.

3.17 **Several sustainability considerations also arise from the 2013-2018 NSG program.** While the sustainability of results in NSG-financed operations seems likely in most cases, a few areas of NSG support pose questions to be considered going forward. Given the private sector merge-out and IDB Invest's strategic reorientation away from direct financing to SMEs, as well as early questions around the potential development impact and additionality of reaching value chains through large companies thus far, IDB Invest's current business model of supporting SMEs in Mexico may need some more adjustments to be sustainable,

105 One example is improvements in nutrition and health among PROSPERA families, which may not be fully sustained over time given the loss of transfers that are conditional on these issues.

106 Examples are the renewable energy projects and the PPP for Red Compartida, the sustainability of which can be affected by changes in contracts, rules, and regulations.

107 One exception is a loan approved for BANCOMEXT (not yet disbursed) to finance part of its lending to the Red Compartida project.

108 Lending to FND and FIRA, which have fewer alternative financing sources, seems more resilient than lending to others. However, several DBs pointed to the value of having an approved (if unused) IDB line as a stand-by for crisis situations.

109 NAFIN, together with BANCOMEXT the most important financier of such projects, reported a reorientation towards financing merchant plants and selling them as soon as they sign a long-term supply contract, since NAFIN understands its mandate as taking only risks that commercial markets are not ready to take.

110 This could change if lending to or through BANOBRAS to subnational entities resumes. This would, however, require either significantly lowering the transaction costs of IDB lending through BANOBRAS, or modifying the financial discipline law for subnational entities so that criteria other than price would be allowed for subnational decisions on financing sources.

additional and effective.[111] Renewable energy accounted for a large part of the NSG approval volume during the evaluation period, and similar levels of activity seem unlikely, at least in the short term, given the uncertainty about the new Government's energy policy. Another area of sustainability concern is securitizations: while being at the market forefront by creating innovative financing solutions is appropriate for IDB Invest as a development bank in an investment-grade country such as Mexico, some of the chosen assets (such as heterogeneous EE investments) may, at least in the short to medium term, remain difficult to securitize without ongoing substantial IDB Invest guarantees—a situation that would limit the demonstration effect and eventual commercially self-sustaining replication of these operations. At the same time, however, the lessons learned from the failed Mareña Renovables project during the period have prompted IDBG (and Mexico's national DBs, with IDB support) to strengthen certain aspects of their practices[112] aiming to ensure environmental and social sustainability.

IV. CONCLUSIONS AND RECOMMENDATIONS

4.1 **IDBG's role in Mexico is limited by institutional factors and IDBG's small size compared to Mexico's development needs.** Given the size of the country and its development challenges, the possible scope of IDBG contributions is necessarily limited. Demand for IDB SG support is moreover not uniform across all areas,[113] with Mexico preferring for IDB to fill specific gaps rather than assume a core role in policy and program design. While IDB could add significant value at the subnational level given the large development needs of some regions, legal (including constitutional) and transactional obstacles continue to prevent effective IDB financing solutions to subnational governments despite an ongoing dialogue with the Government to solve this issue.

4.2 **IDBG's program with the country has been largely relevant.** IDBG has in most cases found ways to provide value and respond to country needs. On the SG side, IDB delivered specific yet important support to several key reforms, and helped them come to life through SG and NSG financing. Even though the CS did not include an explicit geographical focus for IDB support, those parts of IDB's implemented program that directly or indirectly benefited subnational entities predominantly focused on Mexico's poorer states. Moreover, in the areas of social protection, health, and education, IDB more generally addressed socioeconomic disparities through federal programs focused on the poor. Most NSG operations have been clearly additional and supported developmentally relevant activities, some of which were innovative. Some NSG support to SMEs through the supply chains of large companies, however, raises questions about the extent to which the proposed solutions adequately address relevant development constraints. Despite having access to capital market funding at competitive rates, the Mexican government has continued to use IDB funds for some of its external financing

111 Given the need to adjust IDB Invest systems and processes to handle the many and small transactions under IDB Invest's supply chain financing product, the latter also raises some operational risk concerns.

112 IDB Management's action plan in response to the MICI findings included developing better guidance notes for consultations and impact assessments, staff training, and more consistent disclosure practices.

113 An example is the area of citizen security, which – despite posing critical development challenges in Mexico – saw only limited IDB contributions, in line with CS expectations. On the other hand, IDBG involvement in education and especially energy was more substantial than expected at the outset of the period.

needs. However, in various areas IDB support lost some of its relevance during the second half of the period, as declining IDB competitiveness for national DBs, changed Government priorities, and budget cuts led to high IDB loan cancellations.

4.3 **Despite results falling short of expectations in some areas affected by budget cuts and loan cancellations, IDB effectively supported Mexico in its achievement of important development results through the provision of specific technical inputs and lending for key structural reforms.** Outstanding examples of the effectiveness of IDBG support include implementing the energy reform and financing renewable energy projects, the fiscal reforms, and certain rural development programs. IDBG also contributed, if sometimes at the margin, to Mexico's financial sector and general competitiveness reforms and to other Mexican Government programs. During the period, numerous areas supported by IDB across various sectors were affected by budget cuts, so that in some cases operations did not fully achieve their expected results because of loan cancellations or reduced counterpart funding. IDBG provided technical inputs through TCs which were highly valued when they supported key aspects of Government reforms or lending operations, but in other instances were dispersed and received limited ownership and use. The limited availability of information about the effectiveness of some financial sector and TC operations suggests that there are opportunities to better document development results.

4.4 **IDBG's business model of supporting Mexico seems slated for change.** Albeit affected by high cancellations during the second half of the period, IDB's program implementation was again highly efficient during this evaluation period, in large part thanks to large-scale lending for reforms, DBs and established Government programs, some of which IDB had already supported for more than a decade. NSG and SG lending through DBs was furthermore boosted by large financing needs prompted by the opening of certain markets to more private sector participation. Given Government priority changes and market forces, the continuation of this business model seems less likely in the next strategy period, and IDBG will have to explore new ways to provide value and remain relevant to Mexico's needs in various areas. At least in the short term, this will require significant investments into policy dialogue and program preparation, and may result in lower initial financing amounts than during the previous period. A renewed attempt to find feasible ways to finance subnational entities and more directly work with them can boost IDB's value-added in Mexico, but is likely to also require substantially increased IDB resources because of the higher technical support needs of many subnational counterparts. All of these factors point to potentially lower operational efficiency for SG operations with Mexico going forward, at least in the short to medium term.

4.5 **In light of the evaluation findings, OVE recommends to Management:**

For IDB:

1. **Seek avenues for IDB to stay relevant to Mexico's development needs.**

   (a) **Actively engage in a dialogue to identify federal programs and policies where IDB can add value.** Given the likelihood of significant policy changes, the Bank should work with the Government to identify key policy areas where it can add value through technical inputs and financing, and subsequently ensure learning through robust monitoring and evaluation of IDB-supported programs.

(b) **Continue efforts to find solutions for more direct support to subnational entities while weighing needs and feasibility.** Given the stark inequalities within Mexico and the large development needs of some regions, IDB work with subnational entities can add significant value. When continuing its support to subnational governments through development banks, federal government programs and TCs, or exploring options to provide more direct financing, IDB should put particular emphasis on subnationals with important development needs while also taking into consideration trade-offs in terms of operational and financial implications, given the higher technical support needs at that level.

2. **Increase efforts to ensure strategic use and increased counterpart uptake of TC outputs, and improve documentation of results.** TCs can be an important tool to inform a policy dialogue with the new authorities and to use in program preparation. In light of limited IDBG TC resources, and in line with the previous CPE's findings, OVE recommends that Management take measures (such as strategic planning within the country programming exercise and with key Government counterparts) to increase the likelihood that TC products will be useful to, and used by, counterparts. Given the lack of evidence about the use of many client support and knowledge and dissemination TCs, improve IDB follow-up with clients and documentation of results and use.

For IDB Invest:

3. **Strengthen the effectiveness and additionality of IDB Invest's business model of supporting SMEs through value chains.** Since Mexico is the first country to which IDB Invest has rolled out its new supply chain finance product, it serves as an important test case from which to draw early lessons that can inform the implementation of this product going forward in Mexico and elsewhere. Given early indications of limited financial additionality and development impact of the supply chain finance product as implemented in Mexico to date, OVE recommends that IDB Invest tailor the instrument mix (funded vs. unfunded support, senior debt vs. other instruments, technical cooperation, etc.) to each market to ensure financial and/or non-financial additionality. Moreover, clearly document development results, which at a minimum requires tracking the evolution in the number and size of all suppliers to IDB Invest's anchor clients financed through the partner platforms (not just suppliers financed under the IDB Invest lines, or all suppliers served by the platforms). For vertical integration operations, further study the direction and distribution of impacts on supply chain companies, to clearly represent and document development results.

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