PUBLIC
SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
AND IDB INVEST

MEXICO

IDB GROUP COUNTRY STRATEGY
(2019-2024)

NOVEMBER 2019

This document was prepared by Agustín Filippo (CID/CME), Claudia Grayeb (CID/CME), Neile Quintero (CID/CID), Laura Alonso (CID/CID), Marta Ruiz Arranz (CID/CID), Miguel Taborga (CID/CME), German Zappani (FMP/CME), Ariel Rodríguez (FMP/CME), Miriam Garza Cortina (FMP/CME), Karen Díaz (CID/CME), María Cecilia Acevedo (DSP/DCO), Dora Moscoso (LAB/IEB), and VPS specialists, under the supervision of Verónica Zavala (CID/CID) and Tomás Bermúdez (CID/CME).

CONTENTS

LINKS

Country Development Challenges (CDC), Mexico 2019

Fiduciary Technical Note

Portfolio Report

Civil Society Consultation

Donor Coordination

National Development Plan, 2019-2024

ABBREVIATIONS

CDC	Country Development Challenges
EMBI	Emerging Markets Bond Index
GDP	Gross domestic product
IMF	International Monetary Fund
NDC	Nationally Determined Contribution
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
PEMEX	Petróleos Mexicanos
SMEs	Small and medium-sized enterprises
WEF	World Economic Forum

EXECUTIVE SUMMARY

Country context	Macroeconomic stability has improved steadily in Mexico, and the country has become the second largest destination for foreign direct investment in the region after Brazil. This has helped Mexico to position itself in international markets and to deepen trade specialization, mainly in manufacturing. Nonetheless, per capita economic growth has been weak (1.5% on average since 1996) and poverty rates are high (42% in 2018). This is partly the result of gaps in access to social services, labor market deficiencies, and weak investment growth, all against a backdrop of persistent regional disparities.
IDB Group presence in Mexico	The 2013-2018 strategy proposed three areas of intervention: (i) productivity, (ii) social development, and (iii) regional development. The IDB Group approved US$12.960 billion in funds for the country, including US$10.97 billion corresponding to 31 sovereign-guaranteed operations (24 investment loans for US$6.32 billion and 7 policy-based loans for US$4.65 billion). IDB Invest approved operations totaling US$1.827 billion, and IDB Lab approved US$53 million.
Priority areas	The main objective of the IDB Group country strategy with Mexico for the 2019-2024 period[1] is to support inclusive, sustainable economic growth and bolster productivity. To this end, the IDB Group has agreed with the authorities to focus its actions in three areas: (1) supporting equitable and sustainable access to social services, (2) encouraging more buoyant investment, and (3) fostering more balanced and sustainable regional development. Issues of institutional quality and transparency, innovation and the digital agenda, climate change, and gender and diversity will be included as crosscutting themes in each area.
Indicative lending framework	The Government of Mexico has indicated its interest in maintaining a lending framework in line with the previous strategy. Accordingly, the Bank projects sovereign-guaranteed approvals totaling approximately US$10.25 billion over the 2019-2024 period, with a program of approximately US$1.7 billion per year. At the end of the strategy period, the debt with the IDB could account for 53% of the country's debt with multilateral institutions and 8% of its external debt.
Implementation considerations	In response to regional development needs, the Bank, together with the authorities, will continue to explore options for providing support to subnational entities (either directly or through the development banks), taking into account the country's prevailing institutional framework. Operational solutions will also be sought that acknowledge the fact that Mexico has access to a variety of financing sources.

[1] The 2019-2024 country strategy will come into force once approved by the IDB Group Boards of Executive Directors and will remain in effect until 31 December 2024.

Risks

The main risks to the strategy lie in the impact of extreme natural phenomena, on one hand, and a potential weakening of growth and a deterioration in the business climate, on the other, resulting from uncertainty associated with delays in ratification of the United States-Mexico-Canada Agreement, the situation in Petróleos Mexicanos (PEMEX), increased insecurity, and a perceived lack of transparency in the country.

I. SOCIOECONOMIC CONTEXT

1.1 Mexico is the second largest economy in Latin America and was the first country in the region to join the Organisation for Economic Co-operation and Development (OECD). Despite its substantial oil reserves, the country's current position in international markets and trade specialization is driven mainly by the manufacturing sector, which accounts for 88% of exports. Mexico also has a high degree of integration with the United States, a country that accounts for 80% of exports and 47% of imports and with which Mexico has had a free-trade agreement since 1993.[2] Mexico is the second largest destination for foreign direct investment in the region after Brazil, and it ranks among the top 20 in the world. These results are partly due to structural reforms implemented starting in the early 1990s, which have also led to a steady improvement in macroeconomic stability. Credit ratings have improved in response to this trend, increasing from Ba3 (speculative grade) in 1997 to A3 (investment grade) in the most recent ratings.[3]

1.2 Despite this, the quality of life for the population has stagnated. Mexico ranks 77th in the Human Development Index (below Chile, Argentina, and Panama), and although its position improved between 1990 and 2010, there has been no change since then. The country has made little progress in reducing poverty over the last 10 years: in 2018 (latest available data), poverty affected 42% of the population, with extreme poverty affecting 7%. Efforts to improve access to social services have led to moderate improvements in indicators that reflect the multiple causes of poverty (compared to purely monetary measures).[4] Underlying these patterns is a labor market that exhibits high levels of informality (57% of the economically active population, which is high considering the country's income level) and salaries that have grown at a slower pace than labor productivity over the last 10 years.[5]

1.3 There are also persistent disparities in several dimensions. Socioeconomic conditions vary between rural and urban areas and between the country's regions. In the southern states, GDP per capita is on average two thirds that in the northern part of the country, and one third of that in Mexico City. In southern and central Mexico, poverty stands at 55% and 45% of the population, respectively, while in the North it is 25%. In addition to this, climate events tend to exacerbate inequality as they have a greater impact on vulnerable groups. Although social gaps between geographic regions reflect the nature of production (primary or manufacturing activities), the degree of sophistication within a single sector is an important factor for income levels. For example, agricultural activities in developed areas in the Center and North of the country incorporate more innovation and capital and generate higher value-added per worker than those in the South.[6] Inequality is also seen in other dimensions, such as gender and ethnicity. Women have lower incomes than men

---

[2] Country Development Challenges (CDC), paragraph 1.2. The North American Free Trade Agreement (NAFTA) between Mexico, the United States, and Canada came into force in 1993. Its successor, the United States, Mexico, and Canada Agreement (USMCA), is expected to enter into effect soon. It has so far been ratified by Mexico's Congress and is currently awaiting legislative ratification by the other partners.

[3] Mexico's current risk ratings are as follows (outlook in parentheses); Standard & Poor's: BBB+ (negative); Fitch: BBB (stable); Moody's: A3 (negative).

[4] Multidimensional poverty fell from 44% in 2008 to 42% in 2018, while the share of the population with income below the poverty line rose from 49% to 50%. Source: National Council for the Evaluation of Social Development Policy (CONEVAL), August 2019.

[5] CDC, paragraph 1.25.

[6] CDC, paragraph 1.72.

(a gap of 16.5%) and less participation in the labor market.[7] Lastly, poverty and rurality are also associated with ethnicity.[8]

1.4 This social situation is largely the result of weak economic growth. With per capita GDP growth of 1.5% per year on average since 1996, Mexico has grown less than its main trading partners (the U.S., China, and the European Union) and other emerging countries (Chile, Russia, and Turkey). GDP growth in 2018 was 2.0% and is expected to be less than 1% in 2019.[9] This sluggish performance is partly the result of lower investment. Mexico invests around 20% of GDP, which is below the minimum level compatible with sustained growth (estimated at 25%).[10] Public investment has fallen from approximately 6% of GDP in 2010 to 3% in 2018, while private investment remains at 17% of GDP. Investment in infrastructure was less than 2% of annual GDP on average between 2008 and 2016,[11] well below the 4% to 6% of annual GDP required to achieve sustained growth in output per worker and to meet the Sustainable Development Goals.[12] Likewise, several indicators point to slow growth in productivity. According to the KLEMS (capital, labor, energy, materials, and services) model, the contribution of total factor productivity to economic growth has been negative.[13] Sluggish growth and investment reflects several factors, including low human capital, limited access to local financing, insufficient infrastructure, and weak institutions (particularly the structure of taxation, quality of expenditure, rule of law, and transparency).[14]

1.5 In terms of economic structure, although the country has made inroads into international markets and exports a wide variety of manufactured goods,[15] rising manufacturing exports have been accompanied by a greater dependence on imported intermediate and primary goods. As a result, few production chains have been created in the country's regions; instead, a number of production clusters have developed in specific geographic locations.[16] Rural areas and the primary sector have been left behind in this process of economic opening. The rural economy depends on a largely undiversified agricultural sector with low value added, and this has affected the income levels of the population in these areas—mainly the southern states, where agriculture is of a subsistence nature and

[7] The female employment rate is 45.0% in Mexico, compared to 59.4% in the OECD countries and 53.6% in Latin America and the Caribbean. CDC, paragraph 1.27.

[8] Southern Mexico is predominantly rural with considerable ethnic diversity, and poverty rates there are high. Four states with a high proportion of indigenous population—Chiapas, Oaxaca, Guerrero, and Veracruz—account for 17% of the national population but 37.5% of the population living in extreme poverty.

[9] GDP grew at an annual rate of 0.2% in the first half of 2019. The International Monetary Fund's World Economic Outlook for October 2019 estimated GDP growth of 0.4% for 2019, while the Bank of Mexico's April-June 2019 quarterly report (published in September 2019) reported expected growth of between 0.2% and 0.7% for the year.

[10] CDC, paragraph 1.10.

[11] Izquierdo, A. C. Pessino, and G. Vulletín. "Better Spending for Better Lives," 2018, IDB. According to this publication, investment in infrastructure is the lowest in the region apart from Trinidad and Tobago (see Figure 5.1, page 154). Lagarda, G. and J. Linares, "Country Infrastructure Briefs – Mexico," IDB Policy Brief, IDB-PB-316, April 2019.

[12] See Cavallo and Powell, 2019, "Building Opportunities for Growth in a Challenging World." Washington, D.C., Inter-American Development Bank. Fay, M., L. A. Andrés, C. Fox, U. Narloch, S. Straub, and M. Slawson. 2017. "Rethinking Infrastructure in Latin America and the Caribbean: Spending Better to Achieve More." Washington, D.C.: World Bank.

[13] CDC, paragraph 1.9.

[14] The term "infrastructure" refers to clean energy, urban mobility, and water and sanitation in terms of service quality. See CDC, Metodología de Diagnóstico de Crecimiento Económico, paragraph 2.6 et seq.

[15] See CDC, Annex I, paragraphs 1.61 and 1.68.

[16] CDC, paragraph 2.33 and Annex I, paragraphs 1.61 and 1.68.

access to markets is very limited.[17] The difficulties experienced in boosting productivity and promoting private investment in these states stem from human capital challenges, low integration and connectivity with the country's commercial hubs, and an adverse business climate that is associated with problems in access to credit, weaker respect for property rights, and a relative scarcity of infrastructure.[18] The country also faces significant challenges from natural disaster events,[19] which will be exacerbated by climate change and have a disproportionate impact on rural communities in the South.[20]

1.6 The "Country Development Challenges" analysis for Mexico identifies human capital, infrastructure, financing, institutional strengthening, and trade diversification as the main factors that inhibit investment and growth and that need to be addressed by economic and social policies. In addition, development will require a macroeconomic framework that preserves stability and creates suitable conditions for investment, together with a regional approach that responds to the challenges present in the country's different regions.[21]

1.7 The backdrop to implementation of the strategy presents opportunities. Structural conditions in the country, including demographic factors[22] and proximity to the U.S., are favorable for accelerated growth. A fiscal policy based on primary surpluses of around 1% of annual GDP has been announced with the objective of maintaining or even reducing the debt-to-GDP ratio,[23] while monetary policy is managed by an independent central bank. The authorities have prepared a National Development Plan for 2019-2024 that centers on crucial issues such as transparency, the fight against corruption, security, and the implementation of investment plans with emphasis on southern Mexico. In addition, Mexico was the first developing nation to present a Nationally Determined Contribution (NDC) with an adaptation component, which was an important step in managing the challenges presented by climate change.

1.8 Risk factors remain, however, including global trade tensions that create a recessionary bias in the world economy, hindering growth prospects for the Mexican economy. The International Monetary Fund (IMF) expects a slowdown in growth in the U.S. and in the European and Asian economies. Adding to this is uncertainty surrounding the trade agreement between Mexico, Canada, and the United States (USMCA, which is awaiting

---

[17] The lowest rates of annual growth in state GDP (2% or less) are found in the southern states. See CDC, Annex II, for an analysis of priority investments for productivity.

[18] See CDC, Annex II, paragraph 1.80 et seq.

[19] According to data from the National Center for Disaster Prevention (CENAPRED), Mexico ranks 1st out of 40 countries in terms of the economic losses inflicted by natural disasters, which have totaled US$50 billion over the last 30 years. This underlines the importance of an agenda for climate change adaptation. In the area of emissions, according to the National Inventory of Greenhouse Gas Emissions for the period 1990 to 2010, the country's total emissions reached 748 million tons of CO_2 equivalent in 2010, representing a 19% increase over the level in 2001. If this trend continues, the Government of Mexico estimates a further 28% increase by 2020, reaching 1 billion tons of CO_2 equivalent.

[20] Urban areas are also exposed to natural disasters. The September 2017 earthquakes, which affected Mexico City and other urban centers, highlighted weaknesses in different aspects of disaster risk management. In the agricultural regions of the South, which have poor connectivity and high poverty rates, populations are more vulnerable due to the nature of their assets and their more limited access to mechanisms for withstanding shocks and reestablishing themselves afterwards. CDC, paragraph 3.200.

[21] CDC, Annex II, paragraphs 1.78-1.85.

[22] Mexico is experiencing a demographic dividend, with the number of dependents for each 100 people of working age falling from 107 in 1970 to 59.9 in 2017. Another such dividend—the gender dividend—may also begin to have an impact as women's labor participation increases. See CDC, paragraph 1.16 and Figure F9.

[23] The debt went from 48.7% of GDP in 2016 to 45.3% in 2018. The fiscal adjustment required to stabilize the debt-to-GDP ratio is small and has improved since 2015. See Figures 5.3 and 5.4 in Cavallo, Eduardo and Powell, Andrew, "Building Opportunities for Growth in a Challenging World," 2019, IDB.

legislative ratification in all countries except Mexico), as well as the migratory situation involving the U.S., Mexico, and the Central American countries (which could pose risks associated with the immigration policies adopted by the U.S.). These factors could lead to a slower expansion in demand for Mexico's exports, which—together with a reduction in international risk appetite—could affect foreign direct investment and financial flows. Other sources of risk relate to the financial situation in Petróleos Mexicanos (PEMEX), which could have repercussions for the fiscal situation; a deterioration in the business climate associated with negative perceptions of progress in transparency, integrity, and the security situation; and the adverse effects of climate change.

II. THE IDB GROUP'S PRESENCE IN THE COUNTRY

2.1 The Bank's country strategy with Mexico for 2013-2018 was organized into three main pillars: productivity, social development, and regional development. The productivity pillar provided for interventions in the sectors of public management, the financial system, the labor market, and business competitiveness. The social development pillar involved work in social protection and health, while the regional development pillar supported urban and rural development and tackling climate change. Issues of gender, diversity, and integration were identified as crosscutting themes.

2.2 The IDB Group approved US$12.960 billion between 2013 and 2018, an amount that included US$10.97 billion corresponding to 31 sovereign-guaranteed operations (24 investment loans for US$6.32 billion and 7 policy-based loans for US$4.65 million), 105 technical cooperation agreements for US$35.1 million, and 8 investment grants for US$74.5 million. As for the private sector, IDB Invest approved 69 operations for US$1.827 billion,[24] while IDB Lab approved 50 operations for US$53 million.

2.3 **Main results of the IDB Group country strategy with Mexico, 2013-2018.** <u>The following outcomes were recorded in the productivity pillar:</u> In the area of public management, federal-level reforms were implemented with Bank support that succeeded in raising tax revenue (from 9.7% of GDP in 2013 to 13.9% in 2016) and making tax policy more redistributive. With respect to the efficiency and control of public spending, real growth in the education sector payroll was reduced (from 2.5% per year in the decade to 2014 to 0.5% in 2016) and a budgetary reengineering process was implemented that yielded savings of 0.7% of GDP. At the subnational level, new transparency and fiscal responsibility rules were introduced, and investment spending and accountability mechanisms were strengthened.[25]

2.4 In the **financial system**, there was an increase in the amount of financing channeled through the development banks and financial institutions to those segments of the real economy facing the greatest credit constraints. For example: (i) sovereign-guaranteed interventions funded 325 housing developers and more than 36,000 homes for individuals not belonging to the Instituto del Fondo Nacional de la Vivienda para los Trabajadores [Institute of the National Fund for Workers' Housing] (INFONAVIT), with 36% of these in areas with substantial housing deficits. Non-sovereign guaranteed operations provided new or improved housing solutions for 447,292 families; (ii) 13 financial intermediaries agreed to cofinance and strengthen IDB investment, increasing investment in renewable

---

[24] Includes three operations under the Trade Finance Facilitation Program (TFFP) for US$104 million.

[25] Revenue increased during the country strategy execution period, with the land tax rising by 72% between 2015 and 2018 (partly due to modernization of the register). The risk premium on subnational debts fell from 145 basis points in 2016 to 39 in 2018 and indebtedness declined, with subnational debt falling from 90.7% of shared revenue in 2013 to 71.6% in 2018.

energy generation and bringing total installed capacity to 2,897 MW; (iii) in the rural sector, the Bank helped to finance 143 projects run by indigenous women in forested areas, and investments totaling US$52 million were financed in energy efficiency projects for agroindustry; and (iv) the average loan maturity was increased by 50% to support the capitalization of more than 10,000 rural projects and investments to incorporate technology and technical models into almost 4,000 rural economic units, financing 1,836 highly marginalized municipios and securing the financial inclusion of more than 48,000 rural economic units. Also in this sector, the Bank adopted an innovative approach to help banks incorporate environmental and climate change considerations into their interventions; for example, a methodology was designed specifically for Fideicomisos Instituidos en Relación con la Agricultura (FIRA) to issue green bonds establishing greenhouse-based agriculture as sustainable.

2.5 In terms of **business competitiveness**, 1,415 micro, small, and medium-sized enterprises were given access to finance, and 6,350 farmers received improved access to financial resources. Additionally, 176 individual transactions totaling US$100 million were supported under the Trade Finance Facilitation Program (TFFP), benefiting 75 Mexican companies (particularly 61 small and medium-sized enterprises). IDB Lab approved 3 investment funds and provided support to a company to foster innovation and local entrepreneurship aimed at enhancing business productivity.

2.6 In the **labor market**, IDB Group support helped to increase the effectiveness of vocational training for employment in large firms by 20%, with wages for those workers improving by 8%. In addition, 4,725 workers benefited from on-the-job training, while 1,923 low-income youths (male and female) were employed under the program “Training Model for a Culture of Youth Entrepreneurship and Productivity.”

2.7 Within the social development pillar, the Prospera program helped to boost graduation rates in upper secondary education from 33.9% to 43.1% among female students and 25.6% to 34.2% among male students. To improve school attendance, students began receiving transfer assistance instead of their mothers, reducing school dropout rates by 12.2%. In the area of health, support was provided under the Salud Mesoamerica Initiative for the State of Chiapas’ efforts to reduce maternal, neonatal, and child mortality and morbidity in its 30 poorest municipios. A 20% increase in coverage of the measles, mumps, and rubella vaccine was achieved, and progress was made in maternal and child health.[26]

2.8 Within the regional development pillar, in the area of **urban development**, IDB Group actions benefited 4 million households by helping to improve neighborhoods. Support was provided each year for an average of 3,000 infrastructure works and 12,000 educational workshops or social development activities, accompanied by improvements in municipal planning processes. Policies governing the sector were updated, with the enactment of the Human Settlements, Land Use, and Urban Development Act and the creation of a national registry information platform. Improvements were also made to transportation and the road

[26] Care in the immediate postnatal period rose by 47.8% and oxytocin administration after birth rose from 72.3% to 97.3%. Support was provided to strengthen the Seguro Médico Siglo XXI [21st Century Health Insurance] program, increasing the number of interventions financed for newborns (0 to 28 days) and children (29 days to five years of age). This reduced by 15.7% the probability that a household would face high expenses and led to a decline of 1.3% in the national mortality rate. A mobile health project also benefited patients in 30 health centers spread across seven cities.

network.[27] As a result of an investment to improve mobility in Mexico City, 29,684 women have benefited from an integrated transportation system.

2.9 In terms of **rural development**, a biological control system was completed to certify 100% of Mexico's territory as a Mediterranean fruit fly free zone, benefiting more than 1.8 million hectares dedicated to fruit and vegetable production, with annual production of 17.6 million tons and approximately US$7 billion in exports (one fifth of all agricultural exports). Bank interventions helped to remodel 528 Rural Development Service Centers and to modernize their physical and IT infrastructures (digital and communications services). A Single Information Registry System was designed and launched to expedite and enhance the transparency of services and procedures for more than 3.5 million producers. Support was also provided for the construction and operation of a Fishing and Oceanography Research Vessel to conduct research into deep-sea fish stocks. In the area of water and sanitation, coverage was expanded in rural communities between 2014 and 2018, and water and sanitation services were extended to 780,000 people in 3,744 locations (around 50% from indigenous communities).

2.10 With respect to **climate change**, water reserves were created as ecosystem-based adaptation measures in 295 of the country's 757 watersheds, representing almost half of the national territory and around 50% of available surface water. In the forestry sector, financing was provided for 257 agricultural and forestry projects, of which 50 were led by women, 203 were in marginalized areas, and 121 were in indigenous communities. An information system was developed to record progress by government agencies in the lines of action set out in the Special Climate Change Program, and 5 climate change programs were prepared at the state level. The capacities of around 6,350 rural entrepreneurs were improved for the sustainable use of natural resources, while the management of 18,819 hectares of land in the Sierra Gorda was improved as a result of the creation of a mechanism to compensate agricultural producers for carbon capture. Land conservation and reforestation activities were promoted in 30 hectares of the Sierra Ahuisculco biological corridor, with the objective of protecting habitat and connectivity and also mitigating climate change (with more than 8,500 tons of CO_2 equivalent projected over 30 years). Under the Ecocasa Program, which seeks to reduce greenhouse gas emissions and generate economic and social benefits by promoting sustainable low-income housing, more than 52,543 eco-homes were built in the period to December 2018. These will avoid almost 2 million tons of CO_2 equivalent over their 40-year lifespans.

2.11 Lastly, **the following outcomes were obtained in the dialogue areas**: In education, the IDB Group's support focused on improving service quality in rural areas. There was a reversal of the decline in training for community education leaders, who provide community education services, and the number of community education leaders with a high school degree or higher education increased in 172 priority municipios. The proportion of community education leaders abandoning social service also fell during the school year, from 21.6% to 15.3%. Since 2018, the IDB has been providing support to the country's 34,200 community education leaders, delivering quality education to 305,958 children in rural areas. In the area of energy, the Bank supported the preparation of the Intelligent Networks Program, which contains actions to reduce technical losses in power distribution. (These fell from 13.8% in 2014 to 11.6% in 2017). The share of clean energy within overall generation rose from 19.7% in 2016 to 24.1% in the first quarter of 2018.

[27] In the transportation area, the Street Manual for Mexican Cities was implemented in 10 cities, establishing technical guidelines for the construction and improvement of urban roads with emphasis on sustainable mobility. In Mexico City, support was provided for the creation of the Integrated Road Safety Plan, reducing the number of deaths and serious injuries by 2.9%.

The IDB's contribution was important in developing a model agreement between the federal government and the states to simplify permitting and licensing procedures for renewable energy-based generation projects. Technical and legal support was also provided for preparation of the bidding documents for the first medium-term auction, as well as a variety of manuals for the electricity market, thus facilitating investor participation in power generation projects (mainly those based on renewable energies). In terms of coverage, the Bank supported preparation of a financing strategy for implementation of the Universal Electricity Service Fund for the electrification of rural communities and marginalized urban areas, as well as the basic mechanism that is being implemented to expand access. As a result, 134,000 inhabitants were provided with access to electricity in 2017 and a further 520,000 are estimated to have been incorporated in 2018, bringing the electrification rate to 90.2% at the end of 2018. Lastly, with regard to issues of regional cooperation and dialogue, the Bank has collaborated with Mexico on initiatives to support the Northern Triangle, including topics such as cooperation in migratory and consular affairs, electronic invoicing, electricity integration, and infrastructure development.

2.12 **Outstanding portfolio**.[28] The outstanding sovereign-guaranteed portfolio consists of 15 operations with an approved amount of US$3.217 billion and an undisbursed balance of US$774 million. A total of 7 investment grants for US$80 million are also in execution, with an available balance of US$69 million. IDB Invest has an outstanding portfolio comprising 41 operations with exposure of US$705 million, focused on support for financial institutions, infrastructure and energy, and corporates. IDB Lab has a portfolio of 41 operations for a total amount of US$63 million, mainly in the areas of financial markets, development of small and medium-sized enterprises, housing, agriculture, and rural development.

2.13 **Lessons learned.** The main lessons learned by the IDB Group are as follows: (i) the Bank should align itself closely with budget programs in order to increase efficiency and improve the execution of operations; (ii) work should continue with subnational governments (either directly or through development banks), with a view to enhancing development impact; (iii) to improve absorptive capacity and the ability to implement sovereign and non-sovereign guaranteed loans, the IDB Group should continue to strengthen execution capacity by supporting country systems and the country's capabilities for project identification, structuring, prioritization, and management (including specific aspects such as environmental safeguards); (iv) in light of the client's fluid access to local and international capital markets,[29] the IDB Group should use flexible, competitively priced instruments in sovereign and non-sovereign guaranteed operations; (v) the strategic use of technical cooperation funding is key in allowing the Bank to establish a permanent dialogue, position itself, and develop a pipeline of priority projects for financing; (vi) it is imperative that risk monitoring and mitigation actions be strengthened in financial institutions with weaker credit risk evaluation and management capabilities; (vii) close monitoring and support for project execution has resulted in a young, relatively healthy portfolio in which execution and disbursement levels are consistent with planned timelines for most operations. Accordingly, and with a view to introducing timely corrective measures, this monitoring will need to be continued in the new strategy to identify cases of low budget allocations that will require extensions to execution periods, partial cancellations, and adjustments to progress indicators; and (viii) it is important to find

---

[28] Portfolio Report. Sovereign-guaranteed and IDB Lab portfolio data: 30 September 2019; IDB Invest portfolio data: 31 August 2019.

[29] Including local currency instruments for companies and other financial and nonfinancial mechanisms that allow development impact to be maximized while maintaining portfolio quality.

opportunities for synergies between the IDB Group's public and private sector windows so as to add value to the projects. One important example is the telecommunications infrastructure project, in which the public sector window is financing the participation of one of the national development banks and IDB Invest is participating directly in financing the project.

2.14 **Office of Evaluation and Oversight's (OVE) Country Program Evaluation** highlights the challenge that the Bank faces in remaining competitive in Mexico. It makes three recommendations (Annex V): For the Bank: (i) maintain its relevance to the country's needs by sustaining a policy dialogue to facilitate the identification of federal programs and policies in which the Bank can add value, as well as continuing efforts to find solutions that allow more direct support to subnational entities; and (ii) reinforce the strategic focus and use of technical cooperation products to inform dialogue with the country and programming. For IDB Invest: (iii) strengthen the effectiveness and additionality of the business model for supporting small and medium-sized enterprises through value chains.

III. PRIORITY AREAS

3.1 The objective of the 2019-2024 country strategy is to support inclusive, sustainable economic growth and bolster productivity by supporting policies and interventions that focus on three priority areas: (1) supporting equitable and sustainable access to social services, (2) encouraging more buoyant investment, and (3) fostering more balanced and sustainable regional development. Issues of institutional strengthening and transparency, innovation and the digital agenda, climate change, and gender and diversity will be addressed as crosscutting themes in each of the priority areas. IDB Group support will be provided through new interventions, portfolio operations, technical assistance, and analytic studies.

3.2 The choice of these areas is based on the dialogue with the country surrounding the priorities set out in the National Development Plan 2019-2024,[30] the development challenges identified in "Country Development Challenges" (CDC), the lessons learned during the previous strategy, and the Office of Evaluation and Oversight's assessment of the Bank's strategic position. Additionally, these areas offer the chance to build on the results achieved during the previous strategy and to leverage existing execution capacity to support implementation.

A. Supporting sustainable, equitable access to social services

3.3 The country faces challenges relating to the coverage and quality of social services that manifest themselves across an individual's entire lifecycle. Gaps in education, health, water and sanitation, labor market access, and social security affect people of all ages but have the greatest impact on the low-income population, women, children, the elderly, and indigenous communities. At the same time, in areas where investment in critical social infrastructure[31] has lagged behind with respect to adaptation, local populations have been left more vulnerable to the effects of climate change. Changes in regional migration patterns could transform Mexico into a host country for migrants (including returning

---

[30] The objective of the National Development Plan 2019-2024 is to ensure the effective exercise of economic, social, cultural, and environmental rights, with emphasis on reducing inequalities and vulnerabilities in communities and regions. The National Development Plan highlights the fight against corruption, respect for republican principles, security, and the importance of social and economic policies and maintaining macroeconomic stability. It rests on three pillars: I. Politics and government; II. Social policy; and III. The economy.

[31] Water and sanitation, education, and health infrastructure.

migrants) and could pose additional challenges in terms of the labor market and access to services.

3.4 In education, despite advances in coverage at the primary level that are reflected in a 97% enrollment rate, a number of challenges continue to affect the low-income population. Preschool coverage is 76%, and children from low-income households and with less educated parents are more frequently excluded from preschool education. This hinders intergenerational social mobility due to the impact of these initial years on children's performance in subsequent education cycles and, ultimately, the labor market. There are deficiencies in coverage at the upper secondary and tertiary education levels, standing at 65% and 34%, respectively. Among the causes of this are socioeconomic conditions, which curtail demand among families. On the supply side, persistent quality problems are reflected in high dropout rates and poorer educational outcomes than in other countries with similar income levels.[32] These problems stem from insufficient teacher training, a failure to adapt and modernize content, and deficient infrastructure and equipment in schools.[33] Challenges in education are partially responsible for the difficulties that young people experience in gaining a foothold in the labor market and are reflected in a disconnect between people's training and the skills demanded by companies.[34]

3.5 With respect to health, there are persistent challenges stemming from an increase in the incidence of noncommunicable diseases,[35] as well as gaps in primary care and access to services in some regions of the country. Noncommunicable chronic diseases are prevalent in young people and adults, with the evidence pointing to a combination of risk factors such as tobacco and alcohol consumption and a lack of physical activity,[36] as well as weaknesses in the coverage and quality of primary and secondary care and prevention services that affect a wide range of age and income groups.[37] Care-based approaches emphasizing cure and rehabilitation are inappropriate for addressing chronic diseases, and there is a need to replace them with preventive models. Fragmentation in the delivery of services by the health system also affects the continuity of care needed to address these diseases. There are persistent disparities in health services by region, as reflected in higher child and maternal mortality rates in the southern states.[38]

3.6 Problems of quality and access to social services are also found in the water and sanitation sector. Although Mexico has high levels of potable water and sewerage coverage (95.5% and 96.5%, respectively, in 2016), the challenge lies in improving the quality of services. In 2017, only 43% of the population had access to safe water supplies and 50% to hygienic sanitation services,[39] proportions that compare unfavorably with those

---

[32] School dropout rates at the upper secondary level are above average for Latin America and for the OECD, and education results measured through international tests indicate weaknesses in comparison to the OECD.

[33] There is also a component that differentiates by region and area of residence: education provision is weaker, on average, in rural areas and in states with higher rates of poverty, and this is reflected in school performance. See CDC, paragraphs 3.8, 3.10, and 3.21.

[34] See CDC, paragraphs 3.5 to 3.10, and Annex, paragraph 1.92, page 182.

[35] Refers to cardiovascular disease, cancer, diabetes, and chronic respiratory diseases.

[36] Overweight and obesity are widespread among young people. Noncommunicable diseases are the main causes of premature death: heart disease, kidney failure, and, notably, hepatitis. There are also high numbers of hospital admissions due to uncontrolled diabetes, as well as hospital deaths following heart attacks, pointing to problems that go beyond the medical environment and the availability of equipment in hospitals. CDC, paragraphs 3.46-3.51.

[37] See CDC, paragraph 3.46 et seq.

[38] CDC, Annex II, paragraph 1.81.

[39] World Health Organization-UNICEF Joint Monitoring Programme Report, 2017.

in other Latin American countries. These deficiencies in service quality create a source of risk for progress in health indicators.[40] Challenges in the sector relate to insufficient infrastructure investment and weaknesses in the management of resources. Meanwhile, solid waste treatment—while high in terms of collection coverage—is affected by inadequate conditions for treatment and recycling, creating a risk of water pollution and increasing greenhouse gas emissions. Given this context, the projected increase in the population and the effects of climate change could create a critical situation with respect to water resources if the aforementioned challenges are not addressed.

3.7 Mexico's labor market exhibits weaknesses compared to other countries with similar levels of GDP per capita. According to the IDB's Better Jobs Index, Mexico ranks 13 out of 17 countries, despite being the 5th wealthiest in terms of GDP per capita.[41] There are marked gaps in labor participation by gender that are due to: (i) a greater likelihood of career interruptions, (ii) occupational and sector-based segregation, gender preferences (and/or limitations) in the case of longer or shorter remunerated working hours, (iii) employer discrimination, and (iv) women's responsibilities in the household, which limit the time dedicated to remunerated work.[42] In terms of a living wage,[43] young people in Mexico rank second to last (surpassing only Honduras). The main reasons for this are weak economic growth (which means that new workers entering the workforce are not absorbed), the poor quality and relevance of human capital formation, distorted labor incentives (which encourage informality at the expense of formal, salaried employment),[44] and weaknesses in labor rights.[45] In terms of employer-employee relations, although there has been progress in this area, there is still room to improve the adequacy and agility of labor union representation, as well as to implement swift and transparent mechanisms in the area of labor law.[46] Lastly, if Mexico becomes a host country for migrants, this will pose additional operational challenges for the National Employment Service. Although the agency does currently serve migrants, it will need to expand its scope and services in the face of a higher number of such workers.

3.8 The social security system does not adequately cover the challenges faced by the elderly. Mexico faces challenges from rapid aging of its population, which threatens the sustainability of health and pension plans[47] and poses particular challenges for the care sector. Contributory pensions are threatened by high levels of labor informality, while

---

40 See CDC, paragraphs 3.119 and 3.120. The loss of life due to sanitation issues is calculated at 4.3 years in Mexico, compared to 3.1 in the OECD. See CDC, Annex, paragraph 1.96, page 182.

41 By subindex, Mexico ranks 14th in terms of participation, 10th in terms of employment, 10th in terms of formality, and 14th in terms of a living wage. Mexico also has the fourth highest gender gap in the index after Guatemala, Costa Rica, and Ecuador, and it ranks 110th out of 130 countries in this category of the Global Human Capital Report (see CDC, paragraph 2.12).

42 See CDC, paragraph 1.27.

43 Defined as an hourly wage of at least US$1.95.

44 Particularly the approach to financing the social security system, which emphasizes taxes on labor (an implicit subsidy to informality). Social security payments create increasing distortions as the benefits associated with contributory social security coverage are of decreasing quality (Levy, 2018). In addition, the fact that the employment subsidy is never adjusted for inflation means that formal, salaried employment becomes less and less attractive. Reforms to the Federal Labor Act to reduce the cost of dismissals, but with the added protection of unemployment insurance, could improve labor incentives and better protect workers.

45 According to the World Economic Forum (WEF, 2018), Mexico has the weakest worker rights protections in Latin America.

46 Labor union representation (union leaders directly elected through a free and secret ballot) and employment justice (the creation of labor tribunals in the Judicial Branch) were the central features of the recent labor reform approved by the Congress in late April 2019.

47 The proportion of over-65s in the population is projected to increase from 10% in 2030 to 20% in 2050.

noncontributory plans—which are financed by fiscal resources—are insufficient to provide an adequate income package. In this context, and with the exception of only a small group, older adults will need additional income over and above that provided by the system if they are to avoid slipping into poverty.[48] The system is set to become a growing burden on the fiscal accounts in future (growing from 3.5% of GDP currently to 7% of GDP by 2024).

3.9 IDB Group interventions—both the outstanding portfolio and new operations identified during implementation of the strategy—will support the country in addressing the main challenges highlighted in the sectors of education, health, water and sanitation, labor markets, and social security. In this way, the IDB Group will seek a multisector approach to the constraints preventing greater and more sustainable progress in human capital accumulation and poverty reduction in the country.[49] In education, initiatives will be continued to respond to supply and demand factors in education services and that aim to eliminate gaps in access, while support will also be provided for the implementation of education programs and training and work placement schemes for young people and women. In health, the IDB Group will work with the authorities to address the needs for incremental reforms in the health system to strengthen primary and secondary prevention services, particularly to combat chronic diseases and improve maternal and child health care. Initiatives will continue to improve water and sanitation services by increasing the efficiency of service providers and improving the coordination of their institutional framework. In addition, the IDB Group will support interventions that reduce the risk of severe flooding, improve the resilience of urban systems, and increase the supply of water resources. It will also support development of the different public-private partnership arrangements that exist in the water, sanitation, and solid waste sector. The IDB will support the regularization of sites for the final disposal of solid waste (including the use of recoverable waste) and will support Mexico in meeting its mitigation commitments in relation to greenhouse gas emissions.

3.10 In the area of labor markets and social security, the Bank will support the implementation of specific regulations associated with the labor reform, particularly those concerning professionalization of the officials responsible for the new employment law system and electronic management systems. It will also work with the authorities to promote initiatives that address female labor participation. At the same time, the Bank will provide technical assistance for the discussion of pension reforms aimed at strengthening the system and making it more efficient.

3.11 **Alignment.** The proposals in this priority area are aligned with the objectives of the Update to the Institutional Strategy 2020-2023 in terms of offering inclusive infrastructure and associated services, as well as developing quality human capital. They are aligned with the emphasis on innovation through the use of technology in social programs and health, which will be important for increasing the efficiency of transfers and for providing

[48] Of those workers that pay into the social security system (50% of the total), one quarter will be eligible for a pension, while just one third of the latter group will receive more than the minimum. (The minimum pension is equivalent to one minimum wage.) Those depending on the universal pension alone will receive an approximate amount from the system that is equivalent to 50% of the poverty line. The transition itself also creates inequalities: pensioners under the old system enjoy advantages compared to those belonging to the new model. Oliver Azuara, Mariano Bosch, Manuel García-Huitrón, David Kaplan, and María Teresa Silva Porto. IDB working paper, March 2019.

[49] The outstanding portfolio will contribute to this strategic area through interventions to improve learning based on collaboration and dialogue (ME-L1162), promote the comprehensive development of water and sanitation operators, strengthen policies for employment and human resources training (ME-L1258 and ME-L1142), and provide technology for the prevention and treatment of diabetes (ME-L1286).

integrated patient care and effective solutions for chronic diseases. They are also aligned with IDB Invest's Business Plan for 2017-2019, particularly with respect to support for infrastructure development, including social infrastructure. Lastly, they contribute to the objectives of the social policy pillar of Mexico's National Development Plan 2019-2024.

B. Encouraging more buoyant investment

3.12 Mexico faces an important challenge given the low levels and sluggishness of investment. Both public and private investment have fallen sharply compared to the peaks experienced in 2016. Among the factors that affect investment in the country, thus curtailing growth, are aspects of fiscal policy and the quality of expenditure, low access to local financing, and transparency.[50]

3.13 With respect to the public sector, problems in revenue and expenditure affect investment growth and effectiveness. Mexico collects 13% of GDP in taxes,[51] which is below the averages for the OECD (25.7% of GDP) and Latin America and the Caribbean (19.3% of GDP).[52] Although the country's fiscal rules allow for countercyclical spending, including the availability of specific funds to finance this,[53] it is not clear that the authorities have used these powers to protect public investment. On the contrary, corrective and consolidatory fiscal measures have often led to cutbacks in investment spending. Another source of fiscal improvement that can be used to increase investment lies in enhancing the efficiency of spending in order to limit current spending as a share of the total (currently 80%). Technical inefficiencies stemming from transfers, public procurement, and payroll can also be reduced; these stand at 4.7% of GDP in Mexico (slightly above the average of 4.4% for Latin America and the Caribbean as a whole). Meanwhile, weaknesses in public investment management (spanning the processes of selection, implementation, public procurement, and control and accountability) are partly responsible for the efficiency and quality problems affecting the resulting stock of infrastructure.[54]

3.14 Access to finance is one of the main factors affecting the business climate for private investment growth. Domestic financing to the nonfinancial private sector stands at 30% of GDP: a considerable increase compared to 17% of GDP at the beginning of the 2000s, but still low compared to countries at a similar level of development.[55] The market segments that are underdeveloped in relative terms are credit for production (urban and, in particular, rural) and credit and other financial products to support climate adaptation (e.g. resilient and clean infrastructure projects and sustainable agricultural and forestry

---

50 See paragraph 1.4, and CDC, paragraph 1.10.

51 Figures do not include nontax revenue or oil revenue.

52 Low tax collection is a result of weaknesses in the design of the main taxes, with preferential treatment in the different taxes leading to revenue losses of around 3.7% of GDP. Such treatment includes a wide range of goods and services that are either zero-rated or exempt from the value-added tax, as well as the exemption of certain types of income from income tax payments. At the same time, weaknesses in tax collection suggest that there are significant levels of tax evasion.

53 Fondo Mexicano del Petróleo para la Estabilización and el Desarrollo [Mexican Oil Fund for Stabilization and Development], Fondo de Estabilización de los Ingresos Presupuestarios [Budget Revenue Stabilization Fund], and Fondo de Estabilización de los Ingresos de las Entidades Federativas [Federative Entity Revenue Stabilization Fund].

54 See CDC, paragraphs 3.73, 3.79, and 3.81, and Ter Minassian (2018), "Options for reform of the institutional macro-fiscal framework in Mexico." IDB project document, mimeo.

55 The 30% figure is broken down as follows: commercial banks, 18% of GDP; the debt markets, 2% of GDP; development banks, 2% of GDP; nonbank intermediaries, 2% of GDP; and housing funds, 6% of GDP. Even when a broader measure is used—that of domestic lending to the private sector by financial and nonfinancial entities and the public sector (World Bank definition, World Economic Outlook)—credit in Mexico stands at only 35% of GDP, compared to 122% in Chile, 62.2% in Brazil, and 47.7% in Colombia.

businesses). These constraints may compromise the fulfillment of the commitments made by the country in its NDC.[56] Commercial lending is mainly channeled (approximately 80%) to large companies, leaving SMEs with little ability to expand by using credit.[57] Credit access is also a problem for specific segments such as women-led companies[58] and the rural sector.

3.15 Issues of supply and demand are at the root of this situation. The supply of loanable funds is affected by limitations in financial infrastructure, capacity, experience, and risk appetite among financial intermediaries given the high opportunity costs of allocating capital to less attractive businesses. In addition, there are asymmetries and costs in conducting credit analyses, which are partly increased by high levels of informality and the status of financial and monetary regulation. In the long-term credit segment, in which the banking system has relatively limited participation,[59] the lack of development of the institutions concerned poses difficulties for the financing of infrastructure and housing projects.[60] On the demand side, there are a number of important factors, including not only a lack of awareness regarding services and a lack of experience in dealing with financial intermediaries, but also the unpredictability and instability of returns on investments, particularly in SMEs and sectors and market segments that are subject to higher volatility (for example, the rural sector). Sector development faces the challenge of incorporating technology into the financial ecosystem and of continuously adapting regulation (including regulations governing Fintech) to support cost reductions and the implementation of innovative business models.[61] Lastly, the country must seek to effectively comply with the highest international standards in its efforts to combat money laundering and the financing of terrorism. The last factor affecting supply concerns transparency and, in particular, issues of financial integrity.[62]

---

[56] It is estimated that investments totaling US$124 billion (10% of GDP) will be needed for Mexico to meet its NDC, and the long-term horizon for this process is a challenge given the country's relatively small, short-term oriented financial system. Some of the estimates for financing needs in specific sectors for the period to 2030 are as follows: energy efficiency, US$30 billion; sustainable transportation, US$8 billion; and water and sanitation, US$18 billion. See CDC, paragraph 3.165 et seq.

[57] Commercial lending to SMEs in other countries is significantly higher than the level of 20% in Mexico: 40% in Brazil and more than 60% in South Korea.

[58] See CDC, paragraph 1.110.

[59] The average maturity of loans in the system for all companies is 26 months. This indicates that most loans are to finance working capital, rather than to expand production at the company level or to fund infrastructure projects.

[60] The main institutional actors are pension funds, which are smaller than elsewhere in Latin America and the Caribbean (capital of 14% of GDP compared to 22% for the region as a whole) and have a purchase and retention profile that reduces liquidity in secondary markets. Meanwhile, mortgage financing has been limited (16% of the banking sector portfolio), particularly since the 2008 financial crisis that affected the multiple-purpose financial institutions known as SOFOMES. Only 4.3% of the adult population has a mortgage, compared to 7.3% in Latin America and the Caribbean as a whole and 26.7% in the OECD countries.

[61] Mexico has an advanced financial technology (Fintech) sector. Regulations governing the sector are pioneering in the region, and the competitive environment supports the emergence of startups. Compared to the other leading countries in the region in this area (Argentina and Brazil), the share of the financing segment within these types of intermediaries is large in Mexico relative to that of payments.

[62] According to the Basel AML Index, there is a medium risk of money laundering in Mexico, and the country's score has deteriorated from 5.0 to 5.7 since 2015. Mexico's legal regime for managing risks associated with money laundering and terrorism financing is generally appropriate from a technical and legal standpoint but is largely ineffective from a practical perspective. Sentences and asset seizures are so limited that despite the well-designed legal framework, there is de facto impunity (IMF, 2018).

3.16 In response to these limitations, the development banks have designed financing instruments to supplement private sector financial system capacities in those sectors with less access. These public development banks are organized into different specialized entities[63] aimed at serving strategic urban and rural productive sectors, long-term credit for sustainable infrastructure, and mortgage credit. Since the financial reforms, their volume of activity has increased from 1% of GDP in 1997 to 2% of GDP in 2017. There are opportunities to increase their operational efficiency and geographic reach, as well as to strengthen their role in areas such as rural financing, clean infrastructure, and agricultural projects, in which the private financial system faces the most significant challenges.[64]

3.17 Lastly, Mexico faces transparency challenges that affect the strength of investment. According to the World Economic Forum's Global Competitiveness Index (2018), corruption is the main problem affecting the country's business climate—to a greater degree even than crime and insecurity.[65,66] Mexico scores 20 points out of 100 on the control of corruption indicator in the World Governance Indicators (2018)[67] and ranks below the average for Latin America and the Caribbean and the OECD member countries in the main transparency and integrity indicators.[68] Poor transparency affects not only private investment, but also the execution of resources and quality of public investment.

3.18 To support the country in addressing the factors that limit investment and growth, the IDB Group will use its existing portfolio[69] and new interventions to support public revenue policies in tax administration and, on the expenditure side, to emphasize the rebalancing of expenditure between its current and capital components. The Bank will also provide assistance to strengthen the national public investment system and will support the design and implementation of actions in the area of transparency (particularly the use of new technologies in country subsystems).

3.19 In contributing to the country's objective of deepening the financial sector, the IDB Group will support the strengthening of public and private entities in the sector to improve their ability to respond to investment needs, particularly in underserved segments. Specifically, opportunities will be identified to contribute through: (i) shared risk facilities to support the expansion of portfolios; (ii) the use of alternative credit technologies that help financial intermediaries to reduce information asymmetries; and (iii) an expansion in the supply of innovative financial products for financing investments in climate change adaptation (such as green bonds and smart agriculture), as well as serving segments facing credit constraints (such as women-led companies). The Bank will continue its collaboration with the development banks in this area with a view to strengthening their lending capacity and

63 Nacional Financiera SNC (NAFIN); Banco Nacional de Comercio Exterior (Bancomext); Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal, and Pesquero (FND); Banco Nacional de Obras and Servicios Públicos; SNC (Banobras); Sociedad Hipotecaria Federal (SHF); and Fideicomisos Instituidos en Relación con la Agricultura (FIRA).

64 See CDC, paragraph 3.142 et seq.

65 Global Competitiveness Report (2018).

66 Mexico scores 28 points out of 100 in the indicator prepared by Transparency International (where 100 is maximum transparency) and ranks 138th out of the 180 countries included in the measure. https://www.transparency.org/whatwedo/publication/corruption_perceptions_index_2017.

67 World Governance Indicators (2017).

68 The country has slipped down the rankings for corruption variables under the institutional pillar of the WEF's classification, and this has also been the case with respect to the indicator prepared by the World Justice Project. CDC, paragraph 2.28.

69 The portfolio in execution will contribute to this through operations that enhance the capacity for action of the financial system and the public development banks (ME-L1259).

will also promote the use of mechanisms to eliminate gaps in the use of financial services, including capital market instruments and the use of technology and Fintech.

3.20 **Alignment.** The proposals for action in this strategic area contribute to the following objectives in the Update to the Institutional Strategy 2020-2023: fostering innovation and investment and enhancing productivity; including all segments of the population in financial markets; and establishing optimal institutional frameworks. In terms of innovation, the IDB will continue to transfer knowledge regarding the improved identification and management of climate change-related financing. The proposals are also aligned with IDB Invest's Business Plan for 2017-2019, particularly in relation to building partnerships with the financial sector for work in the priority areas for action, such as support for SMEs; and with the IDB Lab's Business Plan for 2019-2021 (document MIF/GN-235-3)—specifically, the thematic area of the Knowledge Economy, which seeks to stimulate entrepreneurial activity, financial inclusion, and the adoption of new innovative technologies and financial services. In addition, they contribute to the objectives of the economy pillar of Mexico's National Development Plan 2019-2024.

C. Fostering more balanced and sustainable regional development

3.21 Mexico faces challenges that create wide disparities between regions,[70] while there are also particular challenges relating to the urban, periurban, and rural nature of population settlements.[71] In southern Mexico, where poverty rates are highest and where the indigenous population is concentrated,[72] 48% of inhabitants live in communities of less than 2,500 inhabitants, compared to a national proportion of 28%. The country's production matrix is relatively sophisticated and internationalized: there are more than 4,000 exportable manufactured products, similar to the level in other OECD countries, with production highly concentrated in the Center-North region. The economic structure in lower-income regions, however—particularly in the South—is dominated by subsistence agriculture, retail, and tourism. Integration and trade opening in these regions are limited, and linkages with the most dynamic productive sectors are weak.[73] These patterns are influenced by limited connectivity[74] and deficiencies in critical social and productive infrastructure, as well as scarce sources of finance[75] and low levels of human capital.[76]

---

70 See CDC, paragraph 2.37 et seq.

71 The social and economic gaps between these typologies of urbanization vary between states.

72 All told, 52% of the population in Chiapas and 51% of that in Oaxaca live in rural areas, accounting for 68% of the country's indigenous population. These communities have higher levels of poverty and gaps in education, as well as greater vulnerability to a loss of assets and deterioration in cultural heritage.

73 The OECD estimates that 82% of regional disparities in income per capita in Mexico are accounted for by differences in labor productivity between the regions. These are partly a consequence of different production structures.

74 The cost of shipping goods to a customs post is 94% higher in the South than in the Center and the East of the country. With regard to digital connectivity, 53 out of every 100 inhabitants in the country's 10 poorest states have mobile internet, compared to 66 at the national level and 91 in Mexico City.

75 Only 28% of the rural adult population has an account and only 7% have taken out a loan from a financial institution. This compares with figures of 48% and 12%, respectively, for Latin America and the Caribbean and 90.1% and 17.3% for the OECD countries. FINDEX (2017), World Bank. Only 6% of rural municipios and 36% of municipios in transition have a bank branch, in contrast to almost complete coverage in urban municipios and metropolises.

76 For a more detailed analysis, see CDC, Annex II.

3.22 At the same time, Mexico has been transformed into a predominantly urban country, and this poses particular challenges relating to the sustainability, productivity, and quality of life in cities. Growth in Mexico's cities has been rapid and disorderly, obeying a low-density model that has created gaps in infrastructure, constraints in the delivery of basic services, and pressure on urban mobility. The low-density model has led to increased car use and, consequently, rising greenhouse gas emissions,[77] and to growing risks of residential segregation, social and climate change vulnerability, and greater demands on municipal governance.

3.23 Deficiencies in both regional planning and investment programming and prioritization have contributed to these regional gaps and represent an important hurdle to addressing the specific problems that the country faces in relation to urban and rural development. The legal framework for land-use planning is fragmented across two parallel, disconnected pieces of legislation. The laws that regulated these issues until 2016 established one framework for human settlements based on controlling rapid urbanization and another for the rural sector, focused on ecological issues. This regulatory environment, which is accompanied by regional administrative fragmentation and weaknesses in institutional capacities, has hindered the process of regulating land use and actions at the regional level. In land-use management, issues of diversity are of particular importance in the country's southern regions given the concentration of indigenous communities in these areas.

3.24 In addition, subnational fiscal management faces institutional capacity challenges that are manifest on both the expenditure side (low quantity and quality of public investment, high budget allocations in the category of "personal services," and a limited ability to deliver key public goods) and the revenue side (a limited base for subnational taxation, weak tax administration capacities, and a high degree of dependence on the federal government). A large number of subnational entities—particularly municipios—lack technical and financial capacities for the satisfactory planning, execution, and operation of sustainable infrastructure and urban and rural development projects. This will affect their response and adaptation to the challenges outlined, as well as other challenges that may arise due to migration and climate change.[78] There are also challenges associated with the fiscal costs of the pension systems run by subnational governments and universities, as well as the implementation of labor reforms that require each federative entity to create labor tribunals and labor conciliation centers, which will require significant investment.

3.25 In terms of land-use management and the determination of investment priorities at the national and subnational levels, climate change introduces important factors that must be considered when managing the different challenges experienced in rural and urban areas, addressing both adaptation and mitigation issues. The north of the country could experience an increase of 2°C in temperature,[79] while changes in the range of 1°C to 1.5°C are projected across most of the territory. With respect to precipitation, the country is expected to experience a reduction of around 10%, yet in some regions the decline will be greater. Water demand will increase as a result, particularly in urban areas.[80] Rural areas exhibit greater vulnerability to climate change, as assets belonging to populations in

---

[77] See paragraph 3.106.

[78] Mexico's municipios are responsible for various public services and investments relating to climate change and greenhouse gas emissions, such as water, sanitation, public lighting, and urban waste (Article 115 of the Mexican Constitution); this makes them key players in efforts to support Mexico's NDC.

[79] Scenarios for the period to 2050. Department of the Environment and Natural Resources, 2014.

[80] Department of the Environment and Natural Resources, 2014.

these regions are usually more affected by climate phenomena (floods, droughts). They also have more limited access to tools that allow them to recover after an event. In this context, it is critical that Mexico move forward in its adaptation and mitigation agenda, which includes adaptation targets for productive systems and strategic infrastructure and commitments in the areas of energy efficiency and the share of clean energy in total supply.[81] It also increases the importance of addressing weaknesses in the disaster risk management system, associated with regulatory and institutional deficiencies in the states, the absence of a municipal risk atlas, and failures in the application of construction codes.[82]

3.26 The IDB Group will support the country in addressing the challenges of sustainable regional development through interventions that contribute to organized land use, fiscal strengthening in subnational entities, rural agricultural productivity, and investment in sustainable infrastructure.[83] Implementation will emphasize both climate change adaptation and mitigation and integration, as well as coordination and complementarity with other priority areas (particularly access to social services for vulnerable populations, higher investment in the most disadvantaged areas, and financing for sustainable infrastructure).[84]

3.27 In terms of organized land use, the IDB Group will seek to encourage orderly and sustainable growth by updating the policies that govern urban development and land use in semi-urban and rural areas. In the area of land-use planning and urban development and housing, the IDB Group will seek to work with cities, in coordination with the federal government, to reduce social and economic vulnerability to climate change. With respect to subnational fiscal management, the Bank will assist in evaluating the incentives and legal foundations for fiscal coordination, as well as introducing new technologies to improve efficiency and transparency. It will also support the strengthening of technical and financial capacities for improved project planning, execution, and operation in the area of sustainable infrastructure and urban development, and this will assist Mexico in meeting its national sustainable development and climate change targets[85] with the participation of the private sector.

3.28 With respect to production challenges in rural areas, the IDB Group will emphasize actions to enhance the productivity, resilience, and integration of the agricultural sector in less developed regions by improving access to finance (based on the potential offered by the development banks) and supporting climate-smart agriculture and sector development policies with low carbon emissions.

3.29 These actions will be accompanied by initiatives to expand the supply of sustainable infrastructure: (i) clean energy generation to bridge the power deficit and respond to the processes of urbanization and growth in production; (ii) support for energy efficiency programs and distributed generation; and (iii) investment in telecommunications

[81] Clean energies account for 7.8% of total generation, which is the lowest in Latin America and the Caribbean, where the average is around 25% (International Energy Agency Statistics, 2015). In the case of the electricity subsector, there is a need to reduce both technical and nontechnical distribution losses, which in 2017 were equivalent to 12% of total power generated.

[82] See CDC, paragraph 3.200 for a description of challenges in disaster risk management.

[83] The portfolio in execution will support these objectives through interventions to improve animal health, strengthen subnational management for the provision of infrastructure and public services, and support rural SMEs.

[84] See paragraphs 3.9, 3.18, and 3.19.

[85] These include the targets established under the 2030 Agenda for Sustainable Development, as well as Mexico's NDC commitments made before the United Nations Framework Convention on Climate Change.

infrastructure to encourage greater broadband penetration in urban and rural areas, digitalization, and the deployment of advanced networks. The role of the development banks and the private sector will be of considerable importance for implementation.

3.30 **Alignment.** The proposals for action in this area contribute to the objectives in the Update to the Institutional Strategy 2020-2023 of eradicating extreme poverty, providing inclusive regional infrastructure, offering urban planning and rural infrastructure, and addressing the economic and social effects of climate change mitigation and adaptation. The proposals are also aligned with the innovation objective in the institutional strategy—for example, through support for telecommunications and broadband, as well as smart agriculture in rural development. The priorities described above are aligned with IDB Invest's Business Plan for 2017-2019, particularly in terms of strengthening capacities in the corporate sector and providing support for infrastructure development (including social infrastructure). They are also aligned with IDB Lab's Business Plan for 2019-2021, and with two of its three thematic areas in particular: climate-smart agriculture and inclusive cities. In addition, they contribute to the objectives of the social policy and economy pillar of Mexico's National Development Plan for 2019-2024.

3.31 **Crosscutting themes.** The IDB Group will support the country in strengthening both institutions and transparency and integrity, with interventions at the federal and subnational levels in the second and third priority areas, respectively. Emphasis will be placed on the application of digital technologies to simplify administrative procedures and improve service to the public,[86] as well as the use of data science to expand coverage of the monitoring of federal and local expenditure. Gender and diversity issues will be addressed in the first priority area through care for mothers, young people, and adult women in social and labor services, as well as in the third strategic area through the focus on regions with large indigenous populations. The Bank will also continue to provide assistance in the area of personal identification, involving both foundational and digital identities. Lastly, the IDB Group will seek to strengthen the resilience of the private sector and the public sector's capacity for disaster risk management and climate change adaptation. To this end, it will provide financing for sustainable infrastructure and institutional strengthening to improve land-use management and coordination between the different agencies and levels of government (issues excluded in the third strategic area).

3.32 **Dialogue.** The Bank will sustain a dialogue with the country regarding the business climate, particularly in the areas of citizen security and issues emanating from cybersecurity, planning, and readiness in the country's Industry 4.0, due to their positive effects on production and logistics, as well as cultural industries. The Bank will continue the dialogue with Mexico on migration and regional integration and will participate in coordination efforts in these areas. Lastly, with a view to complementing planned interventions in the area of urban planning, the Bank will provide technical support for road safety and the design of urban transportation infrastructure.

---

[86] There is considerable room for improvement in this respect, given that only 28% of internet users have interacted with the government online.

IV. INDICATIVE FINANCIAL SCENARIO

4.1 Public sector financing needs will average 2.5% of GDP during the first three years of the 2019-2024 period—higher than the 2.0% of GDP seen in 2016-2018. These needs could increase, however, if the government moves ahead with fiscal or pension system reforms, as it has announced. Said reforms could affect trends in the fiscal deficit. Although financing will be sourced primarily in the domestic debt markets, the government has indicated that it will continue to borrow from the multilateral banks and that it aims to maintain a program with the Bank that is in line with the previous strategy. Added to the fact that the Bank already has a structured relationship with Mexico, with established executing agencies and extensive experience, this provides a basis for the IDB Group to maintain its program of cooperation with the country.

4.2 Accordingly, the Bank projects sovereign-guaranteed approvals for a total indicative amount of US$10.250 billion over the 2019-2024 period, equivalent to an annual program of US$1.700 billion. Although the IDB is an important creditor among multilateral institutions, with a share that could rise to 53% over the course of this strategy, it accounts for 8.1% and 2.9% of the external debt and total debt, respectively (see Annex II).

V. IMPLEMENTATION ISSUES

5.1 **States and municipios.** In light of regional development needs, the Bank will continue its joint efforts with the government to analyze and design alternatives for providing more direct support to subnational entities, with a view to enhancing the impact of interventions in the poorest areas of the country. Given constitutional restrictions[87] on the direct financing of subnational entities, and while alternative mechanisms are being developed, the Bank will seek to continue fostering subnational development in four ways: (i) federal programs with an impact on the states, (ii) programs channeled through the development banks, (iii) technical cooperation, and (iv) fee-based knowledge and advisory services.

5.2 **Work with the development banks.** The development banks accounted for around 25% of the portfolio in the previous strategy period, allowing the Bank to support improved levels of service for segments that have traditionally been unserved, including climate change adaptation and mitigation actions. Based on this experience, and in view of the priorities set out in the strategy—particularly the channeling of financing (second area), rural development and agricultural productivity (third area), and climate change (crosscutting theme)—one aspect of implementation will be to strengthen lines of work with the different agencies in the sector if financial conditions are favorable.

5.3 **Instruments.** To continue supporting investment programs that are better adapted to budget restrictions and financial costs, while also addressing the country's challenges, the IDB will explore the potential of green bonds and the combined use of results-based programs and conditional credit lines, which may respond better to annual budget limits. The use of reimbursable technical cooperation operations and fee-based knowledge and advisory services will also be explored, with the aim of strengthening sector institutional capacities and increasing the Bank's value added for the country.

---

[87] The Constitution prohibits states and municipios from borrowing in foreign currency or from foreign institutions, whether directly or indirectly.

5.4 **Technical cooperation.** The lessons learned and the recommendations of the Office of Evaluation and Oversight both highlight the usefulness of technical cooperation operations. Implementation of the strategy will therefore rely on a deepening of the Bank's technical positioning using this instrument. Technical cooperation operations will be prioritized with the government and will be used to either support operations or to open new strategic spaces for collaboration with the country.

5.5 **IDB Group coordination.** Coordination between the IDB, IDB Invest, and IDB Lab will be of great importance if the IDB Group is to provide an integrated service. This coordination will observe the following parameters: (i) joint implementation of the country strategy; (ii) planning joint missions for discussions with the authorities, particularly in areas in which policy reforms are required and/or there are evident synergies from working in a complementary manner; (iii) organizing joint dissemination activities; and (iv) maximizing operational synergies. In the case of IDB Lab, coordination will be based on identifying opportunities that are aligned with strategic areas and synergies within the IDB Group.

5.6 **Donor coordination.** The IDB Group will continue to work in coordination with other multilateral institutions, such as the Economic Commission for Latin America and the Caribbean (ECLAC), World Bank, European Union, Development Bank of Latin America (CAF), Central American Bank for Economic Integration (CABEI), German cooperation agency (GIZ), and national governments participating in the El Salvador-Guatemala-Honduras-Mexico Comprehensive Development Plan. The IDB Group will also continue to work in coordination with the Agence Française de Développement (AFD), Germany's Kreditanstalt für Wiederaufbau (KfW), the United Kingdom, and other bilateral agencies, creating spaces for discussion regarding the country's public policy challenges, as well as opportunities for partnership that allow the Bank to mobilize and leverage cofinancing resources from these institutions. Cofinancing may also be sought from climate funds such as the Clean Technology Fund (CTF) and the Global Environment Facility (GEF) (particularly in the areas of water, energy, and climate change-related issues). Activities are also being undertaken in partnership with corporate foundations and other private sector entities.

5.7 **Country systems.** Fiduciary supervision is supported by country systems for budgeting, treasury, accounting, internal audit, external audit, information systems, shopping, and partial and advanced national competitive bidding. In terms of the country's fiduciary capacity, available assessments and the Bank's experience to date do not suggest any risks that might adversely affect the achievement of the Bank's strategic objectives with the country (see Table). Several changes are currently in progress at both the regulatory and institutional levels, aimed at substantially improving country fiduciary systems. The recently completed assessment of the country procurement system, conducted using the OECD's Methodology for Assessing Procurement Systems (MAPS), has identified a number of gaps with respect to international good practices that the Bank could help to strengthen. Similarly, the Bank is working with the Government of Mexico City to carry out a Public Expenditure and Financial Accountability (PEFA) assessment at the subnational level and to implement reforms to modernize its public procurement systems. The Bank's fiduciary sector will support the government in disseminating good practices in the use of new technologies to generate efficiencies in the different country subsystems.

Table 1. Country Systems

Country Systems	Level of Usage % of Projects Baseline 2019	Level of Usage % of Projects Projected 2024	Planned actions under the country strategy
Budget	100%	100%	Monitoring of usage
Treasury	100%	100%	Monitoring of usage
Accounting and reporting	0%	10%	Support to Nacional Financiera for managing reports
Internal audit	100%	100%	Monitoring of usage
External control	100%	100%	Support the Auditor General of the Federation in adopting best practices in the use of new technologies
Information system	100%	100%	Monitoring of usage and legislation
Shopping	100%	100%	Monitoring of usage and legislation
Advanced national competitive bidding	90%	100%	Monitoring of usage and legislation
Partial national competitive bidding	0%	0%	
Consultancies	0%	0%	

5.8 **Country environmental and social governance systems.** Mexico has an advanced environmental and social legislative framework. Nonetheless, the concurrent powers of federal, state, and municipal governments within the environmental and social governance system create challenges for effective implementation. The IDB will therefore make its different instruments available to allow the country to strengthen country environmental and social governance systems with the following objectives: (i) improving budget allocations and flows to the environmental authorities at all three levels (federal, state, and municipal); (ii) eliminating overlapping responsibilities between institutions (both vertically and horizontally), as well as gaps in those responsibilities; (iii) improving policy coherence and effectiveness by evaluating the strategic environmental and social aspects of land-use plans at the federal level and in sector development programs; and (iv) improving environmental and social data gathering and management, including the implementation of environmental and social legislation and the economic aspects of environmental policies.

VI. Risks

6.1 **Macroeconomic risks.** Risks that may affect implementation of the strategy include the following: (i) possible **fiscal constraints** associated with a decline in tax revenue, which would compromise public investment spending, growth, and macroeconomic stability. The fiscal situation could also be affected by the financial situation in PEMEX and changes in immigration policies in the U.S., which would intensify spending pressures in Mexico; (ii) **increased uncertainty and a deterioration in the business climate** due to delays in ratifying the United States, Mexico, and Canada Agreement, rising trade tensions, and increased perceptions of corruption and insecurity; (iii) **expectations of a deceleration in global growth** in 2019 and 2020, which could signify lower demand for Mexican exports.

To mitigate these risks, the Bank will work with the government in the areas of tax collection and the transparency agenda, as well as closely monitoring trends in the main indicators using the macroeconomic safeguard mechanisms currently in force, with a view to instituting timely adjustments.

6.2 **Natural disaster risks and the effects of climate change.** A major natural disaster could affect this strategy if the government's priorities were refocused to address the most immediate needs of the affected population. The IDB Group will seek to mitigate this risk by supporting the authorities in the area of disaster management and by making available to the country the mechanisms and instruments that the Bank has developed to address these phenomena. In the area of climate change, the strategy's emphasis on issues of adaptation and mitigation will help to maintain the relevance of actions during implementation.

ANNEX I: RESULTS MATRIX AND COUNTRY SYSTEM MATRIX

Results Matrix

National Plan Priorities	Priority Area	Strategic Objective	Expected Outcome	Indicator	Baseline (source measured)
Social policy	Equitable access and sustainability of social services	Improve health services	Improved social protection for older adults	% of older adults lacking social protection	14.6 National Council for the Evaluation of Social Development Policy, 2015
			Improved coverage of preventive services for chronic diseases	Prevalence of diabetes	10.3% women 8.4% men National Health and Nutrition Survey (ENSANUT), 2016
			Improved rural access to water and sanitation services	% of population with potable water in rural areas (rural population in private homes)	80% (2018) National Water Commission (Conagua), National Water Plan (2019)
		Increase education coverage and quality	Lower dropout rates in upper secondary education	Dropout rate in upper secondary education	12.9% National Education System, Key Figures, 2018-2019, Ministry of Public Education
		Improve the quality and sustainability of water services	Improved service provided by water and sanitation operators	% of households with 24-hour potable water and sanitation services	61% National Water Plan, 2019
		Strengthen the labor market	Increased labor participation rate	Female economic participation rate (population aged 15 and above, %)	43.47% (2018) National Women's Institute
			Reduce informality	Labor informality rate (annual average)	56.7% (2018) National Institute of Statistics and Geography

National Plan Priorities	Priority Area	Strategic Objective	Expected Outcome	Indicator	Baseline (source measured)
			Increased number of people with pensions	% of people aged 65 or above with a contributory or noncontributory pension	70.41% (2018) Labor Markets Information System and social security
Economy	Boost investment	Strengthen public finances	Increased tax collection	Tax revenue (% of GDP)	13 (2018) Department of Finance
		Strengthen access to credit	Increased bank lending to the private sector by the development banks	Lending to the nonfinancial private sector as a % of total bank lending	10.3% 2019, Bank of Mexico
			Improved depth and efficiency of capital and financial markets	Score in the 8th pillar of the WEF's Global Competitiveness Index	4.5% WEF, 2018
			Penetration of clean energy in power generation	Clean energies as a % of electricity generation	23.2% 2018 Department of Energy
			Increased financing for rural environmental sustainability	Amount of credit extended for rural environmental sustainability	0 2019 Financiera Nacional de Desarrollo
	Balanced regional development	Improve rural productivity	Improved agricultural productivity	Value added per agricultural sector worker (constant 2010 dollars)	5,779.46 2018 World Development Indicators
		Improve regional planning	Urban areas are consolidated	% of new housing in central and consolidated urban areas	27.4% 2015 National System of Housing Indicators
		Strengthen subnational fiscal management (municipios)	Increased own revenues at the subnational level	Increase in subnational governments' own revenues as a % of the total	9% 2016 National Institute of Statistics and Geography

Country Systems Matrix

Strategic Objective	Expected outcome	Indicator	Unit of Measurement	Baseline	Base year	Main Objective	Timing	Alignment Corporate Results Framework
Strengthening of country financial management systems	Subnational PEFA assessment applied	Subnational PEFA assessment applied	Number of assessments	0	2019	1 assessment of the public financial management system at the subnational level	End of strategy period	Institutional capacity and rule of law. Productivity and innovation
	Knowledge of good practices in the use of new fiduciary management technologies applied to country systems	Events to disseminate good practices in the use of new technologies	Number of good practices disseminated in the use of new technologies	0	2019	2 good practices disseminated in the use of new technologies	End of strategy period	Institutional capacity and rule of law. Productivity and innovation
Strengthening of country procurement systems or subsystems	(1) Strengthening and development of the professionalization system for public procurement specialists (curriculums will be designed for this purpose). (2) Preparation and training in a market research methodology for public procurement specialists. (3) Support for the process of amending Mexico City's procurement law and associated regulations. (4) Assistance in the design of framework agreements for the procurement of off-the-shelf goods by the Government of Mexico City.	(1) Professionalization system implemented (2) Training completed in market research methodology (3) Revision of the procurement law completed (4) Advisory services completed for design of the framework agreement	Number of outputs accepted by the Government of Mexico City	0	2019	Outputs completed and implemented	End of strategy period	Institutional capacity and rule of law. Productivity, efficiency, and innovation
Increased use of country financial management systems or subsystems	Use of the accounting and reporting system in the Bank's outstanding portfolio	Increase in the use of the country accounting and reporting system	% of the outstanding portfolio using the accounting and reporting system	0	2019	10%	End of strategy period	Institutional capacity and rule of law. Productivity, efficiency, and innovation
Increased use of country procurement fiduciary systems	Advanced national competitive bidding	Increase the use of advanced national competitive bidding	% of the outstanding portfolio using advanced national competitive bidding	90	2019	100	End of strategy period	Institutional capacity and rule of law

ANNEX II: MAIN SOCIOECONOMIC INDICATORS

Variable	2013	2014	2015	2016	2017	2018	2019p
Real							
Real growth (%)	1.6	2.8	3.0	2.9	2.4	2.0	0.4•
Public infrastructure investment (% of GDP)	3.3	3.3	2.9	2.5	1.7	1.7	1.9
Fiscal							
Primary balance (% of GDP)	-0.4	-1.1	-1.2	-0.1	1.4	0.6	1.0
Public sector balance (% of GDP)	-2.3	-3.1	-3.4	-2.5	-1.1	-2.1	-2.0
Historical PSBR (% of GDP) 1/	40.0	42.6	46.5	48.7	45.8	44.9	45.1
Financial cost (% of GDP)	1.9	2.0	2.2	2.4	2.4	2.6	3.0
Monetary							
Inflation (%, annual average)	3.8	4.0	2.7	2.8	6.0	4.9	4.0
Monetary policy rate (%, annual average)	4.0	3.2	3.0	4.1	6.7	7.7	8.0
Exchange rate (Mex$/US$, annual average)	12.8	13.3	15.9	18.7	18.9	19.2	19.2
External							
Current account (% of GDP)	-2.5	-1.9	-2.6	-2.3	-1.7	-1.8	-1.0
Capital and financial account (% of GDP)	4.8	4.2	1.9	3.0	2.5	2.6	1.0
Of which: Foreign direct investment (% GDP)	2.7	1.9	2.2	2.8	2.6	2.2	1.9
Of which: Portfolio investment (% of GDP)	3.4	3.3	2.0	2.8	0.6	0.7	0.8
Errors and omissions and changes in valuation	-1.4	-1.1	-0.9	-0.7	-1.0	-0.9	0.0
Change in gross international reserves	1.0	1.2	-1.6	0.0	-0.2	0.1	0.0
International reserves (US$ billion) 2/	176.6	193.0	176.7	176.5	172.8	174.6	175.0
Country risk indicator (EMBI) 3/	188	183	251	303	256	273	320**
Social							
Poverty (% of population) 4/		46.2		43.6		41.9	
GDP per capita (US$) 4/		10,467.4		10,844.2		10,849.3	
Gini coefficient 4/		0.50		0.50		0.47	
Total population (million) 4/		119.9		122.6		125.1	
Unemployment rate (% of economically active population)	4.9	4.8	4.3	3.9	3.4	3.3	3.5***

Sources: National Institute of Statistics and Geography, Department of Finance, Bank of Mexico, IMF, and the National Council for the Evaluation of Social Development Policy.
• IMF, WEO October 2019.
1/ External public sector borrowing requirement, historical balance. Department of Finance.
2/ End-of-year balance.
3/ EMBI spread, annual average.
* As of 16 August 2019.
** As of 23 August 2019.
4/ National Council for the Evaluation of Social Development Policy.
*** As of June 2019.

ANNEX III: PROJECTED FINANCIAL SCENARIO FOR THE SOVEREIGN DEBT

(US$ million unless otherwise stated)

	Strategy 2013-2018						Strategy 2019-2024						
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019p**	**2020p**	**2021p**	**2022p**	**2023p**	**2024p**	**Total 2019-2024**
Approvals	2,020	2,086	1,550	1,995	1,990	1,330	1,250	2,090	1,560	2,000	2,000	1,350	10,250
Disbursements	-1,906	-1,642	-1,408	-1,324	-1,669	-1,167	-1,351	-1,675	-1,181	-1,622	-1,618	-1,211	-8,657
Repayments	411	407	489	992	618	315	619	612	878	694	1,276	1,519	5,598
Net flows	-1,495	-1,235	-920	-333	-1051	-852	-731	-1063	-303	-928	-342	308	-3,059
Subscriptions and contributions	29	4	36	31	0	0	0	0	0	0	0	0	0
Net lending flow	-1,467	-1,231	-884	-302	-1051	-852	-731	-1063	-303	-928	-342	308	-3,059
Interest and fees	430	441	434	499	526	281	621	623	598	569	542	493	3,445
Net cash flow	-1,037	-790	-450	197	-524	-571	-110	-440	295	-359	200	801	387
													Average*
IDB debt	12,076	13,078	13,663	13,688	14,778	15,288	16,019	17,082	17,385	18,313	18,655	18,346	17,633
IDB debt/ multilateral debt (%)	44.2	46.4	47.7	47.9	49.3	50.6	51.6	53.5	53.0	54.3	53.8	51.4	52.9
IDB debt/ external debt (%)	9.2	9.0	8.5	7.7	7.7	7.6	7.8	8.1	8.1	8.3	8.3	8.0	8.1
IDB debt/total debt (%)	3.5	3.3	3.1	2.7	2.5	2.7	2.8	2.9	2.9	3.0	3.0	2.9	2.9

p = Projected; * Average, 2019-2024.

ANNEX IV: DEVELOPMENT EFFECTIVENESS MATRIX (SUMMARY)

In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluability of all Bank development products.

The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."

COUNTRY STRATEGY: Mexico

STRATEGIC ALIGNMENT

Refers to the degree to which the design and objectives of the CS are consistent with the country development challenges and with the government's development plans and priorities.

EFFECTIVENESS

This measures whether the country strategy is likely to achieve its intended objectives, through an examination of three dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and buildup of country systems.

Effectiveness dimensions	
I. Country Diagnosis - Country Development Challenges (CDC)*	Yes/No
- The CDC is comprehensive / holistic / complete	Yes
- The CDC clearly identifies the main development challenges	Yes
- The CDC presents magnitudes of the main development challenges that are based on empirical evidence	Yes
II. Priority Areas Diagnostics	%
- That clearly identify and dimension, based on empirical evidence, the **priority area's** specific constraints and challenges	100%
- That clearly identify and dimension, based on empirical evidence, the **main factors** or causes contributing to the specific constraints and challenges	100%
- That provide corresponding **policy recommendations**	100%
III. Results matrix**	%
- The strategic objectives are clearly defined	100%
- The expected outcomes are clearly defined	100%
- The strategic objectives and expected results that are directly related to the main constraints identified in the Diagnosis	100%
- The indicators are outcome indicators and are SMART	100%
- The indicators have baselines	100%
IV. Vertical logic	Yes/No
- The CS has vertical logic	Yes

ANNEX V: MANAGEMENT'S RESPONSE TO THE RECOMMENDATIONS OF THE COUNTRY PROGRAM EVALUATION:

OVE Recommendation	Management's Response
Recommendation 1:	**Agreed**
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.	Actions proposed by Management Management agrees with OVE that it is important for the IDB's work in the country to add value to federal programs and policies and to stay relevant to Mexico's development needs. (a) Management is maintaining an active dialogue with the new authorities to identify government policies and programs to which the Bank could contribute. This dialogue is supporting the implementation of reforms, including the labor reform recently approved by Congress; events and forums in various sectors to identify the main challenges; and publications that contribute to public policy discussions, such as BIDeconomics México, a publication that has been widely used by the government. The results of this process will be reflected in the new country strategy, currently in preparation, which will guide the Bank's support of government priorities through technical cooperation and/or financing. This dialogue will be reinforced through the programming exercise with the government, which will define the lending program and the instrument mix to serve the client's needs and ensure the Bank's relevance to the country. With respect to monitoring and evaluation, and ensuring learning, Management will verify that the operations include solid monitoring and evaluation components, and that, as part of the closing process using program completion reports, the lessons learned are clearly identified so they can be incorporated into the design of new operations. In addition, if there is interest, the Bank can support evaluations of government programs through financing or technical cooperation. (b) The Bank will continue to explore options to support subnational entities and its efforts to help reduce regional inequalities. Given restrictions in Mexico's Constitution that prohibit direct financing of subnational entities, the Bank will continue contributing to

	subnational development through: (i) federal programs that impact states (for example, water and sanitation programs in rural communities and educational programs through the National Council for Educational Development (CONAFE); (ii) programs through national development banks (such as programs for productive and inclusive rural financing); (iii) technical cooperation operations (such as the Mesoamerica Health Initiative); and (iv) fee-based (or "funded") knowledge and advisory support services (for example, support to implement the Emerging and Sustainable Cities Initiative methodology in six cities). Management will continue working with the government to explore options and design ways to provide more direct support to subnational entities, to increase the impact of interventions in the country's poorest areas. In terms of implementing the recommendation, the sector and geographic focus of Bank-supported programs will be based on the dialogue between the IDB Group and the government and on prioritized interventions.
Recommendation 2:	**Agreed**
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) 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.	**Actions proposed by Management** As OVE acknowledges in the evaluation, technical cooperation operations in Mexico have been relevant. Management has made great efforts to align technical cooperation operations with government priorities and use these operations strategically—a focus that will continue under the new strategy. For example, these efforts produced results in sectors in which technical cooperation operations supported the design of federal policies, programs, and reforms. Some of these include: (i) Fiscal reform. The Bank supported the design and implementation of the Fiscal Responsibility Act for States and Municipios. (ii) Energy. Financing was used to define key elements of energy reform, such as tendering contracts for renewable energy. (iii) Rural sector. Support was provided to development banks to expand financing to new productive activities and introduce climate change and gender considerations into their financing.

	In terms of the recommendation to increase the strategic focus of technical cooperation operations, a dialogue is taking place with the new authorities to: (i) strategically align technical cooperation operations with Bank-financed programs; and (ii) support sectors in which the Bank's interventions in policy and program design contribute technical value. Management agrees that technical-cooperation operation resources represent an effective tool to establish a dialogue regarding the country's programming with the main stakeholders. Therefore, having mechanisms to promote the usefulness, relevance, and use of technical cooperation operations during programming, and subsequently learning from the results, has been a priority in recent years—specifically since the fourth quarter of 2016, with the launch of the Technical Cooperation Monitoring and Reporting System (TCM). With respect to capturing results, significant progress has been made in terms of verification, documentation, and learning in the past three years. Since the TCM was implemented, a results-oriented approach has been incorporated into the lifecycle of technical cooperation operations, from start to finish. The TCM has provided the Bank with the infrastructure to fully realize the potential benefits arising from technical cooperation operations. In 2018, the IDB's Office of the Executive Auditor (AUG) prepared an appraisal of the TCM, concluding that no other international financial institution has a system that can capture and disseminate the quantity and quality of information that the IDB has with the TCM. Therefore, Management is already working on improvements that are consistent with OVE's recommendation. To ensure that results are documented and verified, project teams will use a results matrix to report on the outputs completed. These deliverables will be classified and included, as applicable, in the Bank's knowledgebase. For Mexico, as of 31 May 2019, 73% of the active technical-cooperation operation portfolio is already being monitored with the TCM.

<table>
<tr><th>Recommendation 3:</th><th>Partial agreement.</th></tr>
<tr><td>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.</td><td>While several elements of OVE’s recommendation are in line with the process to introduce the new supply chain product, Management believes that there is insufficient evidence (at the time of the OVE visit, there had only been seven months of full activity) to be able to reach the conclusions and recommendations presented in the report.

Management’s position focuses on the following elements:

• Strategic alignment. Strategic alignment. Value chain outputs and solutions are one of the pillars of the IDB Invest Action Plan for the Micro, Small, and Medium Enterprises (document CII/GN-364-1), which the Board of Executive Directors approved in May 2018. This is due to their high impact and effectiveness in reaching micro, small, and medium-sized enterprises (MSMEs) in various sectors of the economy.

• Additionality. IDB Invest’s value chain products have financial and nonfinancial additionality, as has been described in the respective loan proposals.

For financial additionality, there is a significant financing gap for anchor-company suppliers, particularly MSMEs. This is a result of traditional barriers to credit, regulatory requirements (including money laundering and “know your customer” regulations, etc.), technology and accessibility constraints, de-risking by traditional financial institutions, information asymmetries, and credit risk. There are also capital constraints in local banks, which restrict the ability of anchor companies to allocate part of their lines of credit to benefit their suppliers.

IDB Invest’s value chain finance products are designed to help close this financing gap, enabling MSMEs, through technology platforms, to access additional lending sources at market rates linked to the anchor company’s risk.

It is important to highlight that, to avoid financial market disruptions and enable investor mobilization in the future, IDB Invest sets its prices based on quarterly market analyses.

For nonfinancial additionality, IDB Invest has supported a partner platform through a technical</td></tr>
</table>

	cooperation operation to strengthen and scale up the affiliation capacity of suppliers. • **Development impact**. Development impact objectives were identified for every operation in the loan proposals, which also included the applicable outcome indicators. Ex post supervision and review of these operations should be consistent with the objectives defined ex ante and take place when the operation has achieved sufficient maturity. Based on these elements, Management recommends: ***1. Strengthen the effectiveness and additionality of IDB Invest's business model of supporting SMEs through value chains.*** - Management will continue implementing the value chain product, under the terms of the IDB Invest Action Plan for the Micro, Small, and Medium Enterprises (document CII/GN-364-1). - When operations achieve maturity, Management will evaluate fulfillment of the development objectives identified when the operations were structured, as well as the financial and nonfinancial additionality specified in loan proposals. ***2. Draw early lessons that can inform the implementation of this product going forward in Mexico and elsewhere.*** - Management agrees on the importance of drawing early lessons that inform the implementation of new products. However, it is essential that they reach a level of sufficient maturity. This is particularly important for value chain products, given the long ramp-up required to add suppliers. - In the meanwhile, Management will continue to monitor and supervise operations that are underway, to verify that they are fulfilling the expected outcomes specified in loan proposals. ***3. 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.***

	- This recommendation extends beyond Mexico, and Management believes that it should not be part of the action plan to implement the recommendations of the Country Program Evaluation. - Nevertheless, Management will continue working to replicate the product and expand the knowledge gained from the initial implementation. The instrument mix will be designed for each country based on client needs, the legal framework, and the availability of electronic invoicing or similar solutions. Moreover, an effort will be made to leverage multi-Latin anchor companies whose value chains extend to countries that lack these types of solutions. - Notably, supply chain operations undertaken to date have included a technical cooperation operation that seeks to improve operating efficiency and scale up the capacity of MSME suppliers to join the platform. Similar technical cooperation operations are being developed. ***4. [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 the operations mentioned, there are several challenges to expand the set of outcome indicators, including limitations in the information that anchor companies collect about their suppliers. Management is working with the platform to add relevant indicators for the universe of suppliers. ***5. For vertical integration operations, further study the direction and distribution of impacts on supply chain companies, to clearly represent and document development results.*** - This recommendation extends beyond Mexico, and Management believes that it should not be part of the action plan to implement the recommendations of the Country Program Evaluation. - Notwithstanding the foregoing, to design operations involving vertical integration of productive cycle activities for a company,

	Management measures the direct impact on efficiency gains for the beneficiary, and if relevant and possible, estimates the indirect impacts, both positive and negative. If these cannot be quantified, that is documented. In these cases, it is also important to document the time horizon of the effects, since initial shifts tend to turn into productivity gains.