Board Meeting of March 26, 1998
Statement by Jan Piercy

MEXICO - Country Assistance Strategy - Progress Report

1. We would like to thank staff for this informative progress report and its frank discussion of both Mexico’s recent accomplishments and the development challenges ahead. From a macro-economic standpoint, the government’s continuing strong commitment to sound economic management is impressive. We particularly commend the resolution which the Government is demonstrating in responding quickly to address the risks which the Asian financial crisis and the resulting decline in oil prices pose to macroeconomic stability. The good track record of the economic management team justifies confidence in Mexico’s ability to continue addressing effectively the still substantial remaining internal and external economic risks. As the progress report states clearly, the success of the Bank’s country assistance strategy also depends critically on this continued good economic performance.

2. We also welcome the positive benefits, including improved portfolio performance and strengthened policy dialogue, which appear to be accruing from decentralization and the Bank’s increased field presence. The high proportion of medium and high risk projects in the Bank’s FY 1998-2000 lending program underscore the challenge of ensuring a process is in place for maintaining and improving loan quality.

3. Our December 1996, CAS discussions stressed the importance of making poverty reduction the overarching objective of the Bank’s program. We therefore are encouraged by the indications that the quality of the Government’s social programs is improving and that the Bank’s efforts in pensions, health and education are generally on track. We believe the Bank’s considerable experience in addressing and targeting poverty programs can help to substantially strengthen the Government’s social agenda. The Government’s efforts to better target financial support to the “poorest of the poor” deserve strong Bank support. We were particularly impressed by the Rural Development in Marginal Areas Project which the Board approved in January. We hope that good results from this project will justify its expansion into other marginal rural areas of the country, and that the strong emphasis on community participation – including women and indigenous people – will provide valuable lessons for replication in other countries. The success of social development programs will also continue to depend heavily on the Government’s commitment to work constructively with civil society.
4. The December CAS also stressed the importance of strengthening Mexico’s financial and banking system. We agree with this strong emphasis, which recognizes the key role of a strong financial sector in economic development and the high costs of banking sector inefficiencies in fiscal expenditure and lost growth. While there has been some forward movement in this crucial area, more forceful policy and institutional action is needed. We therefore welcome recent indications that the Government will speed up its reform efforts in this sector and hope that progress is sufficient to justify on-going Bank support. Banking reforms must also address issues of incentives to lend and access to credit by smaller borrowers.

5. We are disappointed by the lack of progress in the reform agenda for the energy sector. While we recognize the political sensitivities of the oil industry, we hope that the Government’s renewed dialogue with the Bank will result in a pro-active consensus on steps which can be taken to improve efficiency in power generation, transportation and distribution.

6. The approach the Bank is considering for assisting sub-national governments as part of the Government’s decentralization efforts is a major step with both new opportunities and risks. It is clear that more cost-effective delivery of basic services by local institutions could have an enormous beneficial impact on the average Mexican’s quality of life. At the same time, Management’s paper on Adjustment Lending to Sub-National Units which we discussed in February shows the complexity of sub-national lending and describes the comprehensive policy framework which is needed to ensure that such lending is effective and sustainable over the long run. Thus, while we welcome greater attention on improving the administrative, institutional and financial capacities of sub-national governments, we also stress the need for prudence and caution.

- During last month’s discussion, I outlined my government’s views on the necessary condition for sub-national lending. We are pleased to see that some of the elements we advocated are clearly reflected in the CAS progress report. Most notable is the stress placed on the need to reform intergovernmental fiscal relations. The discussion in Annex 1 clearly illustrates the weaknesses and sub-optimal functioning of Mexico’s current system of state/federal fiscal relations, and we commend the Bank’s commitment to assist in strengthening that system. We are surprised, however, that this commitment is not incorporated into the proposed work program at the conclusion of the Annex. Instead, the elements of the program are primarily oriented toward helping the states to raise additional funds and improve their institutional capacity for fiscal management. We urge priority be given to actions which advance the federal-fiscal reform agenda, and to involve more explicitly the national government.

- We also welcome the Bank’s plans to help the states strengthen their access to resources in addition to federal transfers. We are disappointed, however, that so little detail is provided on how this could be accomplished. If, as we hope, reforms in Mexico’s financial markets accelerate, we urge that -- when the time is right -- the Bank and Government will focus particular attention on how best to enhance the states’ market access.
7. The progress report reminds us that corruption is a serious acknowledged problem. We therefore continue to encourage the Government and the Bank to collaborate in giving high priority to laws and structures that encourage good governance and transparency.

8. The progress report also notes a significant improvement in the dialogue on environment. This is another area where we would like to see the Bank’s expertise used proactively to help the Government develop a comprehensive policy.

9. The progress report states that Mexico’s improved access to private capital flows has resulted in a slowdown of IFC activities. While we certainly would not want IFC financing to replace alternatively available private funding, we understand that private flows are still heavily concentrated on the largest and most well established companies and that major opportunities remain for the IFC in smaller and newer private enterprises. We would urge the IFC to be alert for viable opportunities in this area, particularly in Mexico’s less developed and poorer states.

10. In conclusion, I would like to restate the importance my government attaches to the World Bank coordinating its broad range of development activities with other multilateral and bilateral entities providing development assistance to Mexico. This aspect of Bank activity should benefit from Bank decentralization to the field. In this context, USAID has advised us of their strong interest in strengthening their operational dialogue with the Bank and other donors working in Mexico. The Bank and Mexico have defined a major multi-pronged program which can clearly be best addressed in partnership with other donors as the Bank increases emphasis on selectivity and prioritizes its own engagement.