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Report No. P-2101-ME

REPORT AND RECOMMENDATION

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO

NACIONAL FINANCIERA, S.A.

WITH THE GUARANTEE OF

UNITED MEXICAN STATES

FOR AN

INTEGRATED RURAL DEVELOPMENT PROJECT

PIDER II

May 31, 1977

Public Disclosure Authorized

Currency Unit - Peso (Mex$)

The Mexican peso is free to float against other currencies; in recent weeks the rate of exchange has fluctuated in the range of Mex$22 to Mex$23 per US dollar. On May 27, 1977 the peso traded at 22.83 per US dollar.

GLOSSARY OF ABBREVIATIONS

CFE	=	Federal Electricity Commission
CIDER	=	Research Center for Rural Development
CONASUPO	=	National Company for Popular Subsistence
FIRA	=	Agricultural Trust Funds of the Bank of Mexico
PEMEX	=	Petroleos Mexicanos
PIDER	=	Investment Program for Rural Development
PRONDAAT	=	National Program for Extension in Rainfed Areas
SARH	=	Secretariat of Agriculture and Water Resources
SPP	=	Secretariat of Programming and Budgeting
SRA	=	Secretariat of Agrarian Reform

MEXICO

LOAN AND PROJECT SUMMARY

Borrower: Nacional Financiera, S.A.

Guarantor: United Mexican States

Amount: US$120 million equivalent

Terms: Payable in 17 years, including 3-1/2 years of grace, at an interest rate of 8.2 percent per annum.

Project Description: The project consists of directly productive, productive support and social infrastructure components of a program designed to raise the income and improve the standard of living of poor rural families in 20 selected micro-regions in Mexico. The rural industrial component would also be extended to the 30 micro-regions of the Bank-assisted PIDER I project. The individual project components are summarized below:

Directly Productive Components (70% of project)

(a) Construction and rehabilitation of small-scale water facilities including pump schemes, storage dams and distribution networks to irrigate about 34,000 ha and to provide for domestic and livestock use;

(b) Development of rural industries, including: provision of development credit; technical assistance for rural industries; and training of personnel. The rural industries supported would provide employment to some 6,000 rural dwellers;

(c) Development of about 500 livestock units through land clearing, pasture establishment, fencing, and construction of watering and handling facilities;

(d) Soil and water conservation, including construction of contour ridges, terraces, checkdams or other conservation works on about 80,000 ha;

(e) Pilot fruit production units, including planting of a total of 7,500 ha;

(f) Provision of seasonal production credit, and medium- and long-term development credit to enable more effective use of infrastructure facilities;

(g) Other productive investment, including beekeeping, small stock, forestry and fisheries development.

Productive Support Components (20% of project)

(a) Construction of about 2,000 km of feeder roads using labor intensive methods to the extent feasible;

(b) Installation of electric power distribution systems in 300 villages benefitting about 131,000 persons;

(c) Support of a rural marketing program;

(d) Organization and training of farmers for greater participation in development programs;

(e) Provision of intensive technical assistance packages to promote adoption of improved farming methods; and

(f) Assistance for preparing feasibility studies for directly productive investments in each micro-region.

Social Infrastructure (9% of project)

(a) Installation of water supply systems to serve about 214,000 persons;

(b) Construction or renovation and equipping of 1,500 classrooms to accommodate about 60,000 students;

(c) Provision of materials and equipment for self-help activities in ejidos and villages, such as housing improvements, and community centers.

Monitoring and Evaluation (1% of project)

(a) The Center for Research in Rural Development would carry out project related evaluation and applied research and train PIDER planning and administrative staff.

Estimated Cost: The cost of the project is estimated at US$255.0 million equivalent, with foreign exchange costs of US$46 million. The breakdown of the estimated costs is presented below:

Components	US$ Million Local	Foreign	Total	% Foreign Exchange
I. Directly Productive				
A. Infrastructure				
Irrigation	25.4	8.5	33.9	25
Soil and Water Conservation	9.0	1.4	10.4	14
Livestock	14.1	3.5	17.6	20
Fruit, Forestry and Fisheries	8.3	0.9	9.2	10
Rural Industries	3.0	2.0	5.0	40
B. Development Credit				
Agriculture and Livestock	40.0	10.0	50.0	20
Rural Industries	5.4	3.6	9.0	40
C. Incremental Production Credit	11.7	1.6	13.3	12
Sub-total	116.9	31.5	148.4	21
II. Productive Support				
Feeder Roads	14.8	1.1	15.9	7
Rural Electrification	5.5	1.8	7.3	25
Farmers' Organization	5.3	0.2	5.5	4
Extension and Field Demonstration	9.4	0.6	10.0	6
Rural Marketing	0.8	-	0.8	0
Feasibility Studies	3.6	-	3.6	0
Sub-total	39.4	3.7	43.1	9
III. Social Infrastructure				
Education	4.5	0.8	5.3	15
Rural Water Supply	8.2	2.1	10.3	20
Self-Help	3.9	-	3.9	0
Sub-total	16.6	2.9	19.5	15
IV. Evaluation	0.9	0.1	1.0	10
V. Total Baseline Cost	173.8	38.2	212.0	18
Physical Contingencies	10.7	2.4	13.1	
Expected Price Increases	24.5	5.4	29.9	
VI. Total Project Cost	209.0	46.0	255.0	

Financing Plan:

	US$ Million	%
Government	127.8	50
Beneficiaries	7.2	3
Bank	120.0	47
TOTAL	255.0	100

Estimated Disbursements:

FY	Year-by-Year (US$ million)	Cumulative Amount (US$ million)
1978	7.0	7.0
1979	27.0	34.0
1980	48.0	82.0
1981	38.0	120.0

Procurement Arrangements: The following procurement procedures would be applied for civil works and building construction, machinery, equipment, materials and supplies:

(i) In order to obtain as much competition in bidding as possible, contracts would be grouped into larger packages, where feasible.

(ii) Contracts and purchases exceeding US$250,000 equivalent would be awarded under international competitive bidding in accordance with Bank Guidelines for Procurement. A preference of up to 15 percent for domestic suppliers would be permitted in evaluation of bids for manufactured items.

(iii) Contracts of less than US$250,000 equivalent would be let under local competitive bidding, or as negotiated contracts under normal government procedures which are satisfactory, or executed by force account.

It is anticipated that because of the decentralized nature of the proposed project, few contracts would be let under international competitive bidding and that because of the competitiveness of local suppliers, few international firms would be attracted to bid.

Consulting Services: Provision is made for local consultant services to identify and carry out feasibility studies of productive investments in the micro-regions (1,700 man-months to cost about US$3.6 million). The average cost per man-month of local consultant services has been estimated at US$2,100.

Economic Rate of Return:	Average economic rate of return on the directly productive and productive support components is 23.7 percent.
Completion Date:	January 31, 1981
Appraisal Report:	Report No. 1480a-ME, dated May 31, 1977 Central Projects Staff Agriculture and Rural Development Department

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS ON A PROPOSED LOAN TO NACIONAL FINANCIERA, S.A. WITH THE GUARANTEE OF UNITED MEXICAN STATES FOR AN INTEGRATED RURAL DEVELOPMENT PROJECT -- PIDER II

1. I submit the following report and recommendations on a proposed loan to Nacional Financiera, S.A. with the guarantee of United Mexican States for the equivalent of US$120 million to help finance an integrated rural development project. The loan would have a term of 17 years, including 3-1/2 years of grace with interest at 8.2 percent per annum.

PART I - THE ECONOMY

2. Some of the major features of the Mexican economy were analyzed in "An Updating Report on the Economy of Mexico" (1110-ME), distributed to the Executive Directors on March 23, 1976. An economic mission visited Mexico in April-May 1977 and its report is now in preparation. The discussion which follows and the country data sheets contained in Annex I reflect the preliminary findings of this mission.

Past Performance

3. For most of the three decades preceding the mid-seventies, the Mexican economic system has been outstandingly successful in achieving sustained and rapid growth while maintaining stability in prices and the balance of payments. Since 1940, the annual average GDP growth rate has exceeded 6 percent. Inflation averaged less than 5 percent a year from the mid-1950's to 1972, and the dollar value of the peso fixed in 1954 was maintained until the September 1976 devaluation.

4. The Mexican development strategy has relied on a combination of public action and private profit. During most of the last three decades the role of the Government centered upon carrying out direct investments in key industries such as power, steel and petroleum and creating a stable regulatory and institutional framework for private sector growth. This system worked well to achieve rapid growth, but it led to a sharpening of contrasts between classes and among regions. The scope of redistributive policies was necessarily limited as government revenues remained under ten percent of national income. The Government did play a crucial role in the development of private commercial agriculture (through provision of irrigation and credit), in industry (through the provision of infrastructure and protection from imports), and in education. While land redistribution under the reform of 1915 was continued, fiscal resources were insufficient to develop major programs to

improve the economic status of its beneficiaries. It was not until the 1970's that the Government began to give a high priority to programs and policies directed at a broader distribution of the benefits of growth and, in particular, at the problem of poverty in rural areas.

5. Rapid population growth has made social equity even more difficult to achieve. Population growth in Mexico accelerated steadily from 1930 to 1970, primarily as a result of reduced death rates, reaching 3.4 percent per annum in 1970. It has since declined to about 3.2 percent per annum (unofficial estimates for 1976) as birth rates have begun to decline. The rate at which Mexico's population is growing is still one of the highest in the world, however, and presents a formidable challenge for socio-economic development. The most rapid rates of natural increase are in rural areas. In spite of rapid and sustained economic growth, the high demographic growth rate made adequate absorption of the labor force in productive employment difficult. It is estimated that 40 percent of the labor force was, and still is, either engaged in marginal occupations, relatively unproductive and hence poorly paid, or openly unemployed.

6. Income distribution in Mexico is uneven. The estimated share of the poorest 20 percent of Mexican families in total national disposable income was only 2.1 percent in 1975, while the upper 20 percent received 60.2 percent --a ratio of almost 30 to one. Most of the very poor are in rural areas. Estimates for 1975 show that families headed by hired agricultural laborers have incomes averaging 45 percent below the national average while families headed by self-employed agricultural workers earned an average of 35 percent less than the national average; these two groups together account for 31 percent of all families in the nation.

7. The Echeverria Government (1971-1976) attempted to combine past growth policies with several major institutional reform measures. For rural Mexico these included a revised Agrarian Reform Law (1971) and a new Federal Water Law (1972), both of which were intended to promote a more equitable distribution of basic agricultural resources. These measures were complemented by increases in the availability of credit to low-income farmers and the maintenance of more remunerative support prices for basic foodcrops. The Government also increased outlays for agricultural research, training and extension services, paying particular attention to the needs of small farmers. One of the most significant innovations was the new PIDER program for integrated rural development, begun in 1973, with which the Bank has been associated from an early stage with a loan of US$110 million in May 1975 (Loan 1110-ME) and a second loan now under consideration. Urban-industrial development was also promoted by heavy public investment in basic industries--petroleum, chemicals and steel being outstanding examples--and an innovative workers' housing program.

8. Recognizing the implications of Mexico's demographic trends, the authorities initiated a national family planning program in 1972 with the objective of reducing fertility rates and improving the health standards of families. Government health agencies have steadily expanded their services,

and the number of family planning acceptors rose from 900,000 in 1973 to 1.7 million in 1976. However, most new acceptors have come from urban areas; coverage rates of 45 percent were achieved in cities as compared to only 5 percent in rural areas. The new Government has indicated its intention to intensify family planning efforts. The President's declared goal is to reduce population growth to 2.6 percent by the end of 1982.

9. In its efforts to improve both the country's productive base and the living conditions of lower-income groups, the Government doubled public sector expenditures in real terms over the period 1970-1976. Government revenues were also substantially increased, but not enough to compensate for the increase in expenditures, and the difference had to be financed by internal and external borrowing. These policies, together with frequent wage increases in excess of productivity gains (especially since 1974) led to high inflation. The inflation, when combined with the fixed parity of the peso, led to rapidly increasing balance of payments deficits on current account. Growing inflation, rising labor costs, preemption of credit for financing rapidly growing public expenditures, and some Government pronouncements that were interpreted as inimical to private entrepreneurship led to a virtual stagnation of private sector fixed investment, a reduction in deposits of savings in financial intermediaries and related speculative behavior by domestic savers. The rate of growth of GDP slowed from an annual average of 6.8 percent during 1965-1970 to about 5.0 percent during 1971-1976, dropping to 2 percent in 1976--the lowest growth rate experienced by Mexico since the mid-thirties--implying a decline in terms of per capita income.

10. The short-run disequilibria affecting the country at the end of 1975 and the accompanying social and labor unrest and loss of confidence built up strong devaluationary expectations which in turn led to large capital outflows during 1976. Under these circumstances, on September 1, 1976 the authorities abandoned the fixed exchange rate of 12.50 pesos per dollar which had prevailed since 1954 and let the peso float. After some sizable fluctuations before the inauguration of the new Administration in December, the peso has remained rather stable at rates fluctuating between 21 and 23 pesos per dollar.

11. Following the devaluations, Mexico obtained major support from the IMF. In the last quarter of 1976, Mexico was able to draw on the Fund for US$480 million. For 1977-79, an Extended Fund Facility accompanied by a comprehensive three-year stabilization program has been negotiated, which could provide as much as an additional US$861 million once the increase in Fund quotas becomes effective. Thus, total IMF support for the Government's program may exceed US$1.3 billion. The new Government ratified the agreement with the IMF shortly after taking office on December 1, 1976.

Current Economic Policy

12. The present Government inherited a difficult situation upon taking office last December. Many factors indicated a need for economic stabilization. Inflation, fed by high public sector deficits, large wage increases,

and finally the devaluation of around 80 percent was rising faster than at any time in Mexico's recent history--at an annual rate of 57 percent in the three months after the devaluation; moreover, a large amount of private capital had left the country in 1976. Foreign borrowings, which had grown rapidly to make up for reduced domestic savings and to finance the growing public sector deficits, had left Mexico's public sector with a foreign debt of some US$20 billion (including short-term debt). On the other hand, the situation also called for more expansionary policies; economic activity had slowed down, net private investment was virtually nil, and the gap between new job creation and growth of the labor force was increasing. High world prices for petroleum and related products offered profitable investment opportunities in the petroleum and petrochemicals sectors; indeed, increased production for export of these products seemed by far the best way to meet a large part of Mexico's high debt service requirements in the coming years.

13. Faced with these conflicting needs, the Mexican authorities are adopting a mixed strategy aimed at reducing lower-priority public expenditures and increasing public revenues, while proceeding with petroleum and other high-priority investments. The objectives of the Government's program include progressive control of inflation--the target is to reduce it to international levels no later than the end of 1979--together with a return to historic high rates of economic growth by the end of 1978. Better management of public sector expenditures, more rational pricing and cost control in public sector enterprises, promotion of private savings, limiting wage increases to justifiable levels, and more effective cooperation with the private sector are other important parts of the Government's economic strategy.

14. With only a few weeks in which to submit its budget for 1977, the Government made only slight modifications in the proposals prepared by the outgoing Administration. However, the President formally instructed his Cabinet to regard budgeted spending levels as ceilings. Any new expenditure authorizations, limited to projects carrying the highest priority, would have to be accommodated by reducing expenditures on lower priority projects. The only exception to this compensation requirement is the investment program of PEMEX, the state-owned petroleum company, which is to be increased by Mex$20 billion above the initially approved budgetary allocation of Mex$30 billion to realize a rapid increase in production and exports of petroleum and products (see para 22). However, it is planned to finance these additional expenditures through a combination of additional external borrowing and increases in revenues.

15. With effective implementation of the above-mentioned decisions, the Government would be able to contain total expenditures broadly within the budget ceilings; this would represent a major break with the past few years, when actual public sector expenditures averaged about 20 percent higher than initially budgeted. Moreover, to increase public revenue, the tax base has been broadened and the prices of some goods and services produced by the public sector have recently been increased (examples: power rates went up by 52%, petroleum product prices increased by 25%, steel by 15%, fertilizers by

25%, telephone rates by 30%). The Government also expects that delays in the execution of the budget to be expected during the first year of a new Administration will result in a spending shortfall of about 5 percent of budgeted expenditures. The net effect of these measures (expenditure restraint and revenue increases) would be to reduce public sector net borrowing requirements from the original budget figure of 8 percent to an estimated 6 percent of expected GDP. (In comparison, in 1976, public sector net borrowing requirements were about 9 percent of GDP. 1/)

16. Other measures taken by the new Administration include:

- A far-reaching administrative reform, including a new law giving the Treasury more effective control over public sector external borrowings, another law to improve and modernize the budgetary process and to centralize it under the new Secretariat of Programming and Budgeting, and the centralization of direction of government programs related directly to production activities in two ministries, the Secretariat of Agriculture and Water Resources and the Secretariat of National Property and Industry.

- An increase of only 10 percent in the annual minimum wage review in January 1977, which is widely considered as a demonstration of the serious nature of the Government's intentions to stabilize prices, and its support from labor.

- An excess profits tax.

- Price, production, and investment agreements with the private sector to encourage domestic production of wage goods at low prices and to promote private investment of about Mex$100 billion during the next several years.

- A set of measures aimed at inducing a recovery of financial savings and intermediation, in order to relieve the extremely tight credit situation affecting the private sector. Reserve requirements were modified so as to increase the lending to the private sector; interest rates on term deposits are to be allowed to increase gradually so as to better reflect market conditions; new limits were imposed on the liabilities and assets of the banking system so as to increase its stability and independence and to avoid undue concentration of credit, and new financial assets were created in the form of an issue of Mex$2.0 billion of "Petrobonds" (indexed to the peso equivalent of the international price of petroleum).

1/ These figures do not include the deficit of public financial intermediaries. The contrast in fiscal policies between 1976 and the 1977 program is somewhat greater than these figures indicate because of the effect of the devaluation in increasing the deficit in 1977.

- For balance of payments management, the most important measure is the more realistic exchange rate now in effect. Strong government support of tourism development, as well as the restoration of normal export incentives for manufactures, should help increase exports even more; the Government's intended review of the import licensing system and move towards more reliance on tariffs rather than on quantitative restrictions in controlling imports would increase efficiency in domestic production as well as provide a further spur to exports.

Prospects

17. The measures instituted in recent months, as well as some fortuitous events, have already produced good results. Inflation in the first three months of 1977 slowed to an average rate of 2.2 percent per month, as compared to 4.0 percent per month in the last three months of 1976. The deficit in the current account of the balance of payments has fallen drastically (US$245 million in January-March 1977, as compared to US$666 million in the same period of 1976), owing both to reduced imports (in turn caused by reduced economic activity) and to increased exports of petroleum and manufactures as well as higher earnings from export of food crops such as tomatoes, cotton and coffee. For the entire year the current account deficit is estimated at US$2.4 billion, compared to US$3.4 billion in 1976. Mobilization of resources by the banking system increased considerably in the first quarter of 1977, signalling the return of part of the previous year's withdrawals. Perhaps most importantly, there is a general feeling of increased confidence in the Government's economic policy.

18. Nevertheless, 1977 will inevitably be a year of transition. The public sector deficit, while lower, will still be high; inflationary pressures will continue, and debt service (equivalent to 37 percent of exports in 1976) will be a heavy burden. To return to economic growth and price stability will require continued progress in the directions already taken by the Government: public savings must be increased still further through control of expenditures, tax reform, and increased prices for public goods and services; additional domestic savings must be captured by realistic interest rates and otherwise attractive financial assets; balance of payments control requires maintenance of the current realistic exchange rate in real terms, as well as adequate export incentives; efficient growth also depends on increased efficiency and productivity of public spending.

19. In the longer run the prospects for resumption of economic growth with relative price stability are good. Mexico's historically strong economic potential has been further strengthened in recent years by the large investments in agriculture, petroleum, petrochemicals, electricity, steel, and basic infrastructure.

20. In agriculture, the large investments in irrigation, recent revision of the structure of support prices, the new Administration's stated intention to emphasize smaller irrigation and drainage projects over the next few years, and the more realistic exchange rate, all promise a resumption of growth of production for both domestic and export markets.

21. Industry has potential for considerable growth in many sectors, including efficient import substitution in chemicals, petrochemicals and capital goods as well as exports of many different manufactured products.

22. An outstanding example of the benefits of recent public sector investments are the new possibilities opened to the Mexican economy through the recent discoveries of rich petroleum fields. Proven oil reserves are estimated to be at least 11 billion barrels, which gives a production/reserve ratio (computed at the 1977 production rate) of more than 30 years. On the basis of these known reserves and PEMEX plans, production of petroleum could grow at an average annual rate of 19 percent between 1977 and 1982, reaching 2.2 million barrels per day in 1982 (1976 production was 0.8 million barrels per day); exports could increase at an annual average rate of almost 50 percent over the period, reaching 1.1 million barrels per day in 1982, the equivalent of US$7.8 billion per annum in projected 1982 prices.

23. The prospect of rapidly rising petroleum exports has greatly strengthened the balance of payments outlook. Increases in tourism earnings, recovery of agricultral exports, and resumption of growth of manufactured exports are also expected. Thus, even on the basis of somewhat more conservative projections of petroleum production and exports than those mentioned above (see Annex I), the current account deficit can be expected to decline steadily over the next several years, thus reducing Mexico's net external borrowing requirements. The debt service ratio is expected to continue to rise over the next year or two and then to decline sharply to levels around 20 percent in the early 1980's.

24. Thus, Mexico remains creditworthy for borrowing on conventional terms because of its medium- and long-term potential and the Government's decision to adopt the comprehensive gradual stabilization program mentioned above. The Bank currently holds about 8 percent of total medium- and long-term public debt, and this ratio is not likely to increase in the next few years.

PART II - BANK GROUP OPERATIONS IN MEXICO

Bank Operations

25. As of April 30, 1977, Mexico had received 46 loans from the Bank amounting to US$2,512.7 million net of cancellations and terminations; of these, 28 loans totalling US$1,286.7 million were fully disbursed. As of April 30, 1977, the Bank held US$2,065.3 million of which US$799.8 million had not yet been disbursed. Some 35 percent of Bank lending has been for agriculture and rural development (14 loans for US$903.7 million), 27 percent for power (12 loans for US$704.8 million) and 21 percent for transportation

projects (12 loans for US$546.7 million); the remaining 17 percent has been for industry (US$205.5 million), water supply (US$130 million) and tourism (US$22 million) projects. The implementation of several projects fell behind schedule during 1976 and 1977 mainly as a result of a scarcity of counterpart funds. Annex II contains a summary statement of Bank loans as of April 30, 1977 and notes on the execution of on-going projects.

26. Bank lending was active in FY75 with four loans totalling US$360 million, and in FY76 with four loans totalling US$315 million. In July 1976 the Executive Directors approved a US$95 million loan for a second steel project but, as stated in a memorandum distributed to the Executive Directors on April 5, 1977 (SecM77-258), the new Mexican Administration has reconsidered its investment program for the immediate post-devaluation years and decided to concentrate a greater share of its investment resources in fields which have a rapid impact on output and foreign exchange earnings; considering the magnitude and long gestation period of the second steel project, the Government has decided to postpone it sine die, and the loan was consequently terminated on April 15, 1977. The Executive Directors approved a US$42 million loan for a tourism project in May 1977.

IFC Operations

27. As of April 30, 1977, IFC had made 13 investment commitments in Mexico, for a total of US$69.1 million, of which US$37.4 million had been sold, repaid or cancelled. The balance held by the Corporation, US$31.7 million, consists of US$27.2 million in loans and US$4.5 million in equity. A summary statement of IFC investments as of April 30, 1977 is presented in Annex II.

Bank Strategy

28. The main objectives of Bank lending in Mexico have been to: (i) support policies and programs leading to a wider distribution of the benefits of economic growth; (ii) strengthen policies and programs leading to continued economic growth, by helping to finance projects that are to make directly or indirectly significant contributions to output, exports, and employment; (iii) help resolve critical adjustment problems induced by Mexico's continued economic growth; and (iv) complement Mexico's domestic savings by helping to finance economic and social investments in a framework of internal and external financial stability. In the coming years, the Bank will preferentially support projects that make relatively modest demands on budgetary resources and have a strong positive balance of payments effect, and projects of high social priority that improve living standards, attain higher levels of employment and help to decentralize economic activity.

29. For the time being, Mexico's budgetary stringency and heavy external debt burden, together with its need to concentrate an important part of its investment program in social sectors with a low foreign expenditure component, makes the availability of sufficient freely disposable foreign exchange particularly important. To this end, the Government is borrowing heavily from financial intermediaries on a non-project basis. In addition it expects

project financing agencies to finance reasonable proportions of the total cost of projects, even if this involves a certain amount of local expenditure financing as it is likely to be needed in some of the highest priority social sectors. Given the special circumstances of Mexico at this time, this seems a reasonable approach.

30. In view of the difficult structural problems of Mexico's agriculture and the sector's crucial importance to the country's further development, the Bank has made agriculture the leading sector for its lending. Consistent with the overall framework of country and sector objectives, a three-tier approach has been developed. First, to strengthen irrigation and agricultural credit programs so as to meet the demands of a rapidly growing population more adequately and to generate the foreign exchange needed for rising import requirements. Second, to raise the incomes of the rural poor and improve their standards of living through a combination of directly productive, productive support and social infrastructure investments. Third, to strengthen Mexico's institutional capability to use scarce agricultural resources more efficiently.

31. Bank lending for industry has been aimed at assisting the Government's efforts to reduce the balance of payments deficit and decentralize industrial activities away from the major (and increasingly congested) urban areas. Thus, the Executive Directors approved a Second Industrial Equipment Fund Loan in FY76 for US$50 million, aimed at financing industrial projects with a positive effect on the balance of payments; a US$50 million loan made in FY75 to support a fertilizer project is promoting new poles of development in the resource-rich southeast region and the north central area and will help make Mexico independent of imported urea fertilizer in the medium term.

32. As regards infrastructure, the Bank's operations have been focused on investments in key areas of the country as well as on institutional reforms and sector policies aiming, inter alia, at suitable pricing mechanisms to help generate additional resources for investment financing. For example, the Airports Development Project (FY74) of US$25 million was designed in support of the Government's policy of regional integration; the railway loan (FY76) of US$100 million supported improvements of institutional aspects and financial management of the sector. The Mexico City Water Supply Project (FY73) of US$90 million has been instrumental in the establishment of a specialized institution for efficient management of water resources in the Mexico Valley, and in the pricing of water at levels more closely related to costs; a follow-up project is now being prepared.

33. The new Administration is currently preparing a comprehensive investment program covering its six years of office (1977-1982) and, pending finalization of its development program, has announced its decision to concentrate the bulk of its investment resources in fields which have a rapid impact on output and foreign exchange earnings, such as agriculture, petroleum and tourism. It also plans to carry out programs of high social priority to improve health standards, to obtain high levels of employment and to continue to decentralize economic activity. The Government also wishes to support a substantial expansion of private investment in priority industries and in tourism. In consultation with the Government, the Bank is working on several

projects that meet these criteria. The Bank's support to Mexico's development effort would give high priority to: (a) projects requiring a minimum of counterpart funds from the budget, e.g., lines of credits to private entrepreneurs in industry, agriculture and tourism; (b) projects in the designated priority areas (e.g. agriculture, energy, petrochemicals, water supply, regional dispersion of economic activities) where budget support during the stabilization period would be assured. More specifically, the following projects are under active consideration:

(i) a family planning project was prepared in accordance with the wishes of the previous Administration. The new Government, while implementing a comprehensive program with its own resources, is now considering whether to seek active association of an international institution for a substantial expansion of the program into rural areas;

(ii) a project to develop the conurbation zone of Lazaro Cardenas into a growth pole, thereby reducing migration from the Balsas basin to Mexico City has been appraised, and may be ready for submission to the Executive Directors in the coming months if the new Government's present review of the project reaches a favorable conclusion;

(iii) a tourism credit project in support of private investment in hotels and ancillary facilities is presently under appraisal;

(iv) credit projects to support agriculture and livestock development, and for export oriented and efficient import substitution industries are in preparation;

(v) a medium and small industry project is under preparation;

(vi) in response to the pressing needs of the Mexico City Metropolitan area, a water supply project has been prepared and is due to be appraised in the fall of 1977.

The Government proposes to further review with the Bank its borrowing priorities on completion of its six-year investment program when the projects listed above will be complemented with such additional ones as are consistent with the objectives stated in paragraph 28 above.

PART III - THE RURAL SECTOR

34. Mexico's rural sector is a composite of striking differences. On the one hand, it includes commercial farms under the management of efficient and sophisticated rural entrepreneurs who were decisive, until the late 1960s, in Mexico's success in satisfying the demand of a rapidly growing population

and in transforming the country from a net importer to a net exporter of agricultural products. On the other hand, it comprises a large number of smallholders in subsistence agriculture with small plots in unfavorable ecological conditions. These farmers work by traditional methods, barely participate in the market economy, live in poor social conditions and subsist on a modicum of food production from their farms.

35. More than 21 million people live in Mexico's rural areas. Agriculture is by far their most important employment and income source. About 4 million families, representing close to 40 percent of Mexico's labor force, depend on agriculture for their livelihood. They comprise three distinct groups: 1.5 million families living on ejidos, 1/ 1.2 million families living on private farms and about 1.3 million landless families. The number of landless agricultural workers is increasing rapidly, a consequence of limited farm land in relation to an annual rural population growth of 2 percent. It is estimated that 2 million rural families had incomes of less than US$150 per capita in 1974. The income spread, limited employment possibilities and the lack of infrastructure and social services have resulted in massive migration from rural to urban areas.

36. Mexico's efforts to develop its rural areas have featured two major themes in recent decades: growth in agricultural production and consolidation of land reform efforts begun following the 1910 revolution. In the period from 1940 to 1965, Mexican agricultural production more than tripled, making its growth rate among the highest in Latin America. In addition, more than half of all arable and pasture lands were distributed to previously landless families. Income inequalities, however, widened as the economy was unable to provide employment for the poorer sectors of the rural population, particularly those living in rainfed agricultural areas. Per capita rural income in Mexico is one-third of the national average, and the disparity in its distribution--17 percent of the total farm income accrues to 51 percent of farm holders, and at the other extreme 20 percent of income to only 4 percent of farmers--makes the life of the rural poor particularly hard. Since 1967, the growth rate in agricultural production slowed markedly to about 1.8 percent per year despite a continuing increase in internal demand. Mexico has now become an importer of milk powder and dairy stock and, over the last three years, a net importer of basic grains, especially corn.

37. In the early 1970s, the Government began to reassess its rural growth and development strategies. Securing wider participation of the rural population in the market economy became essential for expanding agricultural production as well as for improving the income distribution for social stability in the rural areas. The major efforts were undertaken by five groups:

(i) The Secretariat of the Presidency (recently restructured as the Secretariat of Programming and Budgeting, SPP) commissioned task forces to develop policies for achieving self-sufficiency in basic grains and for investments to assist the rural poor. These study

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1/ A form of land tenure based on usufruct.

groups were later institutionalized as major coordinating entities including PIDER.

(ii) The Secretariat of Public Works (recently restructured as Secretariat of Human Settlements and Public Works, SAHOP) initiated a nation-wide program of labor-intensive feeder road construction in 1971. Five years later some 112,000 km of roads had been constructed, giving temporary employment to some 190,000 rural persons.

(iii) The Secretariat of Hydraulic Resources (recently merged with Agriculture and renamed Secretariat of Agriculture and Hydraulic Resources, SARH) further extended its major program to develop the irrigation potential of substantial numbers of small farmers. The Water Law of 1972 established a framework for more efficient water resource management and a more equitable distribution of the benefits of irrigation to small holders. SARH also developed new criteria and administrative systems and adapted technologies for small scale irrigation works.

(iv) A new Agrarian Reform Law was passed in 1971. The Secretariat of Agrarian Reform (SRA), created in 1974, undertook a complete review of legislation affecting ejido farming, and revised the procedures for the granting of land titles.

(v) Only 15 percent of the farmers received technical assistance of any kind in the past, and few of the small holders had access to institutional credit. Recent Government efforts to correct this situation have been impressive. Specific allocations of credit resources are now reserved in favor of the low-income producers and a comprehensive technological package is being delivered to them through financial institutions and through the national rural development program. The Bank of Mexico, operating through its agricultural credit trust funds and following a study of credit systems oriented to small farmers, promulgated new regulations to encourage the banking system to intensify its operations with smaller farmers. Other agencies, such as CONASUPO (food marketing) and CFE (Federal Electricity Commission) also reworked their investment programs to increase assistance to the rural population.

38. To coordinate and focus these efforts in the most needy areas, a new investment program for rural development (PIDER) was developed. Micro-regions, 1/ with a high concentration of the rural poor were chosen and

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1/ Micro-regions comprise an average of 50,000 poor persons located in two to seven contiguous rural municipalities within a state. They are selected using criteria that balance poverty levels (per capita incomes averaging below US$100) with potential for income increasing productive activities.

specific micro-regional investment programs were prepared. A goal was set to develop 100 such regions, and a capital expenditure budget of US$1.2 billion was programmed. By 1977, investment programs were being implemented in 86 micro-regions with a population of some 4 million persons, and expenditure in the period 1973-1976 had amounted to US$471 million. These investments cover a variety of activities, principally directly productive and productive support activities, but also including social infrastructure. Over the period 1977-1982 an additional US$700 million of public investment is to be allocated to further develop the micro-region program. Some 5 million rural persons, i.e., about 25 percent of the rural population, are expected to benefit when the program is complete.

PIDER I

39. The Bank made a loan of US$110 million in May 1975 (1110-ME) to assist the integrated rural development program in 30 micro-regions; in late 1975 the Inter-American Development Bank also made a loan of US$40 million to assist 15 micro-regions. The proposed PIDER II project will provide Bank assistance to 20 additional micro-regions, and with the proposed loan the two agencies together will support the program in 65 micro-regions out of the total of 86 operational in the beginning of 1977.

40. To date about US$34 million of the Bank loan has been disbursed and physical progress of the program in the 30 micro-regions is summarized in the table below:

	(1) Unit	(2) Projected Development in 3 Years	(3) Actual Development in First 2 Years	(4) Column 3 as % of Column 2
Directly Productive				
Irrigation	Ha	30,000	14,349	47.8
Soil and Water Conservation	Ha	91,000	28,887	31.7
Fruit Production	Ha	9,500	2,778	29.2
Productive Support				
Feeder Roads	Km	1,900	1,773	93.3
Demonstration and Extension	No. of Staff	400	709	177.3
Marketing	Market/Stores	65	52	80.0
Electrification	Persons served	160,000	138,709	86.7
Social Infrastructure				
Health Center and Posts	No.	290	71	24.5
Primary Education	Classroom	1,150	960	83.5
Drinking Water	Persons Served	170,000	131,313	77.2

Productive support and infrastructure investments are nearing completion and provide the necessary base for completion of directly productive investments in accordance with the overall program schedule. Though the overall attainment of targets has been satisfactory, the performance has varied considerably across micro-regions, states and executing agencies. These variations have resulted from factors such as: (i) the quality and quantity of staff; (ii) the priority given to PIDER by the state and local government; and (iii) government-community relations. In the current phase of project implementation, successful experiences are being extended to the less progressive micro-regions.

41. PIDER has been instrumental in bringing about far-reaching and much needed institutional change. The implementation capacity of the many agencies involved under PIDER has been increased and activities directed towards improvement in the productivity and living conditions of the rural poor. The program is now well known and is viewed as highly successful both at local and federal governmental levels. As a result of initial PIDER experiences, agencies have undergone internal reorganization. For example, the reorganization of the national extension service was initiated in response to PIDER efforts. PIDER has been a vehicle for facilitating the testing and introduction of a variety of new technical packages developed for small farmer applications including: (i) a new extension methodology specifically directed toward rainfed agriculture (now institutionalized as the National Program for Extension in Rainfed Areas, PRONDAAT) is currently being applied in 15 micro-regions; (ii) improved farm storage, irrigation, pasture development and soil management techniques in drier areas; and (iii) wider introduction of small stock on project farms. While only two years of an estimated eight-year period to full development have elapsed, in areas where PRONDAAT is in operation, production and income increases are apparent and generally above estimates made when the program was launched. In areas still served by the traditional extension systems, progress is slower -- in many cases the PIDER-supported services represent the first contacts small farmers have had with extension agents. However, generally PIDER has been instrumental in improving the income of small farmers because of three related factors: (i) investment in irrigation works has brought about immediate production increases, (ii) where technological packages and credit have been effectively delivered production has increased, and (iii) investment in feeder roads has facilitated access to markets.

42. After the initial problems of coordinating the accounts for such a complex operation were resolved and satisfactory procedures established the pace of disbursements began to accelerate. About 30 percent of the loan funds were disbursed during the last year and papers for several further substantial expenditure items are being processed for submission to the Bank. As the table in paragraph 40 shows, the physical progress under PIDER I project is ahead of the loan disbursement. Part of the explanation for slow disbursement lies in the inherent time lag between incurring of the expenditure and submission of accounts for disbursement to the Bank. Moreover, the effect of devaluation has also been to reduce the dollar equivalent of peso expenditures.

PART IV - THE PROJECT

Background

43. A report, entitled "Rural Development Project--PIDER II" No. 1480a-ME, dated May 31, 1977 is being circulated separately to the Executive Directors. Negotiations took place in Washington, D.C. from May 19 to May 23, 1977. The Mexican negotiating team was led by Mr. Pedro Galicia, Manager, International Operations, Nacional Financiera, S.A.

Project Description

44. The project consists of directly productive, productive support and social infrastructure components designed to raise the income and improve the standard of living of poor rural families in 20 selected micro-regions spread throughout Mexico (please see the map attached). When the PIDER I loan was approved, the project description was based on Bank appraisal of 15 micro-regions, with agreed selection criteria for the remaining 15 micro-regions; the Government subsequently submitted satisfactory investment plans for the latter group of micro-regions which formed the basis for Bank support. By the time PIDER II project was appraised, investment programs were ready for about 41 additional micro-regions from which 20 were selected on the basis of criteria such as size, poverty level, productive potential and need for infrastructure. Investments in rural industrial development, a new activity under PIDER, would be extended to the 30 micro-regions covered under the Bank-assisted PIDER I project.

45. About 70 percent of the project funds would be channeled into productive investments in livestock, irrigation, rural industries, fruit production, soil and water conservation, and associated farm development credit; 20 percent to productive support investment for the development of feeder roads, markets, extension services, electrification, and farmer organization efforts; 9 percent to investment in social infrastructure, such as construction of primary education and drinking water facilities, and materials for self-help projects on a local initiative basis; and 1% to project evaluation, applied research, and training. The combination of investments contemplated for each micro-region has been detailed in individual micro-regional plans. Assurances have been obtained that: (i) investment plans shall be agreed upon by the Guarantor and the Bank, (ii) not less than 70 percent of the total cost of each such investment plan shall be for productive investments, and (iii) the estimated return thereon shall not be less than 10 percent (draft Guarantee Agreement, Section 3.03). Average investment program for a micro-region under PIDER I was US$9.8 million, as compared to US$12.5 million under the proposed project; the higher nominal unit costs under PIDER II are because of the mix of the investment activities and inflation in the intervening period.

Rural Industries

46. The project would provide about US$14.0 million in support of the development of rural industries. Because this represents a new component, not

included under PIDER I, the funds would be available for projects both in the 20 micro-regions financed under the proposed project and in the 30 micro-regions supported under PIDER I. The basic strategy would be: (i) to develop industries for exploitation of natural resources of the micro-region in order to strengthen small-farm and ejido production; and (ii) to finance small-scale village industry to serve local markets and to provide employment at low cost by utilizing intermediate technologies. The strategy would support the new Government's policy for the development of rural industries. The project would finance:

(a) Development credit for about 50 rural industries located within the micro-regions and owned by ejidatarios and small farmers. About US$4.3 million of the loan would be utilized as credit for rural industries.

(b) Investments in about 300 small scale, labor intensive rural industries (village industries). Such investments would be limited to US$35,000 equivalent per enterprise. The Government is preparing a plan, to be submitted to the Bank before June 30, 1978, for village industries specifying agencies and criteria for eligibility (draft Guarantee Agreement, Section 3.09).

(c) Technical assistance to identify, prepare and assist rural industries as well as to train staff of participating agencies. Technical assistance would comprise:

(i) expansion of technical staff and;

(ii) financing for preparation of rural industry projects in the micro-regions and for assistance to already established enterprises.

Rural Credit

47. Expansion of credit availability to small farmers is an important component of the PIDER project. About US$24 million, or 19 percent of the proposed loan, would be utilized as medium- and long-term credit for on-farm development; in addition about US$24 million of incremental development credit would be provided by Mexican financial institutions. Seasonal production credit would be provided by Mexican institutions but not reimbursed from the proposed loan. Development loans would be made on terms identical with those under other Bank-financed credit programs for low income producers, and any changes in terms under such programs would be automatically applied to new lending under the PIDER II project (Schedule to the draft Project Agreement, Paragraph 2). The Government has recently decided to raise the interest rates for agricultural credit by 2 percentage points from 7.6 percent to 9.5 percent and from 9.0 percent to 11.0 percent. The same institutional arrangements would be used under this project as under other Bank-financed agricultural credit programs in Mexico. A group of trust funds (FIRA) under the control of the Bank of Mexico would rediscount loans to project beneficiaries made by private and public lending institutions.

48. PIDER is designed to provide low income producers in isolated micro-regions with both social and productive infrastructure, as well as increased amounts of technical assistance and production credit. FIRA and PIDER staff have jointly assessed the credit needs of the micro-regions and are currently resolving the organizational problems inherent in operating a sound credit system covering subsistence farmers over such a dispersed area.

Unit Costs

49. To prevent investment in works with excessive unit costs or works benefiting only a few families, the following limits would apply:

- For irrigation, a ceiling of US$32,000 would be continued for small-scale irrigation projects of 25 ha or less each, with a maximum investment of US$5,000 per family of beneficiaries; a per hectare ceiling of US$2,500 equivalent would be imposed; to be eligible, a family's pre-project net agricultural annual income should not exceed US$2,500 (draft Guarantee Agreement, Section 3.05 (a));

- Installation cost of rural electrification would not exceed US$150 per person (draft Guarantee Agreement, Section 3.14 (a));

- The Government's contribution for rural water systems would not exceed US$100 per person (draft Guarantee Agreement, Section 3.15 (a)); and

- A maximum of US$40 of material and equipment per beneficiary of self-help projects would be provided (draft Guarantee Agreement, Section 3.16 (b)).

Organization and Management

50. The Secretariat of Programming and Budgeting (SPP) would have principal responsibility for execution of the project. Under its direction, the following Government Departments and Agencies would participate: the Secretariats of Agriculture and Water Resources, Finance, Public Works and Human Settlements, Health and Assistance, and Agrarian Reform, Federal Electricity Commission, National Company for Popular Subsistance (CONASUPO), Committee for Administration of the Federal School Construction Program, National Arid Zones Commission, National Indigenous Institute, National Institute for Rural Community Development and Low Cost Housing, the National Rural Credit Bank and the Agricultural Trust Funds (FIRA).

51. The need to coordinate closely the activities of so many independent organizations has led to the formation of a three tier structure described below. The basic philosophy behind this structure is to place appropriate responsibilities at the federal, state and local levels, while encouraging and supporting organization of PIDER beneficiaries and their participation in program formulation and project execution.

52. At the federal level, PIDER policy is developed and coordinated through the Directorate of Promotion and Regional Operations of the SPP. This Directorate is supported by a Sub-Directorate of Rural Development (i.e., PIDER) with a staff of some 95 technicians responsible for reviewing investment plans, management operations and monitoring investment.

53. At the state level, coordination of the programs is handled by a Coordinating Committee consisting of the state level directors of the participating agencies under the chairmanship of the state governor. Actual management is the responsibility of the new state level SPP representative who is the technical secretary of the State Committee. The SPP representative is assisted by a technical secretariat of professionals including a state level PIDER coordinator and resident coordinators for each of the states' micro-regions who work closely with local elected officials and community leaders.

54. At the local level, the peoples' participation, essential to the implementation of PIDER investments, is achieved through a variety of schemes which depend on the political, social and administrative characteristics of the sector and micro-region. In some cases such programs as feeder roads or small irrigation works have served to launch permanent village committees which then undertake additional PIDER activities. As a rule, SRA field personnel take the lead in organizing communities at the start, involving municipal chiefs, ejido presidents, teachers, or other appropriate persons. These local leaders in turn generate community participation as well as provide an information link to the state-level technical secretariat.

55. Experience to date indicates that the three tier system works satisfactorily and without undue inter-agency friction. The system enables effective two-way communications: the micro-region staff provides to the federal and state-level authorities a more realistic assessment of ejido and village development preferences. While the authority for approval of the overall investment programs remains at the federal level, the responsibility for plan preparation and coordination of the different agencies is taken over increasingly at the state level. Local participation is essential for success of the rural development program and is encouraged by making beneficiaries increasingly aware of the impact of the projects on the community and their role in implementing and operating those facilities. The individual project works are executed by the appropriate public agency, as determined by the central coordinating committee and concurred in by the state committee. Operation and maintenance, other than for larger works, are increasingly being transferred to the benefiting communities.

Evaluation

56. The national program has an inbuilt evaluation arrangement to ensure the effectiveness of PIDER. Evaluation is carried out by the Rural Development Research Center (CIDER) which has institutional autonomy from PIDER. CIDER is responsible for evaluating the impact of the rural development program in Mexico; its principal focus is on PIDER, though it has undertaken studies of other related programs also. In addition, CIDER is involved in devising an improved rural investment programming methodology and assisting PIDER in

its implementation, in undertaking various research efforts, and in the training of PIDER field staff. CIDER's role is to estimate the real benefit to rural communities from rural development efforts, and in addition to measuring yield and income changes, CIDER gives attention to analyzing administrative and structural changes that are required for the program to result in self-sustaining growth. Thus, in addition to economic analysis, CIDER evaluates (i) the effectiveness of institution building under the PIDER investment and service strategy; and (ii) the degree and quality of local participation in programming and execution of the investment program.

Improvements

57. While the system as described has worked reasonably satisfactorily, the areas described below are being improved:

(i) Interagency coordination between PIDER and FIRA has been improved and formalized through the implementation of an operational agreement between SPP and the Bank of Mexico. Similar agreements have been signed by PIDER with SRA and SARH;

(ii) Construction of works would continue to make the maximum possible use of labor-intensive technologies; feeder road construction would be scheduled to provide the minimum interference with agricultural activities (draft Guarantee Agreement, Sections 3.11, 3.12);

(iii) Planning would be strengthened by requiring (a) feasibility studies for productive investments (draft Guarantee Agreement, Section 3.10), (b) technical and economic plans for soil and water conservation works (draft Guarantee Agreement, Section 3.07), and (c) for irrigation works, the continuation of SARH's practice of conducting feasibility studies (draft Guarantee Agreement, Section 3.05);

(iv) Farmer response to technical assistance has varied across regions, but a clear pattern is evident supporting the effectiveness of the PRONDAAT program. PRONDAAT will be extended to the PIDER II micro-regions by December 31, 1980 (draft Guarantee Agreement, Section 3.13); and

(v) Written agreements with beneficiaries to operate and maintain works would be required prior to commencement of construction (draft Guarantee Agreement, Section 3.06).

Financing, Beneficiary Contribution and Cost Recovery

58. A breakdown of costs is presented in the Loan and Project Summary. Total project costs are estimated at US$255 million equivalent. The proposed loan would finance 47 percent of project costs and would cover the foreign exchange costs of US$46 million and US$74 million of local expenditures. The balance (US$128 million) would be provided by the Government and by the

beneficiaries (US$7 million in cash). Beneficiaries would contribute an additional US$40 million worth of material and labor; the value of these non-cash contributions is not included in the US$255 million cost of the project.

59. As explained earlier, Mexico is passing through a difficult stabilization program. The Government is engaged in reviewing the fiscal situation with a view to reduce the deficit of the public sector. Along with measures that enable the economy to return to an equilibrium growth path, Mexico faces a major problem of finding gainful employment for the new additions to the rural work force, to stem migration away from the villages and to provide a minimum acceptable nutrition level to the poorest of its people. The national rural development program that the Government is now consolidating is modest with respect to the scope of the problem that exists in Mexican villages even though the demand on its limited fiscal resources is significant in the aggregate.

60. The Government's policy is to recover as much as feasible of investments from beneficiaries taking into account the extent to which private benefits are identifiable and beneficiaries have the capacity to repay. Thus, while the Government would aim at substantial recovery of directly productive investments, repayment rates would depend on the income levels of beneficiaries and would be agreed upon in writing with the beneficiaries prior to construction (draft Guarantee Agreement, Section 3.06). Although the benefits of this project would go to the rural poor, who will need part of the project-related incremental income to meet subsistence needs, it is estimated that 61% of investments in directly productive activities would be recovered. Further, 6% of productive support services and 11% of the cost of social infrastructure would be recovered. The cost of maintaining and operating directly productive facilities would be borne fully by beneficiaries. They would also be charged the full operating costs for marketing, electricity, drinking water and selfhelp projects, and would contribute to education (draft Guarantee Agreement, Sections 3.14 and 3.15). At full development, the additional fiscal burden for Government would be US$8 million per annum, a small part of which (10 percent) would be offset through additional tax revenues as a result of incremental production and income from the project.

Procurement

61. This project includes a diversity of relatively small construction jobs spread over a wide area and at several sites with difficult access. Additionally, many project works are designed to use local materials and will be constructed during agriculturally slack periods with labor intensive methods to maximize benefits to the local population. In these circumstances the procurement procedures summarized below would be applied for civil works, machinery, equipment, material and other supplies:

(i) Contracts would be grouped, where feasible, into packages to encourage competition in bidding;

(ii) All contracts and purchases exceeding US$250,000 equivalent would be awarded under international competitive bidding in accordance with Bank Guidelines. A preference for domestic suppliers of up to 15 percent would be permitted in the evaluation of bids for equipment items; and

(iii) All contracts of less than US$250,000 equivalent would be let under local competitive bidding, negotiated contracts or force account, in accordance with Government's regular procedures which are acceptable to the Bank. For such contracts, appropriate unit prices would be pre-established.

It is anticipated that because of the decentralized nature of the proposed project, few contracts would be let under international competitive bidding and that because of the competitiveness of local suppliers, few international firms would be attracted to bid.

Disbursement

62. The Bank would reimburse at the rate of 51 percent of total expenditures for civil works, equipment, vehicles and technical services of agencies participating in the program, against appropriate documentation, and 56 percent of the rediscounts of the development credit component administered by FIRA, against certificates of expenditure. As agreed for PIDER I, documentation for the credit component and for civil works by force account would be retained within Mexico and held available for inspection by the Bank during the course of supervision missions. The statements of expenditure, certified by the Secretariat of Finance, would reflect the expenditures made by each agency in each approved micro-region. The loan is expected to be disbursed in four years, 1978 through 1981.

Project Risks

63. The project has risks. First, while two-thirds of the micro-regions would be in the higher rainfed areas (over 700 mm annually), the remaining third would be located in areas with less rain where the introduction of irrigation, crop and pasture improvement and water conservation works would be emphasized to reduce farmer risks. Improved field demonstration closely tied with intensified extension efforts would be emphasized under the Project. Assurances have been obtained that the improved extension services (PRONDAAT) would be applied in PIDER II micro-regions (draft Guarantee Agreement, Section 3.13). The operational soundness of this approach has been demonstrated under PIDER I. Secondly, while on average the estimated rates of return at micro-region level embody expectations about final outcomes that are reasonable and realistic, the caliber of local leadership and of staff will bear importantly on these outcomes. It would be unrealistic to suppose that staff and leadership quality will be uniform. So, in some regions, expectations may not be fulfilled while in others better than anticipated results may be achieved. However, the PIDER coordinating mechanism has demonstrated a capacity to respond quickly and flexibly to problems of execution, and the CIDER will continue to undertake major evaluation efforts as a basis for ongoing adaptation of the program in the light of changing needs and circumstances. Moreover, the Project would emphasize responsiveness to local needs, self-help

activities, creation of users' associations, and the development of local leadership in order to improve the probability that the Project investments and services would eventually lead to a self-sustaining development momentum at the local level. Thirdly, previous efforts to promote rural industries in Mexico have met with mixed success. The PIDER rural industry project will provide extensive technical assistance in organization and management of industries as opposed to merely providing buildings and equipment.

Project Impact

64. The project would benefit areas with a total rural population of about 1 million. Beneficiaries targeted for project support have family incomes ranging from US$250 to US$750, placing them in the lower 40% of the national income distribution. Under the proposed project, about 46,000 farm families would benefit from directly productive activities. Some 32,000 farm families (190,000 people) would be expected to achieve a near doubling of income over a period of eight years. The incomes of an additional 14,000 farm families benefiting from the 34,000 ha to be irrigated would be expected to triple from present levels at full development. Some 200,000 people would have access to improved rural infrastructure; about 65,000 man-years of temporary employment and 30,000 permanent jobs would be created. Rural industries supported under the project would provide the equivalent of full-time employment to approximately 4,000 persons. The industry component is an important model for further rural investments to increase job opportunities for the large number of rural unemployed and underemployed.

Economic Evaluation

65. The estimated average economic rate of return for the project as a whole is 23.7 percent; this would vary for micro-regions, ranging from 13.2 to 36.5 percent. In computing the rates of return, only the costs and benefits of directly productive and productive support components have been considered. The costs of social investment (10 percent of total project cost) have not been charged against the project, nor have the benefits from improved health and education, social awareness, and community development been credited to it. In calculating the economic cost of labor, shadow prices varying by micro-region from 100% of the minimum government daily wage to 52% were used. The differences reflect mainly the relative uniformity of officially determined wage minima vis-a-vis variations in the minimum supply price of labor, the latter being influenced by severity of rural underemployment.

PART V - LEGAL INSTRUMENTS AND AUTHORITY

67. The draft Loan Agreement between the Bank and Nacional Financiera, S. A., the draft Guarantee Agreement between the United Mexican States and the Bank, the draft Project Agreement between the Bank and the Banco de Mexico, S. A., the report of the committee provided for in Article III, Section 4 (iii) of the Articles of Agreement, and the text of a Resolution approving the proposed loan are being distributed to the Executive Directors separately.

68. The special conditions of the project are listed in Section II of Annex III.

69. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VI - RECOMMENDATIONS

70. I recommend that the Executive Directors approve the proposed loan.

Robert S. McNamara
President

By J. Burke Knapp

Attachments

May 31, 1977

TABLE 3A
- SOCIAL INDICATORS DATA SHEET

MEXICO	MEXICO 1960	MEXICO 1970	MEXICO MOST RECENT ESTIMATE	REFERENCE COUNTRIES (1970) BRAZIL	CHILE	SPAIN**
LAND AREA (THOU KM2)						
TOTAL 1972.5						
AGRIC. 948.9						
GNP PER CAPITA (US$)	420.0	780.0	1190.0*	540.0	640.0	1560.0
POPULATION AND VITAL STATISTICS						
POPULATION (MID-YR, MILLION)	36.0	50.4	60.1	92.8	9.7	33.6
POPULATION DENSITY						
PER SQUARE KM.	18.0	26.0	30.0	11.0	13.0	67.0
PER SQ. KM. AGRICULTURAL LAND	35.0	52.0	63.0	49.0	60.0	105.0
VITAL STATISTICS						
AVERAGE BIRTH RATE (/THOU)	46.1	43.8	42.0	38.4	32.9	21.0
AVERAGE DEATH RATE (/THOU)	14.0	10.2	8.6	9.9	11.0	8.8
INFANT MORTALITY RATE (/THOU)	74.0	68.5	52.0	110.0	79.0	27.9
LIFE EXPECTANCY AT BIRTH (YRS)	56.3	62.4	64.7	59.7	60.6	70.5
GROSS REPRODUCTION RATE	3.2	3.1	3.0	2.6	2.2	1.4
POPULATION GROWTH RATE (%)						
TOTAL	3.1	3.4	3.3 /a	2.9	2.4	1.1
URBAN	4.9	4.8	5.1 /b	5.0	3.5	2.0
URBAN POPULATION (% OF TOTAL)	50.7	58.7	63.3	56.0	76.0	59.1
AGE STRUCTURE (PERCENT)						
0 TO 14 YEARS	44.2	46.2	46.3	42.0	39.0	27.8
15 TO 64 YEARS	52.1	50.1	50.3	55.0	56.3	62.5
65 YEARS AND OVER	3.7	3.7	3.4	3.0	4.7	9.7
AGE DEPENDENCY RATIO	0.9	1.0	1.0	0.8	0.8	0.6
ECONOMIC DEPENDENCY RATIO	1.7	2.0	1.8 /c	1.5	1.6	1.1
FAMILY PLANNING						
ACCEPTORS (CUMULATIVE, THOU)	..	55.5	321.1	250.0	403.5	..
USERS (% OF MARRIED WOMEN)	..	..	13.1	1.6	..	..
EMPLOYMENT						
TOTAL LABOR FORCE (THOUSAND)	11300.0	13000.0	16600.0	29600.0	2900.0	11900.0
LABOR FORCE IN AGRICULTURE (%)	54.0	45.0	41.0	44.0	21.0	25.0
UNEMPLOYED (% OF LABOR FORCE)	..	..	..	..	4.1 /a	1.1 /a
INCOME DISTRIBUTION						
% OF PRIVATE INCOME REC'D BY-						
HIGHEST 5% OF HOUSEHOLDS	28.6 /a	27.2	30.7	35.0 /a	31.0	..
HIGHEST 20% OF HOUSEHOLDS	58.1 /a	58.1	60.2	62.0 /a	55.8	..
LOWEST 20% OF HOUSEHOLDS	3.7 /a	3.4	2.1	3.0 /a	4.8	..
LOWEST 40% OF HOUSEHOLDS	10.5 /a	10.7	8.2	10.0 /a	13.0	..
DISTRIBUTION OF LAND OWNERSHIP						
% OWNED BY TOP 10% OF OWNERS	..	37.1	..	45.0	..	..
% OWNED BY SMALLEST 10% OWNERS	..	0.3	..	1.5	..	..
HEALTH AND NUTRITION						
POPULATION PER PHYSICIAN	1800.0	1480.0	..	1910.0	2210.0 /b	740.0 /b
POPULATION PER NURSING PERSON	2830.0 /b	1620.0 /c	..	3220.0 /b	5830.0 /b	..
POPULATION PER HOSPITAL BED	590.0 /c	960.0	830.0 /d	260.0	270.0	220.0
PER CAPITA SUPPLY OF -						
CALORIES (% OF REQUIREMENTS)	107.0	110.0	115.0	109.0	101.0	107.0
PROTEIN (GRAMS PER DAY)	65.0	65.0	61.0	64.0	71.0	81.0
-OF WHICH ANIMAL AND PULSE	29.0 /d	28.0 /a	..	39.0	32.0	40.0
DEATH RATE (/THOU) AGES 1-4	12.7	9.8	8.4 /e	..	3.9	0.9
EDUCATION						
ADJUSTED ENROLLMENT RATIO						
PRIMARY SCHOOL	81.0	106.0	107.0 /d	87.0	103.0	131.0
SECONDARY SCHOOL	11.0	23.0	24.0 /d	28.0	36.0	57.0
YEARS OF SCHOOLING PROVIDED (FIRST AND SECOND LEVEL)	12.0	12.0	12.0	13.0	12.0	11.0
VOCATIONAL ENROLLMENT (% OF SECONDARY)	24.0	24.0	..	17.0	33.0	20.0
ADULT LITERACY RATE (%)	62.0 /a	76.0	76.0	68.0	90.0	94.0
HOUSING						
PERSONS PER ROOM (AVERAGE)	2.6	2.2	..	1.0	1.3	..
OCCUPIED DWELLINGS WITHOUT PIPED WATER (%)	76.0 /f	61.0 /b	..	73.0 /c	40.0/c	..
ACCESS TO ELECTRICITY (% OF ALL DWELLINGS)	..	59.0	..	48.0	..	..
RURAL DWELLINGS CONNECTED TO ELECTRICITY (%)	..	28.0	..	8.0	..	..
CONSUMPTION						
RADIO RECEIVERS (PER THOU POP)	95.0	276.0	311.0	60.0	143.0	214.0
PASSENGER CARS (PER THOU POP)	14.0	24.0	31.0	25.0	18.0	71.0
ELECTRICITY (KWH/YR PER CAP)	313.0	567.0	707.0	491.0	806.0	1634.0
NEWSPRINT (KG/YR PER CAP)	2.8	3.2	2.5	2.7	5.0	5.8

SEE NOTES AND DEFINITIONS ON REVERSE

NOTES

Unless otherwise noted, data for 1960 refer to any year between 1959 and 1961, for 1970 between 1968 and 1970, and for Most Recent Estimate between 1973 and 1975.

* GNP per capita estimate do not reflect the significant devaluation of peso in August 1976.

** Spain has been selected as an objective country because its per capita income is higher than Mexico's, and because both countries have in common the importance of tourism and the influence of nearby richer countries.

MEXICO 1960 /a 1963; /b Includes midwifery and nursing auxiliaries; /c 1962; /d 1961-62; /e Six years and over; /f Inside only.

1970 /a 1964-66; /b Inside only; /c Including assistant nurses.

MOST RECENT ESTIMATE: /a 1973-75 official estimate; /b 1970-75; /c Ratio of population under 15 and 65 and over to total labor force; /d 1971; /e 1972.

BRAZIL 1970 /a Economically active population; /b Hospital personnel; /c Inside only.

CHILE 1970 /a Gran Santiago; /b Personnel in government services only; /c Inside only.

SPAIN 1970 /a Employment office estimate; /b Registered, not all practicing in the country.

RB, May 26, 1977

DEFINITIONS OF SOCIAL INDICATORS

Land Area (thou km^2)
Total - Total surface area comprising land area and inland waters.
Agric. - Most recent estimate of agricultural area used temporarily or permanently for crops, pastures, market & kitchen gardens or to lie fallow.

GNP per capita (US$) - GNP per capita estimates at current market prices, calculated by same conversion method as World Bank Atlas (1973-75 basis); 1960; 1970 and 1975 data.

Population and vital statistic:
Population (mid-year million) - As of July first: if not available, average of two end-year estimates; 1960, 1970 and 1975 data.

Population density - per square km - Mid-year population per square kilometer (100 hectares) of total area.
Population density - per square km of agric. land - Computed as above for agricultural land only.

Vital statistics
Crude birth rate per thousand, average - Annual live births per thousand of mid-year population; ten-year arithmetic averages ending in 1960 and 1970, and five-year average ending in 1975 for most recent estimate.
Crude death rate per thousand, average - Annual deaths per thousand of mid-year population; ten-year arithmetic averages ending in 1960 and 1970 and five-year average ending in 1975 for most recent estimate.
Infant mortality rate (/thou) - Annual deaths of infants under one year of age per thousand live births.
Life expectancy at birth (yrs) - Average number of years of life remaining at birth; usually five-year averages ending in 1960, 1970 and 1975 for developing countries.
Gross reproduction rate - Average number of live daughters a woman will bear in her normal reproductive period if she experiences present age-specific fertility rates; usually five-year averages ending in 1960, 1970 and 1975 for developing countries.
Population growth rate (%) - total - Compound annual growth rates of mid-year population for 1950-60, 1960-70 and 1970-75.
Population growth rate (%) - urban - Computed like growth rate of total population; different definitions of urban areas may affect comparability of data among countries.
Urban population (% of total) - Ratio of urban to total population; different definitions of urban areas may affect comparability of data among countries.

Age structure (percent) - Children (0-14 years), working-age (15-64 years), and retired (65 years and over) as percentages of mid-year population.
Age dependency ratio - Ratio of population under 15 and 65 and over to those of ages 15 through 64.
Economic dependency ratio - Ratio of population under 15 and 65 and over to the labor force in age group of 15-64 years.
Family planning - acceptors (cumulative, thou) - Cumulative number of acceptors of birth-control devices under auspices of national family planning program since inception.
Family planning - users (% of married women) - Percentages of married women of child-bearing age (15-44 years) who use birth-control devices to all married women in same age group.

Employment
Total labor force (thousand) - Economically active persons, including armed forces and unemployed but excluding housewives, students, etc.; definitions in various countries are not comparable.
Labor force in agriculture (%) - Agricultural labor force (in farming, forestry, hunting and fishing) as percentage of total labor force.
Unemployed (% of labor force) - Unemployed are usually defined as persons who are able and willing to take a job, out of a job on a given day, remained out of a job, and seeking work for a specified minimum period not exceeding one week; may not be comparable between countries due to different definitions of unemployed and source of data, e.g., employment office statistics, sample surveys, compulsory unemployment insurance.

Income distribution - Percentage of private income (both in cash and kind) received by richest 5%, richest 20%, poorest 20%, and poorest 40% of households.

Distribution of land ownership - Percentages of land owned by wealthiest 10% and poorest 10% of land owners.

Health and Nutrition
Population per physician - Population divided by number of practicing physicians qualified from a medical school at university level.
Population per nursing person - Population divided by number of practicing male and female graduate nurses, "trained" or "certified" nurses, and auxiliary personnel with training or experience.
Population per hospital bed - Population divided by number of hospital beds available in public and private general and specialized hospital and rehabilitation centers; excludes nursing homes and establishments for custodial and preventive care.
Per capita supply of calories (% of requirements) - Computed from energy equivalent of net food supplies available in country per capita per day; available supplies comprise domestic production, imports less exports, and changes in stock; net supplies exclude animal feed, seeds, quantities used in food processing and losses in distribution; requirements were estimated by FAO based on physiological needs for normal activity and health considering environmental temperature, body weights, age and sex distributions of population, and allowing 10% for waste at household level.
Per capita supply of protein (grams per day) - Protein content of per capita net supply of food per day; net supply of food is defined as above; requirements for all countries established by USDA Economic Research Services provide for a minimum allowance of 60 grams of total protein per day, and 20 grams of animal and pulse protein, of which 10 grams should be animal protein; these standards are lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Survey.
Per capita protein supply from animal and pulse - Protein supply of food derived from animals and pulses in grams per day.
Death rate (/thou) ages 1-4 - Annual deaths per thousand in age group 1-4 years, to children in this age group; suggested as an indicator of malnutrition.

Education
Adjusted enrollment ratio - primary school - Enrollment of all ages as percentage of primary school-age population; includes children aged 6-11 years but adjusted for different lengths of primary education; for countries with universal education, enrollment may exceed 100% since some pupils are below or above the official school age.
Adjusted enrollment ratio - secondary school - Computed as above; secondary education requires at least four years of approved primary instruction; provides general, vocational or teacher training instructions for pupils of 12 to 17 years of age; correspondence courses are generally excluded.
Years of schooling provided (first and second levels) - Total years of schooling; at secondary level, vocational instruction may be partially or completely excluded.
Vocational enrollment (% of secondary) - Vocational institutions include technical, industrial or other programs which operate independently or as departments of secondary institutions.
Adult literacy rate (%) - Literate adults (able to read and write) as percentage of total adult population aged 15 years and over.

Housing
Persons per room (urban) - Average number of persons per room in occupied conventional dwellings in urban areas; dwellings exclude non-permanent structures and unoccupied parts.
Occupied dwellings without piped water (%) - Occupied conventional dwellings in urban and rural areas without inside or outside piped water facilities as percentage of all occupied dwellings.
Access to electricity (% of all dwellings) - Conventional dwellings with electricity in living quarters as percent of total dwellings in urban and rural areas.
Rural dwellings connected to electricity (%) - Computed as above for rural dwellings only.

Consumption
Radio receivers (per thou pop) - All types of receivers for radio broadcasts to general public per thousand of population; excludes unlicensed receivers in countries and in years when registration of radio sets was in effect; data for recent years may not be comparable since most countries abolished licensing.
Passenger cars (per thou pop) - Passenger cars comprise motor cars seating less than eight persons; excludes ambulances, hearses and military vehicles.
Electricity (kwh/yr per cap) - Annual consumption of industrial, commercial, public and private electricity in kilowatt hours per capita, generally based on production data, without allowance for losses in grids but allowing for imports and exports of electricity.
Newsprint (kg/yr per cap) - Per capita annual consumption in kilograms estimated from domestic production plus net imports of newsprint.

MEXICO: ECONOMIC DEVELOPMENT DATA SHEET

	Actual			Preliminary Estimates		Projected		Growth Rates					As % of GDY		
	1960	1965	1970	1975	1976	1980	1985	1961-1965	1966-1970	1971-1975	1976-1980	1981-1985	1960	1970	1980
National Accounts				Constant 1972 Prices, US$ Millions											
Gross Domestic Product	18,785.2	26,499.5	37,024.7	48,690.2	49,693.2	60,411.0	91,693.8	7.1	6.9	5.6	4.4	8.7	99.9	100.0	99.9
Gains from Terms of Trade	31.3	-72.2	-6.0	-40.2	-114.6	83.8	1,251.0	-	-39.2	46.3	15.8	71.7	0.2	--	0.1
Gross Domestic Income	18,805.8	26,427.3	37,018.7	48,650.1	49,578.6	60,494.7	92,944.7	7.0	7.0	0.4	4.4	9.0	100.0	100.0	100.0
Imports (including N.F.S.)	2,274.9	2,532.7	3,713.2	4,998.3	4,534.6	5,152.7	8,701.6	2.2	8.0	6.1	0.6 1/	11.1	12.1	10.0	8.5
Export (import capacity)	2,005.2	2,382.5	2,983.4	3,596.4	3,725.4	5,941.0	10,562.5	3.5	4.6	3.8	10.6	12.2	10.7	8.1	9.8
Resource Gap	269.8	150.2	728.9	1,401.8	809.2	-788.2	-1,860.9	-11.05	37.2	14.0	--	18.8	1.4	0.2	-1.3
Consumption	15,215.7	21,278.4	30,305.9	39,534.8	40,548.6	45,872.3	69,627.5	6.9	7.3	5.5	3.0	8.7	80.9	81.9	75.8
Investment	3,870.5	5,298.7	7,441.9	10,517.1	9,839.3	13,834.1	21,456.3	6.5	7.0	7.2	5.6	9.2	20.6	20.1	22.9
Gross Domestic Savings	3,600.8	5,148.7	6,712.8	9,115.2	9,030.1	14,622.3	23,317.2	7.4	5.5	6.3	9.9	9.8	19.1	18.1	24.2
Gross National Savings	3,513.0	4,937.9	6,182.9	8,166.6	7,922.7	13,439.3	22,964.0	7.1	4.6	5.7	10.5	11.3	18.7	16.7	22.2
Trade in Goods and N.F.S.				Current Prices, US$ Millions									As % of Total		
Imports															
Food	17.6	25.4	33.7	442.9	148.1	221.9	311.2	7.6	5.8	67.4	-12.9	7.0	1.1	1.0	1.8
Petroleum and Products	34.0	23.9	44.1	291.4	291.8	37.7	53.0	-6.8	13.1	45.9	-33.6	7.1	2.2	1.3	0.3
Other Goods	917.6	1,236.0	2,274.4	5,879.5	5,631.9	8,718.3	20,843.1	6.1	13.0	20.9	8.2	19.0	59.5	66.5	71.1
Non-Factor Services	572.3	792.3	1,067.7	2,022.9	2,206.2	3,283.2	7,754.0	6.7	6.2	13.6	10.2	18.8	37.2	31.2	26.8
Total Imports	1,541.5	2,077.6	3,416.9	8,636.7	8,278.0	12,261.1	28,961.3	6.2	10.5	20.4	7.3	18.8	100.0	100.0	100.0
Exports															
Selected Agricultural Goods 2/	20.6	441.3	421.8	594.3	721.5	635.2	971.8	84.6	-0.9	7.1	4.0	8.9	1.5	23.1	4.5
Petroleum and Products 3/	304.5	40.1	38.4	460.1	556.7	2,711.5	10,847.1	-33.3	-0.9	64.3	42.6	32.0	22.1	2.1	19.2
Selected Minerals	92.5	77.9	91.5	419.9	428.9	701.0	1,350.9	-3.4	3.3	35.6	10.8	14.0	6.7	4.1	5.0
Manufacturers	101.5	206.8	353.5	1,201.8	1,193.1	3,174.3	7,170.2	15.3	11.3	27.7	21.4	17.7	7.4	10.8	22.5
Other Goods	285.6	353.6	442.5	461.1	555.3	1,007.3	1,784.4	4.4	4.6	0.8	16.9	12.1	20.7	18.5	7.1
Non-Factor Services	572.5	792.3	1,397.7	3,077.2	3,345.3	5,907.4	13,030.5	6.7	12.0	17.1	13.9	17.1	41.6	41.4	41.7
Total Exports	1,377.2	1,912.0	2,745.4	6,214.4	6,800.8	14,136.8	35,154.9	6.8	7.5	17.8	17.9	20.0	100.0	100.0	100.0
Trade Indices				Average 1972 = 100											
Export Price Index	68	76	90	171	177	241.3	377.5	2.3	3.4	13.7	7.1	9.4			
Import Price Index	66	80	91	173	183	238.0	332.8	3.9	2.6	13.7	6.6	6.9			
Terms of Trade	85	78	83	99	97	101.4	113.4	-1.7	1.3	3.6	-0.4	2.3			
Value Added by Sector				Constant 1972 Prices, US$ Millions											
Primary	3,287.4	4,070.3	4,793.9	4,691.2	4,595.5	5,113.9	6,150.5	4.4	3.3	-0.4	1.7	3.8	17.5	12.9	8.9
Secondary	5,184.4	8,000.2	12,404.9	16,687.5	16,986.2	20,625.4	30,999.3	9.1	9.2	6.1	4.3	8.5	27.6	33.5	35.9
Tertiary	10,313.9	14,429.0	19,826.0	25,227.4	25,898.4	31,651.2	49,959.7	7.0	6.6	4.9	4.6	9.6	54.9	53.6	55.2
Total (GDP)	18,785.7	26,499.5	37,024.8	46,606.1	47,480.1	57,390.5	87,109.5	7.1	6.9	4.7	4.3	8.7	100.0	100.0	100.0
Consolidated Public Sector Finances 4/				Constant 1972 Prices, US$ Millions									As % of GDY		
Current Receipts	-	3,042.0	4,173.0	6,696.0	8,027.1	10,994.2	16,687.3	-	6.5	9.9	10.4	8.7	-	11.3	18.2
Current Expenditures 5/	-	2,329.0	2,990.7	7,203.5	8,614.2	11,333.5	17,026.7	-	5.1	19.2	3.6	8.5	-	8.1	18.7
Public Savings	-	713.4	1,182.2	-507.5	-587.1	339.3	339.4	-	10.6	--	--	0.0	-	3.2	0.6
Resources for Investment	-	776.3	1,279.2	-473.4	-536.0	399.7	431.1	-	10.5	--	--	1.5	-	3.5	0.7
Investment	-	1,741.5	2,046.7	5,232.6	5,530.7	5,436.6	8,251.9	-	3.3	20.7	0.8	8.7	-	5.5	9.0
Deficit (net)	-	-965.2	-767.5	5,706.0	6,066.7	5,036.9	7,820.8	-	-4.4	--	-2.5	9.2	-	2.1	8.3
Allocation of Consolidated Public Sector Expenditures													As % of Total		
													1970	1975	1980
Agriculture	-	-	843.2	3,245.5	-	-	-	-	-	-	-	-	8.8	15.9	-
Industry	-	-	3,500.3	6,880.3	-	-	-	-	-	-	-	-	36.3	32.4	-
Social Welfare	-	-	2,384.1	4,269.6	-	-	-	-	-	-	-	-	24.7	21.0	-
Transport and Communications	-	-	1,136.9	2,034.6	-	-	-	-	-	-	-	-	11.8	10.0	-
General Administration and Others	-	-	1,772.3	4,202.4	-	-	-	-	-	-	-	-	18.4	20.7	-
Total 6/	-	-	9,637.2	20,332.6	-	-	-	-	-	-	-	-	100.0	100.0	-
Selected Indicators											Period Averages				
											1961-1965	1966-1970	1971-1975	1976-1980	1981-1985
ICOR	2.42	2.91	2.89	5.00	10.49	3.08	2.58	--	--	--	2.9	3.2	3.63	5.78	2.68
Import Elasticity	1.20	.75	1.51	-0.01	-4.50	1.14	1.27	--	--	--	.31	1.16	.96	-.69	1.27
Marginal Savings Ratio	.48	-0.16	-0.24	0.14	-0.32	0.34	0.24	--	--	--	.19	.13	.10	.40	.29

Labor Force and Output per Worker

	Total Labor Force: In Millions 1960	In Millions 1970	As % of Total 1960	As % of Total 1970	1960-1970 Growth Rate	Value Added per Worker (1972 Prices): 1960	1970	% of Average 1960	% of Average 1970	Growth Rate
Agriculture	5.4	5.1	50.5	39.2	-0.6	608.8	939.9	34.7	33.0	4.4
Industry	2.1	3.0	19.6	23.1	3.6	2,468.9	4,134.9	140.6	145.0	5.3
Services 7/	3.2	4.9	29.9	37.7	4.4	3,222.8	4,044.8	183.6	142.0	2.3
Total	10.7	13.0	100.0	100.0	2.0	1,755.6	2,847.6	100.0	100.0	5.0

- Not available
-- Nil or negligible
1/ Imports declined considerably in 1976 and are expected to decline in 1977. This trend is reversed from 1978 onwards
2/ Through 1970; item includes sugar, tomatoes, cotton, coffee, cattle and meat
From 1975, it includes sugar, tomatoes, cotton and coffee.
3/ Projection based on Pemex's intermediate investment program
4/ Includes Federal Government, Federal District, Social Security Agencies, Budgetary Controlled Enterprises and Decentralized Agencies (net savings and investment expenditures) and deficit
5/ Includes extra-system transfers and the deficit financing of part of the non-budgetary controlled Public Sector
6/ Includes total expenditures of the Budgetary ontrolled Enterprises and Decentralized Agencies and debt amortization
7/ Includes unallocated labor force

BALANCE OF PAYMENTS, EXTERNAL ASSISTANCE AND DEBT
(US$ million at current prices)

	Actual		Preliminary Estimates		Projections		
	1970	1974	1975	1976	1977	1978	1980
SUMMARY BALANCE OF PAYMENTS							
Exports (including N.F.S.)	2,745.4	6,063.7	6,081.5	6,800.8	8,123.4	10,213.9	14,136.8
Imports (including N.F.S.)	-3,416.9	-7,763.6	8,636.6	8,278.0	8,001.9	9,305.4	12,261.1
Resource Balance	-671.5	-1,699.9	-2.555.1	-1,477.2	121.5	908.5	1,875.7
Interest (net)2/	-301.3	-908.5	-1,266.5	-1,697.3	-2,295.5	-2,577.6	-2,598.2
Direct Investment Income	-267.5	-549.1	-657.5	-636.6	-619.4	-668.4	-793.6
Workers Remittances	122.7	158.1	174.6	193.0	219.6	249.1	316.1
Current Transfers (net)	55.3	113.4	123.4	146.9	158.3	173.0	189.1
Balance on Current Account	-1,062.3	-2,886.0	-4,181.1	-3,471.2	-2,415.5	1,915.4	-1,010.9
Private Direct Investment	322.8	678.1	748.8	688.1	669.4	766.3	943.3
Public M and L.T. Loans							
a. Disbursement (gross)	781.5	2,968.8	4,322.8	5,850.2	5,777.5	4,954.8	5,789.4
b. Repayments	-474.7	-541.8	-852.8	-1,343.0	-2,401.4	3,726.7	-5,258.9
c. Disbursements (net)	306.8	2,427.0	3,470.0	4,507.2	3,376.1	1,228.1	530.5
Other Capital	534.8	-182.2	127.4	-2,057.1	-630.0	138.7	-187.7
a. Public short-term	59.0	642.0	927.0	880.0	-300.0	-300.0	-300.0
b. Other Capital n.e.i.	475.8	-824.2	-799.6	-2,937.1	-330.0	161.3	112.7
Change in Reserves (- = increase)	-102.1	-36.9	-165.1	333.0	-1,000.0	-217.7	-275.6
GRANT AND LOAN COMMITMENTS PUBLIC M AND L.T. LOANS							
IBRD	146.8	289.0	310	315	-	-	-
IDA	-	-	-	-	-	-	-
Other Multilateral	112.3	162.0	161.1	150.0	-	-	-
Governments	81.0	129.1	120.0	151.7	-	-	-
Suppliers	69.7	57.4	200.0	300.0	-	-	-
Banks and Financial Institutions	434.4	2,145.0	3,181.0	4,432.8	-	-	-
Bonds	-	100.0	210.0	350.0	-	-	-
Total	844.1	2,822.5	4,182.1	5,699.5	-	-	-
DEBT AND DEBT SERVICE							
Public Debt Outstanding and Disbursed (end of period)	3,226.9	8,003.1	11,473.1	15,980.3			
Interest on Public Debt	216.9	576.1	810.5	1,027.5			
Repayment on Public Debt	474.7	541.8	852.8	1,343.0			
Other Debt Service (net)	224.3	332.4	436.2	669.7			
Total Debt Service (net)	915.9	1,450.3	2,099.5	3,040.2			
Burden on Export Earnings (%) 3/							
a. Public Debt Service	24.0	18.0	26.1	33.9			
b. Total Debt Service	31.8	23.3	33.6	43.5			
c. Total Debt Service and Direct Investment Income	44.8	32.1					
Average Terms of Public Debt							
a. Interest as % of prior years D.O. and D.	7.4	10.3	10.1	9.0			
b Amortization as % of prior years D.O. and D.	16.3	9.7	10.7	11.7			
IBRD Exposure							
a. IBRD Debt O. and D. as % of Public Debt O. and D.	18.0	12.2	9.2	7.3			
b. IBRD Debt Service as % of Public Debt Service	7.8	8.4	6.8	5.0			
IDA Exposure							

EXTERNAL DEBT

	Outstanding and Disbursed on Dec. 31, 1976	
	$ Millions	Percent
Public M & L.T. Loans		
IBRD	1,166.9	7.3
IDB	593.0	3.7
Governments	820.2	5.1
Suppliers	410.4	2.6
Bonds	1,043.2	6.5
Financial Institutions n.e.i.	11,946.6	74.8
Total Public M & L.T. Debt	15,980.3	100.0

- Not applicable.
1/ Preliminary estimate based on Mexican data
2/ Includes interest on short term private and public debt
3/ Includes worker remittances

THE STATUS OF BANK GROUP OPERATIONS IN MEXICO

A. STATEMENT OF BANK LOANS (As of April 30, 1977)

Loan Number	Year	Borrower	Purpose	US$ Million: Amount Less Cancellations and Terminations	US$ Million: Undisbursed /1
		28 loans fully disbursed		1,286.7	
793	1972	Nacional Financiera S.A.	Tourism	22.0	0.7
820	1972	Nacional Financiera S.A.	Ports	20.0	0.3
824	1972	Nacional Financiera S.A.	Industry	35.0	2.6
825	1972	Ferrocarriles Nacionales de Mexico and Nacional Financiera S.A.	Railways	75.0	3.2
909	1973	Nacional Financiera S.A.	Water Supply	90.0	57.8
934	1973	Siderurgica Lazaro Cardenas-Las Truchas S.A. and Nacional Financiera S.A.	Steel	70.0	3.3
968	1974	Nacional Financiera S.A.	Roads	90.0	67.4
969	1974	Nacional Financiera S.A.	Irrigation	77.0	29.1
970	1974	Nacional Financiera S.A.	Irrigation	47.0	44.3
1022	1974	Nacional Financiera S.A.	Airports	25.0	16.6
1053	1974	Nacional Financiera S.A.	Integrated Rural Development	50.0	47.3
1110	1975	Nacional Financiera S.A.	Integrated Rural Development	110.0	78.3
1111	1975	Nacional Financiera S.A.	Irrigation	150.0	150.0
1112	1975	GUANOMEX and Nacional Financiera S.A.	Industry	50.0	33.0
1186	1975	Banco Nacional de Obras y Servicios Publicos S.A.	Water Supply	40.0	39.7
1205	1976	Nacional Financiera S.A.	Industry	50.0	45.0
1217	1976	Nacional Financiera S.A.	Agricultural and Livestock Credit	125.0	86.0
1232	1976	Ferrocariles Nacionales de Mexico and Nacional Financiera S.A.	Railways	100.0	95.2
		TOTAL		2,512.7	799.8
		Of which has been repaid		412.0	
		Total now outstanding		2,100.7	
		Amount sold	92.3		
		of which has been repaid	56.9	35.4	
		Total now held by Bank		2,065.3	
		Total undisbursed			799.8

/1 Loan No. 1308 for US$95 million for a steel project was terminated in April 1977 at the request of the Government.

B. STATEMENT OF IFC INVESTMENTS (as of April 30, 1977)

Fiscal Year	Obligor	Type of Business	US$ Million Loan	Equity	Total
1958/59	Industrias Perfect Circle, S.A. /1	Industrial Equipment	0.8	--	0.8
1958	Bristol de Mexico, S.A. /1	A/C Engine Overhaul	0.5		0.5
1961	Acero Solar, S.A. /1	Twist Drills	0.3	--	0.3
1962/65/ 66/68	Compania Fundidora Fierro y Acero de Monterrey, S.A.	Steel	2.3	21.4	23.7
1963	Tubos de Acero de Mexico, S.A. /1	Steel	0.9	0.1	1.0
1963	Quimica del Rey, S.A. /1	Sodium Sulphate	0.8	--	0.8
1964/66	Industria del Hierro, S.A.	Construction Equipment	--	2.0	2.0
1970	Minera del Norte, S.A.	Iron Ore Mining	1.5	--	1.5
1971	Celanese Mexicana, S.A.	Textiles	12.0	--	12.0
1972	Promotora de Papel Periodico, S.A. de C.V.	Pulp and Paper	/2	/2	/2
1973	Cemento Veracruz	Cement	10.5	--	10.5
1974	Cancun Aristos Hotel	Tourism	1.0	0.2	1.2
1975	Mexinox, S.A	Steel	12.0	2.8	14.8
	Total Gross Commitments		42.6	26.5	69.1
	Less Cancellations, Terminations, Repayment and Sales		15.4	22.0	37.4
	Total Commitments Now Held by IFC		27.2	4.5	31.7
	Total Undisbursed		3.0	0.2	3.2

/1 Investments which have been fully cancelled, terminated, written off, sold, redeemed or repaid.

/2 US$25,000.

C. PROJECTS IN EXECUTION 1/

Ln. No. 793 Zihuatanejo Tourism Project: $22 Million Loan of January 22, 1972; Effectiveness Date: March 30, 1973. Closing Date: June 30, 1977.

The loan is expected to be fully disbursed by June 30, 1977. The airport opened more than a year ago and is being served by domestic airlines from international points. It is expected to be included in the next bilateral air agreement with the US. In the tourist zone, two hotels are open for business (534 rooms) and several others are under construction. By June 1977 over 1,500 rooms are expected to be available.

Ln. No. 820 Ports Project: $20 Million Loan of May 17, 1972; Effectiveness Date: August 17, 1972. Closing Date: June 30, 1977.

The project is in its final stages of execution. Various actions to insure proper operation, maintenance and user charges are being discussed with the government.

Ln. No. 824 Industrial Equipment Fund (FONEI) Project: $35 Million Loan of June 2, 1972; Effectiveness Date: October 12, 1972. Closing Date: June 30, 1977.

All funds under this project have been committed and over 90 percent disbursed.

Ln. No. 825 Second Railway Project: $75 Million Loan of June 2, 1972; Effectiveness Date: August 17, 1972. Closing Date: June 30, 1977.

Progress in implementation, procurement and disbursement is satisfactory. Freight traffic during 1976 was maintained at the level of 1975. Locomotive and freight car utilization has improved largely because of the introduction of unit through trains and improved communication and information systems introduced during the past year. The financial situation which had improved in 1975 deteriorated in 1976 due to increase in real costs and wages.

1/ These notes are designed to inform the Executive Directors regarding the progress of projects in execution and, in particular, to report any problems which are being encountered and the action being taken to remedy them. They should be read in that sense, and with the understanding that they do not purport to present a balanced evaluation of strengths and weaknesses in project execution.

Ln. No. 909 Mexico City Water Supply Project: $90 Million Loan of June 18, 1973; Effectiveness Date: April 30, 1974. Closing Date: December 31, 1977.

All project components are either in operation, or about to be completed. The Texcoco component has been delayed due to lack of counterpart funds.

Ln. No. 934 Las Truchas Steel Project: $70 Million Loan of September 12, 1972; Effectiveness Date: October 29, 1973. Closing Date: December 31, 1977.

The plant was inaugurated in November 1976. About 94 percent of the loan has been disbursed.

Ln. No. 968 Seventh Highway Project: $90 Million Loan of March 1, 1974; Effectiveness Date: May 29, 1974. Closing Date: December 31, 1978.

Substantial delays have been encountered in the initiation of project works because of the shortage of budgetary allocations. Substantial cost increases caused by price escalation have also been encountered. The government has requested a change in the scope of this operation and this request is being analyzed.

Ln. No. 969 Rio Panuco Irrigation Project; $77 Million Loan of March 1, 1974; Effectiveness Date: May 29, 1974. Closing Date: December 31, 1980.

Construction is proceeding rapidly; irrigation service has been started on 20,000 ha of the Las Animas unit in early 1977. Intensified manpower training, extension and farm-planning efforts are needed to keep pace with construction, especially since 85 percent of the area is to be settled by ejidatarios under collective farming systems. Cost inflation and some changes in project design have resulted in an overall increase of 71 percent in the cost of this project.

Ln. No. 970 Rio Sinaloa Irrigation Project: $47 Million Loan of March 1, 1974; Effectiveness Date: May 29, 1974. Closing Date: December 31, 1980.

Construction of major project works remain behind the original schedule. Total project costs have doubled over appraisal estimates. Rephasing of the project is being examined by the Government.

Ln. No. 1022 Airport Development Project: $25 Million Loan of May 28, 1974; Effectiveness Date: September 16, 1974. Closing Date: June 30, 1978.

Because of budget constraints, some contract awards have been rescheduled. The Airport Authority (ASA) has an adequate financial position. The cost accounting system and the financial policy study have been completed.

Ln. No. 1053 Papaloapan Integrated Rural Development Project: $50 Million Loan of November 15, 1974; Effectiveness Date: January 27, 1975. Closing Date: June 30, 1980.

Although the quality of works has been satisfactory, first-year goals have not been achieved due to inadequate budget allocations. Counterpart funds for 1977 are adequate; reprogramming of project activities is under preparation.

Ln. No. 1110 Integrated Rural Development Project (PIDER I): $110 Million Loan of May 8, 1975; Effectiveness Date: October 29, 1975. Closing Date: December 31, 1978.

Progress is satisfactory and project investments are generally on schedule. Reforms to strengthen the extension, farmer organization, and credit components are being implemented. Decentralization efforts are moving quickly ahead; many PIDER central staff are now located in the respective states and micro-regions. Greater emphasis is being given under the new PIDER management to investment analysis, community participation, cost recovery, and investment operation and maintenance.

Ln. No. 1111 Seventh Irrigation Project - Bajo Rio Bravo and Bajo Rio San Juan: $150 Million Loan of May 8, 1975; Effectiveness Date: July 30, 1975. Closing Date: December 31, 1982.

The current and near term situation in the irrigation districts is significantly different than foreseen at appraisal in that the need to reduce water losses now appears to be significantly less. The government is currently completing a study to determine the appropriate scope for this project which will be discussed with the Bank shortly. It is currently anticipated that the revised project would cost around $120 million of which $50 million would be foreign exchange as opposed to a cost estimate at appraisal of US$386 million. Pending completion of this study and project replanning, no expenditures have been incurred.

Ln. No. 1112 Fertilizer Project: $50 Million Loan of May 22, 1975; Effectiveness Date: July 30, 1975. Closing Date: December 31, 1978.

Project execution has been delayed by difficulties in procurement, by uncertainty among suppliers resulting from the devaluation of the peso and by financial constraints in Guanomex.

Ln. No. 1186 Medium Cities Water Supply and Sewerage Project: $40 million Loan of January 13, 1976; Effectiveness Date: April 26, 1976. Closing Date: December 31, 1980.

The agreements for subprojects in Mexicali have been signed and it is expected that the agreements covering the Morelia subproject will be signed soon. Initial delays in executing the project and the change of administration have resulted in a slippage of about six months.

Ln. No. 1205 Industrial Equipment Fund (FONEI) Project: $50 Million Loan of April 30, 1976; Effectiveness Date: August 30, 1976. Closing Date: December 31, 1979.

About 34 percent of the loan has been committed to industrial subprojects.

Ln. No. 1217 Fifth Agricultural and Livestock Credit Project: $125 Million Loan of March 11, 1976; Effectiveness Date: August 30, 1976. Closing Date: January 1, 1980.

Commitments under this project are running ahead of schedule. Funds for medium-income producers and agro-industries are expected to be fully committed by August 1977. The recently formed National Rural Credit Bank has been declared eligible for rediscount of up to US$15 million under this project thereby increasing the rate of commitment of funds to low-income producers.

Ln. No. 1232 Third Railway Project: $100 Million Loan of April 30, 1976; Effectiveness Date: June 16, 1976. Closing Date: June 30, 1979.

Execution of the project is satisfactory; the track rehabilitation and telecommunications programs are on schedule. Tenders have been called for the Bank-financed rails, components for cars and track/workshop machinery but award of contracts has been delayed due to the imposition of substantial budgetary cuts. This will reduce purchases to be made during 1977, and force a rescheduling during the following years.

MEXICO

RURAL DEVELOPMENT - PIDER II

SUPPLEMENTARY PROJECT DATA SHEET

I. Timetable of Key Events

(a) Time taken by country to prepare the project: approximately one year. Date of technical, economic and financial feasibility studies: January, 1976.

(b) Project prepared by the Secretariat of the Presidency: June, 1976.

(c) First presentation to the Bank: January, 1976.
First Bank mission to consider project: July, 1976.

(d) Departure of appraisal mission: July, 1976.

(e) Completion of negotiations: May 23, 1977.

(f) Planned effectiveness: September, 1977.

II. Special Bank Implementation Actions

(a) Continued intensive supervision.

III. Special Conditions

(a) Micro-region investment plans will be agreed by the Bank and Borrower and must include at least 70% of total investment cost in productive investments, the estimated return on which must equal at least 10% (para. 45);

(b) A ceiling of US$32,000 would be continued for small-scale irrigation projects of 25 ha or less and the maximum investment per family would be US$5,000; a per hectare ceiling of US$2,500 equivalent would be imposed; to be eligible, a family's pre-project net agricultural income would have not to exceed US$2,500 (para. 49);

(c) for irrigation works, about 10% of investment cost would be recovered; such additional amounts as are reasonable based on the capacity of beneficiaries to repay would also be recovered (para. 60);

(d) prior to construction of each proposed irrigation project, technical and socio-economic feasibility studies would be made (para. 57);

(e) interest rate and re-discounting arrangements would be automatically adjusted to correspond to those applicable to low-income producers credit under other Bank loans for agricultural credit (para. 47);

(f) soil and water conservation works would focus on labor intensive improvement of partly eroded slopes, and technical and economic conservation plans would be prepared prior to construction (para. 57);

(g) labor intensive techniques would be used on project works where technically and economically appropriate (para. 57);

(h) to improve the rainfed extension service, PRONDAAT operations would be implemented in the 20 PIDER II micro-regions no later than December 31, 1980 (para. 57);

(i) construction of feeder roads would be scheduled to minimize conflict with agricultural tasks (para. 57);

(j) feasibility studies for productive investments would be undertaken; individual studies costing up to US$15,000 would be contracted at the discretion of the state SPP representative, and studies over US$15,000 would be subject to the approval of the Director of PIDER at the federal level (para. 57);

(k) the Government would submit a plan for the development of a pilot rural industries program by June 30, 1978 (para. 46);

(l) new investment commitments for individual projects would include written agreements with the beneficiaries that provide for adequate operation and maintenance arrangements (para. 57);

(m) for the productive investments: (i) cost recovery and/or cost contribution rules would be negotiated and agreed upon in writing with beneficiaries prior to construction; and (ii) beneficiaries would be given the option to defray their repayment obligations through labor and material contributions (para. 60); and

(n) installation costs for rural electrification would not exceed US$150 per person and villagers would pay the regular CFE rates which cover the full cost of operation and maintenance and a portion of investment cost (para. 60);

(o) a minimum contribution of cash, labor or materials of 15% of investment costs of rural water systems would be made by villagers either at the outset or during construction; full payment for operation and maintenance costs would be obtained; and there would be a limit on government's share of system costs of US$100 per person benefited (para. 60); and

(p) eligibility criteria for self-help funds would be relaxed to include villages without potable water and electricity; and a maximum equivalent to US$40 of materials and equipment per beneficiary would continue to apply (para. 49).

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