

INITIAL PID

25851

Country Name	Mexico
Loan name	Rural Finance Development Structural Adjustment Loan (RFDSAL)
Region	Latin America and the Caribbean
Sector	Finance
Proposed ID	P074655
Borrower	The Mexican Federation
Implementing Agency	Financiera Rural (<i>Rural Finance Agency</i>) General Director: Dr. Jose Antonio Meade Baja California No. 261 Colonia Hipódromo Condesa Ciudad de México México Telephone: 52 55 5230 1602
Date this PID Prepared	April 14, 2003
Project appraisal date	April 21, 2003
Project Board Date	June 12, 2003

Country Sector and background

Mexico has completed the restructuring and recapitalization of the commercial banks affected by the 1994-1995 crisis. The challenge now is the restructuring of the development banks which are increasingly out of step with the now more efficient private banks. The Government's efforts to restructure the development banks focus in three areas: (i) legal and institutional reforms to promote and strengthen non-bank financial intermediaries and popular banking; (ii) legal and regulatory reforms to improve the governance and accountability of development banks and subject them to the same regulation and supervision as commercial banks. These reforms also aim at promoting the operational efficiency and cost effectiveness of development banks, and limit the losses that they may cause to the Treasury; and (iii) restructuring of development banks emphasizing their role of development agencies in charge of developing the financial markets in areas not well covered by the private banks. As development agencies, these institutions are funded directly through the budget, ceasing to take deposits from, and issue debt to the public. Their lending activities are (over time in some cases) limited to second-tier lending through banks and non-bank financial intermediaries, and their capacity to provide subsidies is limited, making those that they provide more targeted and transparent.

Loan Objectives and Description

The proposed loan would support the liquidation of BANRURAL, the worst performing public bank in Mexico, replacing it with a new Rural Finance Agency, a non-banking decentralized agency, in charge of promoting the development of rural

financial markets as well as providing credit for rural activities. The new Rural Finance Agency is funded directly through budgetary allocations; it must maintain the value of its capital endowment; report periodically to Congress, lend to low and middle income rural producers; move, over time, to second-tier lending and; eventually, cease to lend and concentrate on development activities. The new Rural Finance Agency will expand access to credit to traditionally underserved low and middle income rural producers (lower income rural producers will have access to new subsidized programs), but do this in a financially sustainable way. The proposed loan would be disbursed in three tranches. Conditions for tranche disbursements have been designed to be closely linked to building a financially viable rural finance agency.

Loan financing

The proposed loan will be for US\$500 million.

Project Implementation

The implementing agency will be the Rural Finance Agency.

Program sustainability

The Government has already taken important steps in implementing its development banks reform program. A new **Organic Law for the National Rural Finance Agency** was approved in December 2002. The law establishes a transition period for the disposition of assets and liabilities of BANRURAL and the creation of the Rural Finance Agency, which will start operating in July 2003. Congress also approved a modification to the Income Law of the Mexican Federation for the Fiscal Year 2002, to include a budgetary allocation of up to M\$48.9 billion to fund the dissolution and liquidation of the BANRURAL system and the initial capital endowment of the new agency. The management of the new agency is in the process of: (i) establishing an organizational structure and branch network; (ii) identifying its client base, loan products and distribution system, (iii) developing a Strategic Plan and a Financial Plan, and (iv) setting up the necessary infrastructure to meet the lending plan, including the development of a credit manual and other normative documents, a basic cost accounting, and a management information system.

Lessons learned from past operations in the country/sector

Lessons learned from past banking sector operations in Mexico and other countries in Latin America have been taken into account in the design of this operation. These include: (i) banking sector operations should set limited objectives. It is more realistic to support a program of reforms with sequential operations that address specific aspects of the program and build upon the success of the previous ones; (ii) tranching operations are useful when the banking sector reforms are complicated, time-intensive, and have to be implemented in stages. Mexico has a good track record with tranching operations; and (iii) loan disbursements should be linked to

the enactment of major pieces of legislation and the completion of specific bank resolution actions.

Poverty category

The measures supported by this operation would have important long-term social implications as they would stimulate the provision of prudent lending to the rural sector, with the associated benefits in terms of output growth, employment generation and poverty alleviation. The objective of closing of BANRURAL and creating the new Rural Finance Agency is to transform an inefficient public bank into a development agency that would help strengthen the market infrastructure for rural finance and promote the development of the financial markets; while phasing out its activities as first tier lender. The new agency would promote sustainable access to financial markets of rural producers and small enterprises, today largely excluded from bank financing. Greater access to credit by small and medium rural producers would create more job opportunities, an important objective in a country with a high level of disguised unemployment. Furthermore, the closing of BANRURAL, the public bank that generates the largest fiscal losses, and the creation in its place of a financially sustainable agency, will free fiscal resources to fund needed social programs.

Environmental aspects

This operation would not have any direct effect on the environment. For that reason, it has been placed in Category "C", in accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.00 Annex A).

Program Objective Category. The Program Objective Category is Economic Management (EA).

Contact Points

Mariluz Cortes
Lead Operations Officer
The World Bank
1818 H Street NW
Washington, D.C. 20433
Room I-5077
Telephone: (202) 473-0029
Fax: (202) 522-2106
mcortes@worldbank.org

The World Bank InfoShop
The World Bank
1818 H Street NW
Washington, D.C. 20433

Telephone: (202) 458-5454

Fax: (202) 522-1500