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MEXICO

PROGRAM TO BOOST PRODUCTIVITY IN MEXICO II

(ME-L1186)

LOAN PROPOSAL

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ABBREVIATIONS

BDS	Business development services
CCLIP	Conditional Credit Line for Investment Projects
CEPs	Consejos Estatales de Productividad [State Productivity Councils]
CNBV	Comisión Nacional Bancaria y de Valores [National Banking and Securities Commission]
COFECE	Comisión Federal de Competencia Económica [Federal Economic Competition Commission]
COFEMER	Comisión Federal de Mejora Regulatoria [Federal Regulatory Improvement Commission]
CONACYT	Consejo Nacional de Ciencia y Tecnología [National Science and Technology Council]
CONDUSEF	Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros [National Commission for the Protection and Defense of Users of Financial Services]
FDI	Foreign direct investment
IFT	Instituto Federal de Telecomunicaciones [Federal Telecommunications Institute]
INADEM	Instituto Nacional del Emprendedor [National Entrepreneurs Institute]
INEGI	Instituto Nacional de Estadística y Geografía [National Bureau of Statistics and Geography]
MSME	Micro, small, and medium-sized enterprise
OECD	Organisation for Economic Co-operation and Development
PBL	Programmatic policy-based loan
PCU	Program coordination unit
PDB	Public development bank
PND	Plan Nacional de Desarrollo [National Development Plan]
PRONAFIDE	Programa Nacional de Financiamiento del Desarrollo [National Development Financing Program]
R+D+I	Research, development, and innovation
SAPIBs	Sociedades Anónimas Promotoras de Inversión Bursátil [stock investment promotion corporations]
SARE	Sistema de Apertura Rápida de Empresas [Rapid Business Startup System]
SHCP	Department of Finance
SME	Small and medium-sized enterprise
TFP	Total factor productivity
WEF	World Economic Forum

PROJECT SUMMARY

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<table>
<tr><th colspan="5">Financial terms and conditions</th></tr>
<tr><td colspan="3" rowspan="2">Borrower: United Mexican States</td><th colspan="2">Flexible Financing Facility[a]</th></tr>
<tr><td>Amortization period:</td><td>Bullet payment on 15 July 2028</td></tr>
<tr><td colspan="3" rowspan="2">Executing Agency: Department of Finance (SHPC)</td><td>Original weighted average life:</td><td>Maximum 11.83 years[b]</td></tr>
<tr><td>Disbursement period:</td><td>5 years</td></tr>
<tr><th>Source</th><th>Amount (US$)</th><th>%</th><td>Grace period:</td><td>Bullet payment on 15 July 2028</td></tr>
<tr><td rowspan="2">IDB (Ordinary Capital)</td><td rowspan="2">600 million</td><td rowspan="2">100%</td><td>Inspection and supervision fee:</td><td>[c]</td></tr>
<tr><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td rowspan="2">Total</td><td rowspan="2">600 million</td><td rowspan="2">100%</td><td>Credit fee:</td><td>[c]</td></tr>
<tr><td>Currency of approval:</td><td>U.S. dollars from the Ordinary Capital</td></tr>
<tr><th colspan="5">Project at a Glance</th></tr>
<tr><td colspan="5">Objective/description: The general objective of this programmatic policy-based loan (PBL) series is to boost productivity in Mexico. This will be achieved through the following five specific objectives: (i) strengthen the institutional framework of the productivity agenda; (ii) improve the allocation of production factors through access to business financing; (iii) strengthen competition and the business climate; (iv) improve innovation and productive development; and (v) promote regional convergence in productivity.</td></tr>
<tr><td colspan="5">Special contractual conditions precedent to the sole disbursement: Disbursement of the loan proceeds will be contingent on fulfillment of the policy reform conditions set forth in the Policy Matrix (Annex II), the Policy Letter, and the conditions established in the loan contract (see paragraph 3.2).
This is the second of two consecutive, single-tranche loan operations that are technically linked but financed independently under the programmatic PBL modality.</td></tr>
<tr><td colspan="5">Exceptions to Bank policy: None.</td></tr>
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<tr><td colspan="2">Challenges:[d]</td><td colspan="3">SI ☑ PI ☑ EI ☑</td></tr>
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</table>

(a) Under the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.
(b) The original weighted average life and grace period may be shorter, depending on the effective signature date of the loan contract.
(c) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors in accordance with the corresponding policies.
(d) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).
(e) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and the Rule of Law).

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Background, problems, and rationale

1.1 **Background.** This project is the second in a series of two programmatic policy-based loans (PBLs) intended to boost productivity. The series began in 2013 (2993/OC-ME), with approval of the 2013-2018 National Development Plan (PND), and was agreed on with the Government of Mexico as a complement to a series of structural measures designed to strengthen the country's productive base.

1.2 The policies of both loans incorporate elements of various reform initiatives (for example those grouped by the Mexican government under the so-called Financial Reform or the Telecommunications Reform). All these policies, envisaged together with the other reforms undertaken by the Mexican government on the basis of a multi-party consensus forged in the Pact for Mexico (Education Reform, Energy Reform, Financial Reform), constitute a synchronized agenda for ambitious structural change. Specifically, the proposed operation supports policy reforms whose specific objectives are to eliminate structural barriers that affect businesses' access to financing, improve the business climate and competition among businesses, modernize the national innovation and research system, and promote more balanced regional development. These objectives are identical to the ones envisioned in 2013 when the first operation in this series of programmatic loans was approved (2993/OC-ME). In that operation, the program's main legal and institutional reforms were identified. The loan was disbursed in the same year, once the conditions precedent were fulfilled. This second project will consolidate policy decisions that have achieved significant progress to date, particularly the reforms approved in the telecommunications and financial sectors.

1.3 **Macroeconomic context.** Mexico has a solid economic policy framework,[1] which has enabled it to maintain macroeconomic stability despite the recent rise in international financial market volatility and the sharp drop in oil prices. Inflation fell to an historic low in 2015, closing the year at 2.1% supported by the telecommunications reform and lower prices of energy goods, and has remained below the 3% target thus far in 2016. This has contributed to real gains in family purchasing power, driving domestic demand and economic growth in the face of less external demand for Mexican manufactures. Despite the unfavorable global environment between 2013 and 2016, the economy grew moderately, averaging 2.1%. Growth of around 2% is expected in 2016 following the significant slowdown in the second quarter of the year to an annual 1.5% (seasonally adjusted figures). In 2015, government revenue was affected by the sharp drop in international oil prices,[2] although it was largely offset by a significant increase of three percentage points of GDP in nonoil tax revenue, spurred by the impact of the 2014 tax reform

[1] Monetary policy is governed by a system of inflation targets. In addition, the flexible exchange rate has allowed the economy to adjust to external shocks. Fiscal policy is governed by a fiscal rule that sets annual caps on the deficit and on spending growth. Mexico also has a solid regulatory and supervisory framework for the financial system (IMF 2015) that complies with international standards.

[2] In 2015, the average price of Mexico's crude oil mix ended the year at just 28.2% of the value observed at the end of 2013. In 2015, the government's oil revenue was 3.7 percentage points of GDP lower than in 2013.

and the reduction in the gasolines subsidy.[3] Additionally, to address this decline in revenue, and in a scenario of low international oil prices over a long period of time, in early 2016 the government has announced reductions in public spending of approximately 1% of GDP. Moreover, the government is committed to continuing the process of fiscal consolidation begun in 2014 for the next two years, which should stabilize the public sector's financial requirements at 2.5% of GDP in 2018.

1.4 **Productivity issues.** A number of diagnostic assessments[4] agree that the country's biggest long-term challenge is to secure conditions that enable the economy to boost its productivity. Growth in Mexico's productivity over the last 25 years has been low compared to the regional average, the region's main economies, and the advanced countries.[5] Since 1991, the contribution of total factor productivity (TFP) to growth has been negative, subtracting 0.33 percentage points from average annual GDP growth between 1991 and 2014, while the value of production over the period grew by 3.01%. Recent provisional figures for TFP growth in 2013 and 2014 are negative (-0.65 and -0.19 of annual average growth, respectively).[6] This is the main reason why, despite having experienced a rapid buildup of the factors of labor and capital, the gap in per capita GDP in Mexico has widened compared to the more advanced economies[7] and development has fallen short over the last three decades, with an impact on poverty.[8]

1.5 The constraints on productivity growth in Mexico fall into two categories: those that distort the efficient allocation of the factors of production between sectors (constraints on access to credit, the business climate, including problems of competition and an inefficient contractual and regulatory framework, quality of education, and policies that encourage informality); and those that hamper growth in productivity inside businesses (lack of research, development, and innovation, training, and education). The economic structure is marked by geographical and entrepreneurial duality and by a degree of informality that results in inequities. The concentration of regional economic activity in the central, northern, and western parts of the country widens disparities between states and cuts into aggregate productivity.[9] Small enterprises account for 99% of the total, 57% of private employment, and 23% of value added, while medium-sized and large companies

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3 The reform was supported by the Bank's Public Finance Strengthening Program, Phases I and II (3201/OC-ME NS and ME-L1189).

4 Levy (2010) "Good Intentions, Bad Outcomes, Social Policy, Informality, and Economic Growth in Mexico," International Monetary Fund (IMF). *Financial Sector Assessment Program* (FSAP), 2012; IMF, 2015 Article IV Consultation. World Economic Forum (WEF), The Global Competitiveness Report 2014-2015.

5 For a comparative view of productivity growth, see: Pagés, C., ed. (2010). *The Age of Productivity*, IDB-DIA; Organization for Economic Co-operation and Development Economic Surveys. Mexico. Overview.

6 Source: National Bureau of Statistics and Geography (INEGI). 2016.

7 See C. Daude and E. Fernández Areas. (2010). On the Role of Productivity and Factor Accumulation in Economic Development in Latin America and the Caribbean, IDB-WP-155.

8 Gordon H. Hanson (2010): Why isn´t Mexico Rich? Journal of Economic Literature, American Economic Association, vol. 48 (4), pages 987-1004, December. Describes the main factors behind low growth (1.1% in the last two decades) and productivity: weakness of the credit markets, size of the informal sector, and high production costs associated with inadequate regulation in sectors such as telecommunications, the Internet, and electric power.

9 In the six most productive states, nonoil labor productivity is 67.2% above the average and grew by 10.4% between 1993 and 2008, while in the 12 least productive states, productivity is 32% below the average and has shrunk by 7%. Figures based on the economic censuses 1993–2008.

(with more than 50 workers) account for 1%, 43%, and 77%, respectively. Moreover, two thirds of all businesses are informal, accounting for 35% of jobs and 21% of value added.[10] About 57% of workers are employed in the informal sector, although the number has been dropping slightly.[11] Furthermore, informality is countercyclical and forestalls the transmission of the positive effects that negative shocks can have on growth.[12]

1.6 To address the challenge of low productivity, the Mexican government decided to undertake a structural reform agenda and attack the main constraining and lag-causing factors. The measures were identified in the first operation and are updated and presented below.[13] These reforms go hand in hand with the extensive work the Bank has been doing to support the country in recent years, especially through investment programs to finance Mexican public financial institutions with the aim of strengthening sector productivity (see paragraph 2.4) (loans 2838/SX-ME, 3335/OC-ME, 3178/OC-ME, 3178/OC-ME, 3302/OC-ME, 3597/OC-ME, 3531/OC-ME, and 3563/OC-ME).

1.7 **Institutional framework to support productivity.** One of the factors identified to boost productivity was the establishment of a formal institutional framework to organize cooperation between the public and private sectors and the dialogue among political, economic, and social agents. In Mexico, public-private collaboration is essentially informal and poorly structured.[14] It was therefore important to strengthen the institutional framework that structured such collaboration. To maximize the benefits of public-private dialogue, an organization was needed, endowed with a well-defined mandate, transparent rules, balanced and operational representation of interests, and strong technical capacity.[15]

1.8 In the context of the first programmatic loan (2993/OC-ME), the Mexican government approved the PND, incorporating the productivity strategy as a crosscutting element and establishing the National Productivity Committee as a forum for dialogue between the government (finance, education, and labor) and economic and social agents (including unions and universities) with the capacity to propose and deploy actions, and the Business Advisory Council as a forum for formal dialogue between the government and business organizations. In 2014, the

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[10] The figures are from the 2014 economic census.

[11] Average informality over the 2005-2014 period involved 59% of the workforce (Source: INEGI, National Occupation and Employment Survey, and the Mexican Social Security Administration).

[12] A. Fernández and A. Meza (2015). "Informal employment and business cycles in emerging economies: The case of Mexico," Review of Economics Dynamics 18 (2015) (381-405). The authors present empirical and theoretical evidence on the nature and impact of the informal labor market on economic cycles in Mexico.

[13] The policy matrix of the first programmatic loan already included the commitments for this second loan. The changes in how those commitments are formulated are merely semantic/formal. See optional electronic link #6, comparative policy matrix.

[14] Ross Schneider (2010). Business-Government Interaction in Policy Councils in Latin America*,* IDB WP 167.

[15] A. Rodríguez Clare (2011). Institutions for Productive Development Policy*,* IDB, Mimeo.

subcommittees met more than 86 times.[16] On 6 May 2015, the Productivity and Competitiveness Law was promulgated, institutionalizing the National Productivity Committee and its role in building a long-term economic development policy.

1.9 In this context, the short-term challenge to be addressed in this second operation is to help lay the institutional and governance foundations for the effective operation of the information and dialogue framework among the public, private, and social agents, and the promotion of consistency among the three levels of government. Sector strategies will also be agreed upon in priority sectors, and metrics will be adopted to track the relevant indicators in the programming of productivity and competitiveness policies through publication of the corresponding policies.

1.10 **Improved allocation of production factors through access to business financing.** Another factor identified by the Mexican government to promote productivity was enhancement of financial system effectiveness and efficiency, as a key area for action to channel investment projects and promote the efficient reallocation of the factors of production into highly productive activities. Today, factors such as high levels of informality exacerbate the problems of obtaining information and make credit analysis difficult, thereby increasing the cost of financing or of the collateral required. This situation reduces the growth opportunities of the most productive businesses that are on the leading edge of technology[17] and the incentives to formalize for entrepreneurs who could see access to credit as an incentive for doing so.[18] This further skews the business structure toward microenterprise and informality, reducing aggregate productivity. The financial system in Mexico is profitable, liquid, and well-capitalized,[19] but it does not provide credit for businesses under suitable terms and conditions or in sufficient amounts. The financial reforms[20] have been aimed at removing structural constraints in the supply of credit in four complementary areas that are addressed in this operation:

a. Under the first programmatic loan (2993/OC-ME), a new legal and regulatory framework was established to **boost the effectiveness and efficiency of public development banks (PDBs),** with submission of the Credit Institutions Law and the legislation governing the country's PDBs to Congress. The main objective of this reform was to make the regulatory framework governing PDBs more flexible, to contribute to financial system development. Progress was made in the legal framework toward clearly defining the banks' mandate in facilitating access to credit and financial

16 Nineteen of the 26 committee agreements signed during the regular meetings have been acted on. In particular, diagnostic assessments have been conducted examining the productivity gaps between sectors and prioritizing strategies, taking into account the size of the sector (number of jobs) and its level of productivity. For example, in the Economy Formalization Subcommittee, it was agreed to simplify bureaucratic requirements and reduce the costs of starting up and operating formal businesses; and in the Subcommittee to Support SMEs and Entrepreneurs, a program was formulated to establish value chains in the auto parts, electricity-electronics, and tourism sectors.

17 R. G. Rajan and L. Zingales (1998). Financial dependence and growth, American Economic Review, 88.

18 For an analysis of the links between credit and formality: L. Cata, C. Pagés, and M.F. Rosales, Financial Dependence, Formal Credit and Informal Jobs*,* IDB-WP-118.

19 The banking system's return on assets (ROA) and return on equity (ROE) at December 2015 were 1.32% and 12.47%, respectively. Source: National Banking and Securities Commission (CNBV), 2016.

20 A description of the financial reforms can be found at: Análisis de la Reforma Financiera. Price WaterhouseCoopers, S.C., Mexico, Sector Financiero, 2013.

services, with the establishment of rates, tenors, operational risks, and types of business. The mandates of the PDBs was broadened in priority areas for national development, such as small and medium-sized enterprises (SMEs). These measures have already had short-term results, as reflected in the lower interest rates for micro, small, and medium-sized enterprises (MSMEs)[21] and in the increase in the financing available to the private sector.[22] The second programmatic loan will consolidate the reform of PDBs through the development and publication of a National Development Financing Program (PRONAFIDE) and an improvement in the administration of human capital.

b. **Development of the capital market as an alternative to bank credit, which enables businesses to diversify their liabilities and strengthen their balance sheets.** With the aim of stimulating capital market development in Mexico, progress was made in the improvement of regulations to increase legal certainty and attract more issuers and investors, with the submission to Congress of amendments to the Securities Market Law, which sought to speed up the process of issuing securities in the market, in a framework of legal certainty and security, and to improve the modus operandi of the entities that comprise it. In addition, the reform of the Investment Companies Law makes the current regime more flexible and standardizes categories included in the rest of the laws. As a result of this reform, there are fewer requirements related to tenors and the minimum shareholders' equity required to turn stock investment promotion corporations (SAPIBs) into stock corporations under the Securities Market Law. In addition, the category of investment funds has been created to replace investment companies under the Commercial Companies Act. In the second programmatic loan, in the context of the capital market, the development and publication of regulatory guidelines and capital market access programs for SMEs and the development and publication of secondary regulations related to investment funds will move forward.

c. **Enhanced competition in financial services and consumer protection**. The objective is to enhance the mobility of financial services users and ensure access by all banks to credit information systems, while guaranteeing consumer protection. Progress was made in this regard under the first program with the submission to Congress of a regulatory framework governing competition, to increase user mobility, eliminate restrictions on foreign direct investment (FDI), and amend the Financial Service Users Protection and Defense Law to include all financial services within its target sphere. To date, the adjustment of the legal framework of the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) has provided, among other advances, for the creation of a consultation tool, the Financial Entities Bureau, which will enable users of financial services to obtain relevant information for decision making.[23]

[21] Average interest rates fell by 4.32 points for microenterprises, 4.85 for small businesses, and 1.48 for medium-sized businesses between July 2009 and September 2014. Source: CNBV.

[22] In 2014, the PDBs granted more than 1.82 billion pesos in financing to the private sector (6.7% of GDP), for annual growth of 15%. Source: National Development Financing Program 2013-2018*, Logros 2014,* Government of Mexico.

[23] As of the third quarter of 2015, the Bureau had information on 4,104 financial institutions in 25 sectors and the website had received 485,356 visits since it was launched on 30 September 2015.

However, the Department of Finance (SHCP) still needs to develop and publish a system to evaluate the performance of public banks, bank operations, and compliance with the precepts established in the reform as part of the competition and protection framework for users of financial services. CONDUSEF's Charter, the Law for the Protection and Defense of Users of Financial Services and provisions applicable to financial institutions, also need to be amended for purposes of institutional strengthening. These matters are covered in the second operation.

d. **Strengthening of prudential regulation**. The aim is to ensure that the autonomy and capacities of prudential regulation institutions are strengthened. Given the concentration of the banking structure in Mexico, and to ensure the integrity and stability of the financial system and protect its investors, depositors, and participants, under the first programmatic loan progress was made towards establishing a regulatory framework that strengthened the CNBV's autonomy and supervisory capacity. Prudential regulation was improved by raising the corporate governance and information standards for unregulated financial institutions and financial group regulation, through amendments to the Financial Groups Act in keeping with international standards. However, to move ahead with the reform, liquidity standards and self-correction measures to be observed by full-service banks and credit institutions would need to be implemented. These advances are included in the second loan operation.

1.11 **Improved competition and business climate**. The development of these institutions is key to the efficient allocation of factors. For example, frameworks regulating competition or the efficient enforcement of collateral obligations are essential for improving access to the capital factor by the most growth-oriented and efficient companies. Business climate reforms can lead to increases in production and TFP ranging from 20% to 58% and from 7% to 19%, respectively.[24] In 2015-2016, Mexico was ranked 57th in the World Economic Forum's (WEF) competitiveness ranking, which measures the business climate.[25] In 2016, the competitiveness indicators showed progress in the Global Competitiveness Report ranking, thanks to the financial market reforms (up 17 places to 47th), greater business sophistication (up 8 places to 46th), and fostering of innovation (59th). Three areas of the business climate were identified in the first loan as offering room for improvement: (i) competition in key sectors; (ii) efficiency and effectiveness in the enforcement of contracts and bankruptcy proceedings; and (iii) simplification of the regulatory burden (WEF, 2015-2016).[26]

a. Under the first programmatic loan (2993/OC-ME), competition was improved in strategic sectors by granting greater autonomy and regulatory capacity to the Federal Economic Competition Commission (COFECE). In the area of telecommunications, entry barriers were lowered through the deregulation of

[24] See D. Norris et al. Reforms and Distance to Frontier, IMF Discussion Note, 2013.

[25] The WEF's Global Competitiveness Index combines 114 indicators grouped into 12 institutional pillars: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation. In this ranking, the United States placed 3rd, Chile 35th, Panama 50th, Costa Rica 53rd, and Colombia 61st.

[26] Other areas related to business climate in Mexico that affect businesses but are not addressed by the program are security and education. Nonetheless, the PND contains concrete actions in these areas.

investment (as in other sectors) and the capacities and autonomy of the Federal Telecommunications Institute (IFT) were increased.[27] These reforms have had a very direct impact on consumers in the form of lower prices.[28] The pending challenges addressed with the new programmatic loan include amendments to the Competition Act, with the aim of promoting incentives for the growth of the most innovative businesses as well as more efficient business management. In the sphere of telecommunications, progress is still needed in terms of fixed and mobile broadband services penetration.[29] To this end, a constitutional reform was presented in 2013, whose main thrust was to expand basic rights—access to information and telecommunications technologies and broadband—, update the legal framework, strengthen the regulatory agencies including the IFT, and promote effective competition, universal digital inclusion, and new broadband infrastructure. With broadband deregulation on 31 December 2015, headway still needs to be made in the project to promote coverage and the solicitation of bids for the shared network, which provides for better use of the spectrum, the trunk optic fiber network, and all other public assets, with the aim of increasing coverage and lowering consumer telecommunications rates. The proposed programmatic loan calls for amendments to the Telecommunications Act and the startup of the IFT, with new regulatory capacity to promote competition, such as the imposition of obligations on the dominant operators. Given the rapid advances in the telecommunications sector, technological developments and what they mean for the sector's limits in terms of competition need to be closely monitored, to which end a system of telecommunications indicators needs to be developed and published, as well as a national digital strategy for information and communications technology and information security.

b. A second aspect to be considered for the purpose of improving competition and the business climate is efficiency in the enforcement of collateral obligations and a reduction in the cost of credit and in the incentives for informality. The first program made progress towards improving bankruptcy proceedings through the submission of Bankruptcy Law reforms, and in enforcing collateral obligations and contracts through legal reforms to facilitate such enforcement, shortening time periods and increasing the enforceability of public documents. Thanks to the regulatory reform, the foundations have been laid for modern, effective, efficient, and fair bankruptcy proceedings, through protection for creditors, preservation of the economic value of assets, and the establishment of procedural and electronic mechanisms to bring the proceedings to a close, without impairing the assets of the bankrupt party. Under this second loan the regulatory reforms

[27] Some studies forecast the expected impacts on growth (3.2%) and productivity (2.6 percentage points) in response to a 10% increase in the penetration of broadband services (A. Garcia Zaballos, R. Lopez-Rivas, 2012).

[28] After the telecommunications reform came into force, a reduction of 4.4% was reported in the cost of local fixed telephone service and of 40.7% in international service (drop in the communications component of the consumer price index of 9.6% between March 2015 and 2016 alone as reported by INEGI).

[29] Although fixed broadband penetration in Mexico (10.95%) is above the Latin American and Caribbean average (8.33%), the gap with the OECD countries (26.1%) and leader countries such as South Korea (37.56%) and the European Union (28%) is still wide.

mentioned will be implemented and the efficiency of bankruptcy proceedings are expected to improve through institutional strengthening of the courts in commercial matters.

c. The first loan operation also had the objective of easing the excessive regulatory burden, which constitutes an unnecessary cost for businesses, discouraging them from entering the formal market and making their operations in it more expensive. Government functions were streamlined and an effort to lighten the regulatory burden was started by establishing the National Digital Strategy Coordination Office as a single unit and submitting a reform of the Commercial Code and the Commercial Companies Act to Congress. The Federal Regulatory Improvement Commission (COFEMER) is currently implementing the 2015-2016 Regulatory Improvement Program at the federal level and the Joint Regulatory Improvement Agenda in coordination with federal entities [states and capital city] and municipios.[30] In addition, a national program for oral commercial trials is being implemented, with the objective of designing a critical path for implementing oral proceedings at the national level that resolve disputes with greater speed, make proceedings transparent, and result in better quality decisions.[31] Nevertheless, there is still a need for alignment between the different levels and functions of government; the lack of quality in the regulations at the state and capital city level makes it necessary to promote the development and publication of a program to simplify bureaucratic requirements at the federal, state, and municipal levels, following international best practices. In addition to actions along these lines, under the second program the areas of improved regulation and simplification of processes will be reinforced by developing and publishing a national digital strategy to simplify business requirements and electronic government, with particular emphasis on streamlining all the stages of registration that affect businesses as legal entities, in particular, with formulations that streamline bureaucratic requirements for small businesses.

1.12 **Productive development and innovation in businesses**. As was identified under the previous operation, productivity within Mexican businesses is low in comparative terms and has not been improving.[32] This situation is not related to the sector composition of the economy and applies to low- and high-technology

[30] The biennial results in 2015 indicate a reduction in the regulatory burden as a percentage of GDP to 3.44%, which exceeded the planned target (3.9%). COFEMER programs include: (i) the Program to Streamline Procedures (SIMPLIFICA), to measure the economic cost of bureaucratic requirements and services at the municipios and federal entity levels and make them simpler; (ii) the Rapid Business Startup System (SARE) to ensure that municipal operating licenses are issued within less than 72 hours through a one-stop window for low-risk businesses; 322 SAREs have been set up in municipios; (iii) the Certification and Operating Program to certify SARE modules; and (iv) simplification of building permits in seven pilot municipios, for permits to be issued in under 36 days, requiring five steps.

[31] A program carried out by the Department of Economic Affairs through its deconcentrated administrative body, COFEMER, and the National Superior Courts Commission through the Special Commission on Improved Procedural Regulations, in coordination with the World Bank. To implement oral proceedings in commercial cases, COFEMER will cooperate with the 32 federal entities (31 states and Mexico City) in establishing: a manual of procedures, a protocol for hearings, training, architectural designs, an attorneys' manual, and technological infrastructure.

[32] A typical manufacturing company in Mexico has labor productivity of 3.14, which is lower than the Latin American and Caribbean average of 3.43. It is measured as a logarithm of the value of sales divided by employment. World Bank/IDB Enterprise Survey 2011.

sectors alike.[33] The key conditions for raising business productivity include investing in business development services (BDS) and in research, development, and innovation (R+D+I). A great deal of evidence exists showing that the use of BDS and the promotion of R+D+I help to increase business productivity.[34] The public sector's role is essential in the provision of these services because of the existence of significant market failures.[35] The program has supported the Mexican government's efforts to promote and improve the structuring of BDS and R+D+I.

1.13 Under the first programmatic loan (2993/OC-ME), essential conditions for boosting business productivity and delivering public services were overhauled. The first loan provided for the creation of the National Entrepreneurs Institute (INADEM) as the lead agency in the execution and coordination of BDS, pursuant to the government's efforts to promote and improve the structure of BDS and R+D+I. Following on this institutional framework, a Special Science, Technology, and Innovation Program (PECiTI) 2014-2018 was designed as a tool to formulate crosscutting planning elements for consolidating science, technology, and innovation capacity in all the sectors involved. PECiTI is the responsibility of the National Science and Technology Council (CONACYT) and proposals from the scientific, academic, and technological communities and the productive sector, solicited by the Science and Technology Advisory Forum, were taken into account. In addition, the National Entrepreneur Fund was established in INADEM to promote stronger entrepreneurship and business development throughout the country.[36] These regulatory and institutional efforts need to be coupled with higher spending on scientific research and experimental development.[37]

1.14 With the second programmatic loan, efforts to promote and strengthen science, technology, and innovation policies will continue, with the approval by CONACYT of the Special Science, Technology, and Innovation Program, development and publication of the strategic plan of activities for INADEM, promotion of policies to support ventures, continuity in holding meetings of the National Science and Technology Conference, and an increase in R+D+I budgets, in line with the targets established in the first program.

1.15 **Regional development and convergence.** The evolution of productivity at the regional level in Mexico's states since the early 1990s has been characterized by a

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[33] In sectors with low/high technology, Mexican productivity is 3.02 and 3.67, while the averages for Latin America and the Caribbean are 3.43 and 3.97.

[34] See a summary of the evidence in Charles Hulten (2013). "Stimulating Economic Growth through Knowledge-based Investment," OECD Science, Technology and Industry Working Papers, 2013/02, Paris; Castillo et al. (2010). *Evaluación del impacto del Programa de Reestructuración Empresarial (PRE) sobre el empleo, los salarios, y las exportaciones de las empresas Argentinas*; and Castillo et al. (2011). Innovation Policy and Employment: Evidence from an Impact Evaluation in Argentina.

[35] The main market failures are: (i) the existence of public goods; (ii) asymmetrical information problems (moral risk and adverse selection); and (iii) transaction costs. See Gonzalo Rivas. 2010. *Cuándo y cómo intervenir: Criterios para guiar las intervenciones de apoyo al desarrollo productivo*, IDB-TN-160.

[36] In 2014 and 2015, a total of 56 calls for proposals were made. The program has benefitted 394,284 MSMEs and 686,017 entrepreneurs (Source: *Informe Trimestral 2015 de los Programas Sujetos a Reglas de Operación y de Otros Subsidios*.

[37] For Mexico, the value of this indicator was constant up to 2012 at 0.43% of GDP. It has been growing in recent years, to 0.58% in 2015 (Source: SHCP), but is still a distance from the 2.37% spent by the developed countries. See the link [OECD.STAT Main Science and Technology Indicators, 2016].

lack of convergence and a high level of diversity.[38] In most of the states, structural change has been negative, i.e. the working population has moved into less productive sectors. The states in which productivity has increased have some features in common, such as: (i) a sector composition that is less skewed toward the trade sector and more focused on higher value added sectors (such as communications and financial services); and (ii) higher regulatory quality, particularly in the business climate area.[39] That is why the program called for strengthening regulatory improvements at the state level and establishing ad hoc regional programs to boost productivity. To counteract the negative structural shift toward less productive sectors that has characterized the lack of regional convergence since the 1990s and integrate all the country's regions with national and international markets, formal coordination mechanisms and programs at the federal and state levels were developed under the first programmatic loan, such as signature of framework agreements for regulatory improvement in the states. The Federal Labor Law also came into force, establishing a legal framework for the creation of State Productivity Councils (CEPs). At the sector and regional levels, criteria were defined for the establishment of three special economic zones to help narrow the gaps between the less developed regions and the rest of the country. The challenges remaining to be addressed with this new programmatic loan include territorial diagnostic assessments conducted by the relevant institutions and entities, and the development and publication of specific sector plans to boost productivity.

1.16 **Program rationale and strategy**. The proposed loan will help to consolidate the Bank as the Mexican government's strategic partner in aspects of sector knowledge for policy development, complementing the far-reaching and extensive work of the Bank in recent years, through its investment loans to improve access to financing for SMEs and financial inclusion, with the objective of improving productivity. This programmatic loan will strengthen these actions by stressing the implementation of policies that foster reforms in the financial, telecommunications, and science and technology sectors, intended to improve productivity.

1.17 **Strategic alignment.** The program is consistent with the 2013-2018 Country Strategy with Mexico (document GN-2749), which includes boosting productivity as a priority area of action,[40] with the objective of increasing the level of financing available to the real economy. Specifically, the Bank's intervention in the country will include the following strategic objectives: (i) development of financial markets; (ii) increased business competitiveness; and (iii) better governance. The program is also consistent with the Update to the Institutional Strategy 2010-2020

[38] For example, while the average annual growth rate of labor productivity (nonoil) between 1993 and 2008 in the state of Chihuahua was 1.5%, it was -1.7% in the state of Guerrero. The most disadvantaged states and those in which labor productivity increased the least were Chiapas, Guerrero, Hidalgo, Michoacán, Morelos México, Nayarit, Oaxaca, Sinaloa, Tabasco, Tlaxcala, and Veracruz. There is therefore no territorial homogeneity, since not all the northern states have lower labor productivity levels or trends than those in the south, and vice versa.

[39] Measured at the regional level in *Doing Business*.

[40] The relationship between better financing and productivity is mentioned in the program objective and rationale (see paragraphs 1.8 and 1.11), with empirical evidence provided in the Support to SMEs and Financial Access/Supervision Sector Framework Document (GN-2768-3). This program also complements other reforms promoted by the Mexican government that affect productivity, in particular the energy reform and the reforms intended to improve the quality of education and the operation of the labor market.

(document AB-3008) and is directly aligned with the development challenges of: (i) social inclusion and equality through financial reforms to improve access to credit, the national digital strategy, and emphasis on state development and convergence; (ii) productivity and innovation through an improved business climate and competitiveness and productivity within businesses; and (iii) economic integration through a review of foreign investment processes and caps. The program is also aligned with the crosscutting area of institutional capacity and the rule of law. The operation will also contribute to the Corporate Results Framework (CRF) 2016-2019 (document GN-2727-4) through its alignment to comply with the results indicator for the number of micro, small, and medium-sized enterprises financed (see Table 2 of the CRF). The program's results matrix contains an indicator for the percentage of SMEs that finance their investments with bank loans.

1.18 The operation is also consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (GN-2768-3) in the development of institutional and regulatory reforms to promote access to financing; with the Institutions for Growth and Social Welfare Sector Strategy (document GN-2587-2), since it promotes reforms to strengthen Mexican financial institutions; and with the dimensions of success and lines of action of the Innovation, Science, and Technology Sector Framework Document (GN-2791-3).

1.19 **Lessons learned.** The Bank has garnered extensive experience in designing operations in Mexico, particularly in the financial sector, through multiple investment loans that it has implemented with different public financial institutions, which have been taken into account in designing this program. This holds true, for example, of the CCLIP (ME-X1024) for productive and inclusive rural financing, which had the goal of helping to raise primary sector productivity and promote financial inclusion through access to financing and productive investments. Although the objectives of the other investment programs differ from the proposed programmatic loan, they complement each other in their promotion of access to productive credit and help to meet the vast need for investment financing faced by Mexico's productive sector to raise its productivity, covering multiple sectors and regions. Both projects include indicator monitoring and impact evaluation to measure program benefits and attribution in terms of effectiveness.

1.20 Furthermore, the program addresses the lessons learned by the Bank in the design of policy-based loans. Recent policy-based loans to strengthen financial regulation and supervision include a program with Uruguay (3627/OC-UR), one with Jamaica (3704/OC-JA), and one with Nicaragua (NI-L1096). Some of the lessons learned from the design of those programs in particular refer to the importance of: (i) effective sequencing of the reforms;[41] (ii) the country authorities' interest in promoting a reform agenda and their ownership thereof that is reflected in the alignment between the proposals and the strategies of the National Development Plan; (iii) support for the reforms through technical assistance;[42] and

[41] Since the main legal and institutional reforms begun under the first loan are consolidated in this second operation, with publication of the laws reforming the Securities Market Law, the Economic Competition Law, and the constitutional reform in the area of telecommunications, among others.

[42] The technical-cooperation project entitled "Institutional Capacities for State Policies for Productivity" (ATN/FI-14669-ME) is helping to build capacities in the policies at the state level to raise and democratize productivity in Mexico.

(iv) coordination with multilateral organizations. These lessons have been incorporated into the program's design.

1.21 **Coordination with other donors**. In accordance with international diagnostic assessments and the Bank's experience in the country, the general objective of the proposed loan is to boost productivity. This second loan of the programmatic series is coordinated with the IMF's recommendations on the stability of the financial system and complements the actions of the World Bank, the Organization for Economic Cooperation and Development (OECD), and the Andean Development Corporation (CAF)-Latin American Development Bank in areas such as regulatory improvements in the context of "Everyday Justice" throughout the region.

B. Objectives, components, and cost

1.22 **Objectives.** The overall objective of this programmatic policy-based loan series is to boost productivity in Mexico. This objective will be achieved through the following five specific objectives: (i) strengthen the institutional framework of the productivity agenda; (ii) improve the allocation of production factors through access to business financing; (iii) strengthen competition and the business climate; (iv) improve innovation and productive development; and (v) promote regional convergence in productivity.

1.23 **Beneficiaries.** The program's reforms are crosscutting and designed to surmount regulatory and financial constraints that stand in the way of the effective operation of the financial system and the productive sector, and their respective contributions to growth. Given this objective and the broad nature of the reforms, the program is expected to benefit all actors in the economy. The financing components for productive development and higher productivity within the businesses emphasize SMEs, by strengthening the actions of the public banks, improving the business climate, and building up the support system for productive development and innovation.

1.24 The program will be carried out through six components.[43]

1.25 **Component I. Macroeconomic stability.** The objective of this component is to ensure fulfillment of the conditions for a stable macroeconomic context consistent with the program's objectives and the principal points of the Policy Letter.

1.26 **Component II. Strengthening of the institutional framework of the productivity agenda**. This second operation provides for development of State Productivity Committees (CEPs) and a guide for evaluating policies from the standpoint of productivity, particularly through the approval of guidelines for the setup and operation of the CEPs. Projects have been launched for the institutional and technical strengthening of the CEPs, in accordance with international best practices.[44] This operation will also seek to develop and obtain approval of the sector programs envisaged in the PND and to adopt metrics related to the

[43] Some of the measures promoted by the program have been implemented over the last year and are the result of ongoing dialogue between the Bank and the Mexican government. They are essential to developing the agenda supported by the Bank in terms of strengthening financial regulation and the different institutions involved.

[44] A productive development strategy has been designed for the state of Chiapas under a technical-cooperation project with the IDB and Harvard University's Center for International Development. The technical-cooperation project entitled "Support for Strengthening Negotiating and Management Capacity of the CRNM" (ATN/CC-10176-RG) is also supporting the strengthening and governance of the State Productivity Committees, in coordination with the SHCP's National Productivity Committee.

budgetary and investment programs' focus on the democratization of productivity.[45] This will make it possible to thoroughly evaluate the outcomes and impacts, with a view to improving the operational efficiency and effectiveness of the interventions.

1.27 **Component III. Improved allocation of production factors through access to business financing**. This second operation continues the reform of the public development banks (PDBs), with the development and publication of PRONAFIDE to strengthen the mandate of public banks and improve their efficiency. This component also includes better administration of human capital in at least three PDBs, conferring greater flexibility and autonomy for their effective administration and organization of their internal structures, with the aim of recognizing good work and contributions to objectives. In order to attain this objective, human resources committees will be strengthened, and remuneration manuals approved.

1.28 In the capital markets sphere, progress will be made in developing and publishing regulatory guidelines and programs for access to capital markets for SMEs, and in developing and publishing secondary regulations related to investment funds.

1.29 Under the program, the Federal Economic Competition Commission (COFECE) will conduct and publish a study on competition in the financial sector, with a view to improving competition in financial services and consumer protection. Also, a system to evaluate the performance of the public banks will be developed and published by the SHCP. Lastly, the institutional strengthening of CONDUSEF is a step toward expanding the powers of the Institute for the Defense of Financial Users with the reform of the Financial Service Users Protection and Defense Law and general provisions related to transparency and abusive clauses.

1.30 With regard to the strengthening of prudential regulation, under this component the CNBV will develop and publish regulations on self-correction measures for public banking institutions and liquidity requirements for credit institutions for effective risk management and supervision.

1.31 **Component IV. Improvement of competition and the business climate**. As for stronger competition in strategic sectors, the second operation includes the publication of amendments to competition and telecommunications legislation. This programmatic loan also proposes to amend the Telecommunications Act, launch the IFT and COFECE, develop a communications and transport sector program, and develop and publish a system of indicators for telecommunications markets.

1.32 As for improvements in commercial bankruptcy proceedings and the enforcement of collateral obligations and contracts, institutional strengthening for courts in commercial matters through COFEMER activities will be carried out under this second loan.

1.33 In the area of improvements in the simplification of electronic government processes, the program will develop and publish the National Digital Strategy for information and communications technologies and information security, and programs to simplify bureaucratic requirements at the national and subnational

[45] The phrase "to democratize productivity" is used in Article 8 of the Law to Promote the Sustained Increase of Productivity and Competitiveness in the National Economy, DOF 06-05-2015, when describing sector policies whose objective is to promote the sustained and sustainable growth of the national economy at annual rates capable of absorbing the demand for jobs and significantly boosting the population's income, for the purpose of democratizing productivity in the short, medium, and long terms.

levels. It also includes a review of foreign investment processes and the raising or elimination of caps on FDI in specific sectors and publication of the corresponding policies.

1.34 **Component V. Improved productivity within businesses**. This component will support the development and publication of an INADEM strategic plan. It also includes an agreement to create and strengthen points of access to programs for entrepreneurs and SMEs in at least 15 states, the special R+D+I program by CONACYT, continuity in holding meetings of the National Science, Technology, and Innovation Conference as a point of territorial coordination, and the commitment and publication of the budget allocation for investments in R+D+I.

1.35 **Component VI. Regional development and convergence.** With this component, the program will support the establishment of a framework to improve state regulations through territorial diagnostic assessments by the relevant institutions and entities, boost state productivity, and develop and publish specific sector plans in the agriculture, services, and tourism sectors.

C. Key results indicators

1.36 The program's objective is to boost productivity. The key indicators for measuring the attainment of this objective will be the contribution of TFP to GDP and GDP growth. The TFP's contribution to GDP is expected to go from negative to positive, making for more solid growth. The program's specific objectives will be measured through the following indicators: bank credit to the private sector and SMEs as a percentage of GDP; the Boone indicator to measure competition in the financial system; the quality of capital market regulation; the effectiveness of antitrust laws; protection of legal rights; business sophistication; investment in science and technology as a percentage of GDP; and the standard deviation in productivity between states. Further details can be found in the program's Results Matrix and in the Monitoring and Evaluation Plan.

1.37 **Economic analysis**. The economic analysis estimates the impact of program-supported policies on GDP growth and calculates the difference between it and the trend production level that would have been reached in a scenario without reforms. In addition, the implementation costs of a series of program policies are discounted to obtain a net present value (NPV) for the program of US$34 billion with a discount rate of 12%. The results were analyzed for their sensitivity to variations in GDP growth projections, the expected impact of the program, and efficiency in policy implementation. In all scenarios, the NPV remains positive and significant.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

2.1 This is the second of two consecutive operations that are technically linked but independently financed under the programmatic policy-based loan modality. The amount of the second operation is US$600 million, which is in line with the country's external financing needs with multilateral agencies, as it accounts for 21.73% of those needs for 2016. It therefore meets the loan dimensioning criteria set in paragraph 3.27 (specifically, the criterion of letter "b") of document CS-3633-1, "Policy-based Loans: Guidelines for Preparation and Implementation."

B. Environmental and social risks

2.2 In accordance with Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (document GN-2208-20 and Operational Policy OP-703), this operation does not require classification. The proposed reforms have no negative environmental or social impacts.

C. Project sustainability and other risks

2.3 **Program risks.** The risk related to the sustainability over time of the measures envisaged in the program is medium, so the Bank is making a significant effort to monitor and support the current macroeconomic and fiscal conditions. However, the reforms are well advanced and budget cuts are not expected to affect their implementation. The public management and governance risk that would weaken implementation of the reforms due to the lack of coordination or technical capacity on the part of the Government of Mexico or the lack of coordination between federal government entities and the states is considered low because: (i) the policy commitments are aimed at addressing institutional and managerial weaknesses; (ii) the country's technical capacities are satisfactory; and (iii) a Bank technical-cooperation project is being implemented to build capacity.[46]

2.4 **Sustainability of the results.** This second program in the programmatic series will help to consolidate implementation of the reforms supported in the context of the Mexican government's priorities, and complements the extensive work performed by the Bank in recent years, particularly through programs to finance Mexican public financial institutions, intended to boost sector productivity (see paragraph 1.6). More specifically, the proposed public actions are consistent with the targets established by the SHCP for the 2013-2018 National Development Plan.[47] In turn, the Bank's contribution through the programmatic conditions agreed upon with the SHCP and the outputs of the technical-cooperation projects (Institutional Capacities for State Policies for Productivity-ATN/FI-14669-ME and the Mexican National Broadband Plan-ATN/OC-13987-ME) reinforce the program's development objectives and expected outcomes.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The executing agency will be Mexico's SHCP, as the department responsible for coordinating all of the country's development planning. The SHCP has designated

[46] The technical-cooperation project "Institutional Capacities for State Policies for Productivity" (ATN/FI-14669-ME) is providing institutional strengthening for the less developed states to reduce poverty through job creation and higher productivity, through the State Productivity Councils. International best practices in telecommunications services and simplification of e-government processes were analyzed under the technical-cooperation project "Mexican National Broadband Plan" (ATN/OC-13987-ME).

[47] Particularly with regard to objective 5 (to promote inclusiveness, education, competition, and transparency of the financial, insurance, and pension systems to increase their penetration and coverage while maintaining their soundness and security) and objective 6 (to expand credit for the development banks, facilitating access to financial services in strategic sectors, with greater private sector participation), for which indicators are calculated and monitored annually.

its Economic Productivity Unit as the program coordination unit (PCU),[48] in cooperation with the International Affairs Unit and in coordination with the Department of Economic Affairs. The PCU will be responsible for: (i) supporting the institutions involved in implementation; (ii) coordinating execution; (iii) submitting the work plans and progress reports; and (iv) monitoring compliance—as planned and on schedule—with the Policy Matrix (Annex II).

3.2 **Special contractual conditions precedent to the single disbursement of the loan. Disbursement of the proceeds from the Bank's loan will be contingent on fulfillment of the policy reform conditions set forth in the Policy Matrix (Annex II), the Policy Letter, and the conditions established in the loan contract.**

B. Summary of results monitoring arrangements

3.3 Program implementation will be monitored by the PCU, which will send periodic information and track the means of verification of the program reforms. The borrower and the Bank will hold quarterly meetings to review fulfillment of the policy commitments. At the end of the series, the Bank will prepare a Project Completion Report and an ex post evaluation (see the Monitoring and Evaluation Plan and the Economic Analysis). The evaluation will be the responsibility of the Capital Markets and Financial Institutions Division (IFD/CMF), with support from the Office of Strategic Planning and Development Effectiveness (SPD).

3.4 Given the diversity of components, the program's impact evaluation will examine the impacts of two of the reforms (financial reforms and reforms involving the telecommunications sector) separately. The synthetic control method will be used. In the first instance, the impact of the financial sector reforms on the level of financial depth will be measured as a percentage of credit to the private sector over GDP. For the telecommunications sector reforms, their impact on sector revenue as a percentage of GDP will be measured. Lastly, an exercise will be performed to evaluate the impact of the program as a whole based on more aggregate variables such as GDP and total factor productivity. The baseline information for both evaluations is publicly available through the World Bank's international databases (World Development Indicators and Global Financial Development) and from the International Telecommunications Union.

IV. POLICY LETTER

4.1 The Policy Matrix for the proposed program is aligned with the Policy Letter issued by the Government of Mexico, which reaffirms the government's commitment to implement the activities agreed upon with the Bank for the programmatic series.

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[48] With two bureaus and reporting directly to the Secretary, the functions of the Economic Productivity Unit include promoting the efficient use of productive resources, in cooperation with the agencies of the federal public administration, local governments, and the economic, private, and social sectors.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality -Productivity and Innovation -Economic Integration -Institutional Capacity and the Rule of Law**		
Regional Context Indicators	**-Growth rate of GDP per person employed (%) -Global Innovation Index (LAC average) -Research and development expenditure as a percentage of GDP (%)**		
Country Development Results Indicators	**-Micro / small / medium enterprises financed (#)**		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2749**	**Increase the level of finance to the real economy.**	
Country Program Results Matrix	**GN-2805**	**The intervention is included in the 2016 Operational Program.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Evaluable**	**Weight**	**Maximum Score**
	8.2		**10**
3. Evidence-based Assessment & Solution	**9.6**	**33.33%**	**10**
3.1 Program Diagnosis	**3.0**		
3.2 Proposed Interventions or Solutions	**3.6**		
3.3 Results Matrix Quality	**3.0**		
4. Ex ante Economic Analysis	**7.0**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**2.0**		
4.2 Identified and Quantified Benefits	**2.0**		
4.3 Identified and Quantified Costs	**2.0**		
4.4 Reasonable Assumptions	**0.0**		
4.5 Sensitivity Analysis	**1.0**		
5. Monitoring and Evaluation	**8.1**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**1.0**		
5.2 Evaluation Plan	**7.1**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Low**		
Identified risks have been rated for magnitude and likelihood	**Yes**		
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation			
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)			
Non-Fiduciary	**Yes**	**Strategic Planning National System, Monitoring and Evaluation National System.**	
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	**Yes**	**The Bank has supported the sector with the following Technical Cooperations: ME-T1260, ME-T1187, and ME-T1670.**	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan	**Yes**	**The evaluation plan proposes a synthetic control methodology to estimate the impacts of the reforms. This would be a novel approach to be applied in the country as to evaluate this type of reforms.**	

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The "Program to increase productivity in Mexico II" (ME-L1186) is the second operation of a programmatic series of two policy based loans. The objective of the series is to improve productivity in Mexico. To achieve this goal, the second operation (for up to US$600 millions) will encourage regulatory and institutional changes through five components (aside of that of macroeconomic stability): i) strengthening of the institutional framework for the productivity agenda; ii) improvement of firms' access to finance; iii) improvement of competitiveness and business climate; iv) improvement of firms productivity and v) strengthening of the regional convergence on productivity aspects.

There is clarity in the diagnosis of the problem, which is low productivity, as well as in the description of its two principal causes. The first one is related to distortions in the allocation of productive factors across economic sectors, such as credit constraints and poor business climate (issues related to competition, inefficient contractual and regulatory framework, quality of education, and policies that stimulate informality). The second cause is the presence of constraints that deter productivity improvements in the firms, such as limited R&D or poor human capital. The diagnosis is also well articulated with the proposed solutions as it can be seen in the specific components of the program.

This second operation maintains the validation of the General Economic Analysis methodology approved in the first operation of the series. However, standards for benefits and costs estimation based upon a general equilibrium model are encouraged for future programmatic loans.

The Monitoring plan defines the means of verification that are necessary to conduct accountability of the delivery of outputs and the achievement of results. The Evaluation plan presents a proposal for the estimation of impacts of the reforms based upon a synthetic control methodology.

The program is expected to face low risks.

POLICY MATRIX

Policy objectives	Agreements Loan I	Agreements Loan II
I. Stable macroeconomic framework		
Macroeconomic framework	Maintain a stable macroeconomic framework conducive to the achievement of the program's objectives.	Maintain a stable macroeconomic framework conducive to the achievement of the program's objectives.
II. Strengthening of the institutional framework of the productivity agenda		
Establish the objective of boosting productivity as a priority pillar of the 2013-2018 National Development Plan (PND).	Approval of the PND, including democratization of productivity as a cross-cutting strategy of the government's economic policy.	
Establish a framework that structures and informs the dialogue between all public, private, and social actors involved in the productivity agenda.	Creation of the National Productivity Committee as an advisory body to the executive branch of government, for the purpose of setting objectives, goals, strategies, actions, and priorities in the areas of productivity and employment. Creation of a Business Advisory Council for the Economic Growth of Mexico that will serve as a link between the federal government and the country's business sector, and will be responsible for coordinating actions for the formulation of policies and programs aimed at promoting sustained economic growth.	Approval of guidelines for the setup and operation of the State Productivity Committees, in a manner consistent with the objectives of the Special Program to Democratize Productivity.
Formulate principles and guidelines for action in the area of productivity.	Approval by the executive branch of a Special Program to Democratize Productivity, which defines the basic principles for the federal government's actions in the area of productivity.	Approval of the sector programs included in the PND that are consistent with the Special Program to Democratize Productivity Definition and adoption of the metrics for guiding the budget and investment programs toward the democratization of productivity through publication of the corresponding rules.

Policy objectives	Agreements Loan I	Agreements Loan II
III. Improved allocation of the factors of production through access to business financing		
(i) Reform public development banks (PDBs)		
Strengthen the mandate of public development banks (PDBs) in order to improve their effectiveness.	Introduce a bill to Congress to amend the Credit Institutions Law and laws regulating the country's PDBs, in order to clearly include the following in their mandates: (i) facilitate access to credit and financial services, particularly for small and medium-sized enterprises (SMEs) and agricultural producers; and (ii) serve the country's strategic and priority sectors, taking gender equality criteria into account.	Formulate and publish the National Development Financing Program, taking into account the new mandate defined in the financial reform.
Make the operation of PDBs more flexible in order to enhance their efficiency and effectiveness.	Introduce the bill to Congress to amend the Credit Institutions Law in order to: (i) increase the authority of PDBs to formulate a human resources policy; (ii) focus the work of the Boards of Directors of PDBs on strategic issues and increase the operational functions and information transfer duties of the officers of the PDBs; and (iii) clarify the limits and objectives of the investment policy and reduce constraints on their operations.	Develop a wage and human resources policy in at least three PDBs that ensures the attraction and retention of talent, through: (i) the creation of Human Resource Committees with the power to propose organizational and human resource policy improvements; and (ii) approval of Compensation Manuals.
(ii) Strengthen capital markets		
Increase efficiency and legal certainty in the operation of the securities market in order to increase access to the capital market.	Introduce a bill to Congress to amend the Securities Market Law, in order to: (i) provide more flexible investment and information programs that facilitate SMEs' access to the capital market.; (ii) establish the legal framework and types of credit instruments based on the type of investment; (iii) eliminate restrictions to the participation of the general investing public in the securities market; and (iv) authorize and facilitate capital market integration arrangements.	Develop and publish regulatory guidelines and programs to provide SMEs' access to the capital market, in accordance with international best practices.
Increase investment firms' ability to attract and diversify investments.	Introduce a bill in Congress to amend the Investment Firms Law and the Securities Market Law in order to: (i) adapt the corporate structure of the investment companies to operate as investment funds; and (ii) regulate the service providers of investment firms, in accordance with international best practices.	Develop and publish the secondary regulation related to investment funds by the National Banking and Securities Commission.

Policy objectives	Agreements Loan I	Agreements Loan II
(iii) Increase competition in the financial sector		
Increase the mobility of users in the financial products and services market.	Introduce the regulatory framework for competition to Congress in order to increase the mobility of users in the market, through the following actions: (i) reduce restrictions on the transfer of consumer loans between financial institutions; (ii) prohibit making the granting of loans or operations contingent on the purchase of services (iii) allow financial institutions that are part of a financial group to offer the financial products and services of other institutions; and (iv) facilitate the portability of secured loans between financial institutions, which are intended to purchase, construct, remodel, or refinance housing. Eliminate restrictions on foreign direct investment (FDI) in the capital stock of financial institutions, such as insurance companies, auxiliary financial institutions, multipurpose financial institutions, and credit unions.	Have the Federal Economic Competition Commission (COFECE) conduct and publish a study on competition in the financial sector, including recommendations on guidelines for increasing competition in the sector. Have the Department of Finance develop and publish a system to evaluate the operations of banking institutions and their compliance with the provisions of the financial reform.
Increase the availability of credit information and the protection and defense of financial service users.	Amend the Financial Service User Protection and Defense Law and other related laws in order to: (i) grant more powers to the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) to regulate contracts, oversee the quality of financial information available to users, and enable the establishment of a financial institutions bureau; and (ii) strengthen the arbitration system for financial matters, in order to settle disputes between financial institutions and customers.	Strengthen CONDUSEF by improving its internal procedures, coordination with actors, and budget and staff allocations through publication of the corresponding amendments to its charter, the Law for the Protection and Defense of Users of Financial Services, and provisions applicable to financial institutions.
(iv) Strengthen prudential regulation		
Strengthen the autonomy and capacities of prudential regulation institutions.	Introduce a bill in Congress and/or submit it to the appropriate administrative bodies to amend financial legislation to include the following measures: Legal strengthening of the autonomy and capacity of the National Banking and Securities Commission (CNBV) in the area of prudential regulation, in order to: (i) supervise currency exchange centers and money transmitters, auxiliary credit organizations,	Have the CNBV develop and publish regulations on self-correction measures and liquidity requirements.

Policy objectives	Agreements Loan I	Agreements Loan II
	multipurpose financial institutions, credit unions, and investment fund service providers; and (ii) strengthen the information exchange system.	
Improve prudential regulation.	Strengthen the regulatory framework for credit unions, multipurpose financial institutions, and auxiliary credit organizations, in order to: (i) improve corporate governance and the transparency of their operations; and (ii) clearly regulate entry and exit conditions when conducting operations. Amend the Financial Groups Law pursuant to Basel II standards, in order to: (i) improve the corporate governance of holding companies; (ii) increase the oversight capacity of the authorities in charge of liquidating financial groups; (iii) improve coordination with authorities in other countries in charge of the oversight of financial conglomerates; and (iv) introduce limitations to operations with related persons that may be carried out by a credit institution, as well as noncompliance penalties.	
IV. Improvement of competition and the business climate		
(i) Increase competition in strategic sectors		
Strengthen the regulatory framework for competition.	Implement a regulatory framework for competition that includes: (i) granting more autonomy (constitutional autonomy) to the Federal Economic Competition Commission (CFCE), and making a distinction between its analysis duties and its commissioner duties; and (ii) granting greater regulatory capacity to the CFCE, particularly with respect to the regulation of essential inputs, and ordering the divestiture of assets and rights, to prevent competition problems.	Publish the amendment to the Competition Law, to include new COFECE mandates and capacities.
Increase competition in the area of telecommunications and audiovisual services	Implement a new framework for competition in the telecommunications and broadcasting sector, which includes: (i) reducing barriers to entry, particularly of FDI; (ii) creating the Federal Telecommunications Institute (IFETEL) as the regulatory agency for the sector and defining its responsibilities; (iii) increasing autonomy, regulatory capacity, and ability to assess	Publish the amendment to the General Telecommunications Law and principal secondary regulations. Publish the regulations governing the start of operations of IFETEL and COFECE. Develop and publish a communications and transportation sector program (2013-2018)

Policy objectives	Agreements Loan I	Agreements Loan II
	penalties for the regulatory agency, particularly in the area of abuse of dominant position; and (iv) improving the efficiency of the judicial branch in the area of telecommunications.	Develop and publish a system of indicators for telecommunications markets.
(ii) Improve bankruptcy proceedings and the enforcement of collateral obligations and contracts		
Increase the efficiency of bankruptcy proceedings.	Introduce an amendment to the Commercial Bankruptcy Law in order to streamline the bankruptcy process, incorporate more modern and standardized technological and accounting mechanisms, and strengthen the rights of creditors and merchants. Introduce the amendment to the Judiciary Law in order to increase specialization in commercial matters and make case assignment more efficient.	Institutional strengthening of the courts in commercial matters through activities of the Federal Regulatory Improvement Commission (COFEMER).
Improve efficiency in the enforcement of collateral obligations.	Introduce an amendment to the Commercial Code to shorten time periods and increase the enforceability of public documents. Introduce an amendment to the General Law on Negotiable Instruments and Credit Transactions that includes the option of transferring the ownership of pledged securities without the need for a judicial proceeding.	
(iii) Further simplify electronic government processes		
Make government management more flexible and efficient	Create a National Digital Strategy Coordination Office in a single unit responsible for coordinating the National Digital Strategy on information and communications technologies, in coordination with public administration offices.	Develop and publish a National Digital Strategy to simplify business requirements and electronic government (e-government).
Reduce regulatory burdens	Introduce a bill to Congress to amend the Commercial Code and Commercial Companies Act, which will simplify administrative transactions in order to facilitate business activities and strengthen the rights of minority shareholders, in accordance with international best practices	Develop and publish a program to simplify bureaucratic requirements at the federal, state, and municipal levels, in accordance with international best practices, as well as its outcomes. Review processes and foreign investment caps, with the objective of increasing productivity and competition, and publish the corresponding policies.

Policy objectives	Agreements Loan I	Agreements Loan II
V. Improved productivity within businesses		
Institutional strengthening and promotion of policies on entrepreneurship and innovation.	Create the National Entrepreneurs Institute (INADEM) as a tool to: (i) execute and coordinate the national policy to support entrepreneurs and SMEs; and (ii) promote innovation, competitiveness, and entry into national and international markets in order to increase SMEs' contribution to economic development. Have INADEM identify strategic sectors for business development and entrepreneurship at the state level.	Develop and publish the Strategic Work Plan for INADEM. Create and strengthen points of access to programs related to entrepreneurs and SMEs in at least 15 states in the nation.
Institutional strengthening and promotion of science, technology, and innovation policies.	Strengthen the regulation and governance of science, technology, and innovation policies: (i) set up a science, technology, and innovation coordination office in a single administrative unit in the Office of the President of the Republic, in charge of heading and efficiently coordinating the efforts of the various actors in the sector; (ii) set a goal of national investment in science, technology, and innovation of at least 1% of GDP by 2018; and (iii) increase the budget allocation for the 2013 fiscal year earmarked for Research, Development and Innovation (R+D+I) by 10%.	Have the National Science and Technology Council (CONACYT) approve and publish the Special Science, Technology, and Innovation Program. Continue to hold meetings of the National Science, Technology, and Innovation Conference in order to improve the coordination of CONACYT with the states, as reflected in the respective proceedings and resolutions. Allocate budget resources so that the national investment in R+D+I increases annually and reaches the established R+D+I investment goal, and publish the corresponding allocations.
VI. Regional development and convergence		
Definition of a policy for specific regions and sectors in order to integrate all of the regions in the country into national and international markets.	Sign a framework agreement for cooperation between the Federal Commission on Regulatory Improvement and the Mexican Economic Development Association to promote increased and more effective collaboration between the Federation and the federal entities with regard to improving and simplifying regulations on entrepreneurial activity. Entry into force of the Federal Labor Law establishing a legal framework for creating State Productivity Committees.	Have the relevant institutions and entities conduct specific territorial diagnostic assessments to increase productivity in at least three states. Develop and publish specific sector plans to increase productivity, preferably in the agriculture sector, the services sector, and/or the tourism sector.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/16

Mexico. Loan ____/OC-ME to the United Mexican States
Program to Boost Productivity in Mexico II

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the United Mexican States, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the Program to Boost Productivity in Mexico II. Such financing will be for the amount of up to US$600,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___ __________ 2016)

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