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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED

TAX REFORM ADJUSTMENT LOAN

IN THE AMOUNT OF US$303.04 MILLION

TO THE

UNITED MEXICAN STATES

May 20, 2002

Poverty Reduction and Economic Management
Colombia Mexico and Venezuela Country Management Unit
Latin America and the Caribbean Region

CURRENCY EQUIVALENTS
Currency Unit = Peso
9.4675 pesos = US$1

WEIGHTS AND MEASURES
Metric System

FISCAL YEAR
January 1 - December 31

ABBREVIATIONS AND ACRONYMS

Banco de Mexico	Central Bank
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CIT	Corporate Income Tax
ConTigo	With You
Crédito al Salario	Government Subsidy for Salaries
GDP	Gross Domestic Product
GEF	Global Environmental Facility
IDB	Inter-American Development Bank
IMF	International Monetary Fund
INEGI	Instituto Nacional de Estadística, Geográfica e Informática (*National Statistics Institute)*
NAFIN	Nacional Financiera *(National Financing Agency)*
OECD	Organization for Economic Cooperation and Development
Oportunidades	Opportunities
PEMEX	Petróleos Mexicanos *(State-Run Petroleum Company)*
PIDIREGAS	Proyectos de Impacto Diferido en el Registro del Gasto *(Government Subsidy for Private Investment with Public Benefits)*
PIT	Personal Income Tax
PROGRESA	Programa de Educación, Salud y Alimentación
PRONAFIDE	Programa Nacional de Financiamiento del Desarrollo (*Education, Health and Food Program*)
PSBR	Public Sector Borrowing Requirement
SAL	Structural Adjustment Loan
SAT	Sistema de Administración Tributaria *(Tax Administration Service)*
SHCP	Secretaría de Hacienda y Crédito Público, (*Finance and Public Credit Secretariat*)
TRAL	Tax Reform Adjustment Loan
VAT	Value Added Tax

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PROPOSED TAX REFORM ADJUSTMENT LOAN
Loan and Program Summary

Borrower:	United Mexican States
Implementing Agency	Secretaría de Hacienda y Crédito Público, (SHCP) (Finance and Public Credit Secretariat)
Amount:	US$ 303.04 million
Terms:	Fixed-spread variable interest rate loan in US dollars, with a single repayment of principal in 10 years.
Commitment Fee:	0.85% per annum during the first four years and 0.75% per annum thereafter on undisbursed loan amounts, beginning to accrue sixty days after the loan agreement is signed.
Front-end fee:	1% of the loan amount, to be financed under the loan.
Objectives:	The proposed loan will support the first stage of the Government's fiscal reform program; the first stage focuses on the corporate and personal income taxes. Mexico needs to strengthen its tax system to sustain macroeconomic stability, which is essential, though not sufficient for growth and poverty reduction. Since most of the fiscal benefit of these measures will come in the medium term as the reduced tax distortions contribute to higher sustainable growth of private sector, the financing of the loan will help the Government assure fiscal sustainability and thus macroeconomic stability in the meantime. The eventual growth of fiscal resources will contribute to debt reduction, and in the short run the loan will help avoid a fiscal contraction, which would be counterproductive in the present environment. Raising more resources from a stronger tax system is essential for expanding the Government program of social sector services and infrastructure investment. Finally, by simplifying the tax policy to administer, the policy reforms will contribute to the Government's programs for Reform of the State and reduction of corruption.
Description:	The proposed operation will support key reforms to the Mexican tax system. In the area of corporate income taxes, the new law i) eliminates the special cash-flow regime for calculating income for the agriculture and road transport sectors; ii) simplifies the inflation adjustment regime, just using the annual price index to calculate real change in

monetary assets and liabilities; iii) eliminates the reduced tax rate for retained earnings, thus unifying the corporate and maximum personal tax rates at 35 percent, and reduces the rate gradually to 32 percent by 2005; iv) limits the corporate deductions for payment of fringe benefits to non-union workers; and v) phases out the reduced tax rate for the publishing industry, bringing the rate there up to the standard rate by 2006. In the area of personal income taxes, the new law i) aggregates all the taxable income of an individual and taxes it at the corresponding progressive rate; ii) simplifies the structure of rates, reducing the number to five by 2005; iii) reduces the government subsidy (*credito al salario*) for workers in the formal sector and provides incentives for firms to continue paying it; and iv) simplifies the tax regime for individuals with entrepreneurial activity.

Benefits and Risks:

The expected benefits of the operation are more growth due to reduction of distortions in the tax system, enhanced macroeconomic stability, more equity in the personal income tax code, and more tax resources to finance social programs. The reforms supported by the loan are expected to bring an additional 0.9 percent of GDP, compared with tax revenues of about 11.4 percent of GDP previously. The risks of the operation itself are mainly the implementation of the reformed tax system, which a simultaneous technical assistance project (US$ 82 million total size, with US$52 million of Bank lending) aims to strengthen over the next four years.

Implementing the subsequent phases of the Government's overall fiscal reform, in the tax area and other areas, faces risks despite the strong commitment of the executive. Key parts of the agenda require changes in the law and even the Constitution, which will require approval of the Congress and sometimes even the states. This, in turn, requires a political consensus that is harder to obtain now in a more competitive political environment. There is also a general macroeconomic risk of appreciation of the real exchange rate, which recent fiscal tightening tries to combat and would counteract even more with stronger taxation.

Poverty Category: Not Applicable.

Estimated Disbursement **July 2002**

Project ID Number: **P074750**

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MEXICO

PROPOSED TAX REFORM ADJUSTMENT LOAN (TRAL)

DRAFT PRESIDENT'S REPORT

I. INTRODUCTION AND RATIONALE

1. To continue the modernization of its economy and reduction of poverty, the Mexican Government, which took office in December 2000, is engaged in a program of Fiscal Reform. The overall program, described in the Letter of Development Policy, has seven main areas; three involve taxation—Tax Policy, Tax Administration, and Subnational Finances—and the four others are important for improving the use of fiscal resources—Fiscal Discipline and Transparency, Budgetary Reform, Energy Pricing Policy, and Federal Spending Policy. The proposed loan supports the first phase of reform in the Tax Policy area. In some other areas the Bank has already provided lending support (Subnational Finances, with the Decentralization Adjustment Loan, approved December 1999) or prepared projects to do so (Tax Administration Institutional Development, proposed loan in FY02). The government recognizes that it needs to invest more in human resource development and public economic infrastructure, to complement investment in the private sector. Without overburdening or crowding out the private sector, which must remain the main engine of growth, the public sector needs to increase its resources and reduce its dependence on the oil sector.[1] To meet these objectives, Mexico's fiscal reform efforts are balancing six criteria for success:

i. Increasing tax revenue. This is needed both to finance the Government's programs for poverty reduction and economic development and to keep its finances stable.
ii. Improving efficiency of the private sector, by reducing the distortions in tax incentives for resource allocation.
iii. Improving equity of the public sector. This would come in three ways from the tax reform—assuring that it puts no excessive burden on the poor, making the burden of taxes more equal among people with the same level of income, and channeling the increased revenue into poverty reduction programs.
iv. Making taxes simpler to administer.
v. Making the federalism system more balanced and incentive compatible.
vi. Being politically feasible.

2. No reform can achieve the maximum in all of these dimensions, for they compete to some extent, but a good reform needs to make at least some improvements in all of them and substantial improvements in several. The tax reforms that take effect in 2002 make important progress in these dimensions, and consequently the Government has requested that the Bank complement its analytical and technical support with financial support, in the form a US$303.04 million Tax Reform Adjustment Loan, as proposed in this document. The document also

1. World Bank 2001, *Mexico: Country Economic Memorandum: Challenges and Prospects for Tax Reform*; World Bank 2000, *Mexico: Fiscal Sustainability.*

explains the government's wider program of tax reforms and other fiscal reforms, which form the context of this operation.

3. The experience in Mexico, especially in the 1990s, shows that macroeconomic sustainability and stability are essential, although not sufficient, conditions for reducing poverty and continuing growth. The analytic involvement and financial support of the Bank contribute to the quality and credibility of the reforms and thus helps protect the growth and poverty-reduction process. The rationale for adjustment lending in this situation is also that the beneficial revenue effects of the 2002 reforms described below will come mainly in the medium term, and in the meantime the financial assistance from the Bank will the reduce the government's borrowing costs and thus help it meet its targets for fiscal adjustment.

II. THE FISCAL POLICY CHALLENGES IN MEXICO

a) Recent Economic Developments

4. After an extended period of strong expansion, economic activity in Mexico experienced a sharp slowdown during 2001 as the downturn in the global economy, and in particular in the U.S. economy, spread across emerging markets. Growth of Mexican manufactured exports, nine tenths of which go to the United States, plummeted from an average annual growth rate of 20 percent to minus 3 percent last year. Such a pronounced drop in external demand and the related slump in manufacturing investment led to a contraction of real GDP growth during 2001, down to -0.3 percent, in contrast to the 5.6 percent average annual growth rate observed over the preceding five-year period.

5. Even during the contraction, the economy proved resilient in many ways—thanks in large part to sound macroeconomic management. Whereas during the rapid economic expansion of 2000 there was a relatively expansionary fiscal stance and a tight monetary policy, the new authorities during 2001 targeted a lower budget deficit (0.65 percent of GDP), and implemented budget rules automatically cutting expenditures when revenues turn out lower than budgeted. Monetary policy was eased, although cautiously, in the face of strong capital inflows, weakening of domestic demand, and lower inflation expectations. Cautious monetary management, the appreciation of the currency (due to the strength of capital inflows), and the slowdown in growth, all combined to keep inflation in check—the 2001 year-end inflation rate fell to 4.4 percent, well below the initial target of 6.5 percent. The exchange rate has remained stable, in the same range where it has been for the past 3 years.

6. The external accounts remained manageable. The balance of payments' current account deficit stayed practically unchanged from the previous year (at 2.8 percent of GDP), as lower manufacturing export revenues and lower oil prices were largely offset by a similar reduction in imported intermediate inputs and capital goods. Mexico has continued to enjoy favorable access to external financing and steady investment flows. This simultaneously allowed for the bulk of the current account's deficit to be financed through foreign direct investment, an accumulation of international reserves, a strengthening of the peso, a reduction in private investors' perception of country risk as measured by sovereign bond spreads, and a significant reduction of domestic interest rates. As of March 2002, Mexico's sovereign bonds have investment-grade rating by all three major international rating agencies, making it possible for a broad range of foreign institutional investors to buy Mexican bonds. The economy thus seems well positioned for a

strong recovery upon the rebound of economic activity in the United States, expected in the second half of 2002.

b) Tax Policy

7. Since the late 1970s, Mexico has carried out a number of reforms aimed at establishing an adequate and effective tax system. Many of the instruments of modern tax policy are in place, including income and value-added taxation at the national level and property taxation at the local level. Income taxes are integrated between the corporate and personal levels, with indexation for the effect of inflation on net asset values. A corporate asset tax backs up the corporate income tax and is creditable against it. A value-added tax replaced scattered and often competing sales taxes.

8. Nevertheless, the reforms up to 2001 have not yet borne the expected fruit:

- Increased resources for growth and poverty reduction through provision of adequate social services and economic infrastructure;
- Reduced distortions in the tax environment for private sector growth; and
- Improved accountability of the public sector to the taxpaying citizens.

9. Over the last ten years it has become clear that Mexico needs greater non-oil tax revenues, sustainable in the long term, in order to provide for more public expenditure in areas such as poverty alleviation, health, education, and infrastructure, as well as to pay for the recent social security reform and banking sector support. Regular tax revenue, net of petroleum and social security revenue, is only about 11.4 percent of GDP, which is the lowest in the OECD and lower even than most Latin American countries. The oil-revenues will probably at best stay constant in real terms, so growth in the Mexican economy and its requirements for public services will need an increasing share of financing to come from non-oil taxes. Mexicans are not paying enough taxes to cover the public expenditure that they want because of problems in the tax system itself, which are the focus of the part of the program supported by this loan. The failure of tax policy and administration to collect enough resources to pay for the public services people want goes back to an endemic problem—that that people do not perceive that the taxes are fair in practice. Tax policies and how they are administered have let some people and businesses pay much less tax than others with the same levels of income. Thus a central objective of the tax reform is to make it more fair.

10. **Corporate income tax**. The income tax is the most important source of revenue, and the corporate income tax (CIT) is the most important part, bringing in over 2.5 percent of GDP in the late 1990s, including the tax on the self-employed. Prior to the reforms at the very end of 2001, the standard regime of the CIT applied a rate of 35 percent to corporate income (profit), including net real capital gains, adjusting for inflation in a complex way, which thwarted the sophisticated objectives of the law and made compliance and enforcement more costly. On retained earnings firms paid a reduced rate of 30 percent, with the remaining 5 percent deferred until the earnings were paid out. The corporate tax is integrated with the personal income tax, so that, at least in principle, individuals pay tax only on profits that have not been previously taxed at the corporate level, and they pay at the same rate whether profits are received via capital gains or distributed dividends. The unification of the personal and corporate income tax in Mexico is an important strength of the system—eliminating double taxation—which will show more

clearly when other defects of the system are eliminated. Since 1989 an asset (net worth) tax of 1.8 percent was introduced to deter evasion and complement the CIT, against which it is creditable. The measure is effective as a minimum tax, except when tax administrators accept the asset tax as a full substitute for the CIT properly due. It was excessively complex in its original form, however, due to a system of monthly adjustments for inflation.

11. Prior to 2002, there were two partly overlapping exceptional (and preferential) regimes to the standard CIT. First, businesses in agriculture, agro-industry and trucking could choose a cash-flow accounting system, by which they paid tax only on the money taken out of the firms and not on the retained earnings. Second, the agriculture and publishing sectors enjoyed a special rate regime of half the standard rates. There is no economic justification for these sectoral preferences, and they created a lot of distortions, especially the manipulation of transfer prices and cross-sectoral mergers to reduce tax liabilities with the cash-flow regime. The special regimes also made enforcement more difficult.

12. **Personal income tax**. The personal income tax (PIT) is the most progressive part of Mexico's tax system. There is no double taxation of dividends, for shareholders can take as a credit the tax paid by corporations they own, including via stock ownership. Despite these good basic principles underlying the tax, the proliferation of exemptions, different tax rates on different kinds of income, the low-salary subsidy (*credito al salario*), and uneven administration made the PIT unequal horizontally and inefficient for raising revenue. Prior to the reforms taking effect starting in 2002, revenues from the PIT declined as a share of GDP over the past two decades, because various concessions, such as limits on taxation of fringe benefits, narrowed the tax base and made the PIT generally too complex. A special regime for individuals with entrepreneurial activity, with annual gross income below 1 million pesos, taxed their gross income at graduated rates ranging from 0.25 to 2.0 percent. This simplified compliance and enforcement for individual entrepreneurs with limited administrative capacity, but the graduated rates made enforcement difficult. The PIT has been progressive because the regular (positive) PIT starts at a low rate of 3 percent and moves up to 40 percent. The brackets were indexed twice annually for inflation. In the formal sector the PIT provided subsidies for the wages of workers in the formal sector (with the largest rate of subsidy going to those with the lowest wages) and for those whose fringe benefits were low or absent. On income from agriculture, fisheries, and book editing, the rates were one half of the regular rates (consistent with the CIT). Persons with exclusively agricultural incomes below 20 times the local minimum wage paid no PIT. These multiple regimes made the PIT inefficient for raising revenue, hard to administer, and unequal across households with similar incomes but different employment situations and sources of income.

13. **Value-added tax**. The value-added tax (VAT), with a standard rate of 15 percent, has been the second largest revenue source for the Government after the income tax (corporate and individual). The standard rate applies to about 55 percent of total consumption. Individuals (with entrepreneurial activity) with annual sales up to MxP 1 million have the option to be exempt. There is zero rating for food, medication, and books. Private schooling is exempt.[2] The rate for

2. Exempt operations do not collect and pay VAT on what they sell, but they do pay VAT on taxable inputs and get no rebate for this. So their consumers effectively pay the VAT only on value added in stages prior to the exempted one. This makes sense in some cases, for instance, with micro retail operations, where collection would be prohibitively difficult. With zero-rated items, on the other hand, the final consumer does not pay any

taxable items is only 10 percent in the border areas, with the aim to enhance competitiveness, and the border zone has a broad definition, including all the territory of the states of Baja California, Baja California Sur, and Quintana Roo. The exceptions to the standard rate and poor enforcement seriously undermine the revenue generation of the VAT, for it yields only about what would be expected from a rate of 5 percent on all consumption.

14. **Excise taxes**. Prior to 2002 the Federal Government collected excise tax on gasoline, tobacco, and alcoholic beverages. The gasoline tax remains the most important and has grown on average, but with wide fluctuations (inversely with other kinds of fiscal revenues from the oil sector). Revenue from excises other than gasoline has roughly doubled over the last two decades, exceeding two percent of GDP by the end of the 1990s. The revenue potential of these taxes invites using them more, especially because some excise items, such as gasoline and tobacco, have negative externalities. This inclination needs to be tempered with a recognition that the revenue elasticity of these taxes will eventually decline due to evasion or reduced sales in response to the tax.

c) Tax administration

15. Tax administration has been the weakest link between the often sophisticated objectives of Mexican tax policy and the actual tax revenue collected. For instance, a study in 1996 indicated that the evasion of the VAT in Mexico was about 60 percent. While the VAT is perhaps the most serious area of evasion, the income taxes also fall far short of their potential; total revenues (PIT and CIT) are only 7 percent of corporate profits and less than 5 percent of total wages, salaries and profits. Five fundamental problems have hindered tax administration: a) the tax code has been too complex; b) filing and payment, even by those willing to pay, are too difficult; c) evasion has been too easy—rarely discovered and even more rarely punished; d) the application of the code by those who administer it has been inconsistent across taxpayers and across time; and e) the system has collected insufficient information and failed to use it well. The reforms supported by the proposed TRAL address the first issue, complexity of the code. The Tax Administration Service has started programs to address some of the other issues, with the establishment of a large tax-payer unit and a client-service unit, computerized cross-checking of data to determine the needs for audits, and the initiation of unified accounts. While these programs are just beginning to bring in additional revenue, the Secretary of Finance and the Subsecretary of Revenue have given high priority to further improving tax administration and enforcement, and intensified general effort in 2001 brought in an additional 0.6 percent of GDP. Much remains to be done, as discussed below in Section III b.

d) Subnational Finances

16. The part of Mexico's fiscal reform program dealing with subnational finances has three main subparts: taxes and revenue sharing, spending and earmarked transfers, and borrowing and debt control.

17. Concerning taxes, subnational governments in Mexico collect very little revenue either as a share of GDP (about 1 percent) or as a share of their own expenditures (about 10 percent). This imbalance is inconsistent with the reality that has emerged in the past ten years: political

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VAT even indirectly, because the seller does not collect VAT and gets a rebate of the VAT on any taxed inputs. This is a more significant tax benefit than an exemption.

and constitutional autonomy of the states, opposition control of the federal congress (and of many state congresses), major spending responsibilities in the hands of states, and substantial subnational autonomy to borrow. Redressing that fiscal imbalance is more than a technical tax matter, as it will make the states more accountable to their populace for the public services that they now provide and more able to raise extra resources to finance investments and pay for other improvements in their services. If devolving taxes to the states reduces the revenue collected by the central government, then the revenue sharing formulas may need to be adjusted accordingly.

18. In the 1990s the states were given major responsibilities for social spending—basic and secondary education and health care for the uninsured population—along with earmarked transfers to pay these costs. The largest fiscal problem with this arrangement is the great inequality of resources per capita going to the states to cover the cost of these programs—with the most generous per-capita allocation being almost three and a half times the smallest. This happened because the initial allocation of transfers was set to cover the cost of the stock of federal education employees (teachers, etc) being transferred to the states in the early 1990s, and subsequent allocations were mostly percentage increases on the original base. The original allocation of federal employees differed widely because some states had already developed their own social programs to meet part of the need, and the federal transfers took little account of the cost of these state employees. There is also a major management problem the decentralized social sectors in that the states did not get adequate authority to manage the programs, especially in education, for the federal government and unions have remained largely in control. This problem is especially severe in the economically less developed states, where the private sector is weak.

19. Until recently, the subnational governments faced minimal incentives to improve the efficiency of their spending of to raise more resources, because they frequently could get discretionary transfers from the federal government or could get loans on easy terms even if they lacked credit worthiness. To improve the incentives for fiscal prudence at the state level and to prevent subnational fiscal problems from disrupting the national macroeconomic framework, the federal government in 1999-2000 revised its rules to give the states harder budget constraints. They ended the practice of discretionary transfers from the federal executive.

20. For controlling subnational borrowing and debt, the federal government instituted new rules in 2000 that ended the previous implicit federal guarantee on state and municipal borrowing. The new rules required banks to treat the debt as potentially risky and to hold higher levels of capital for the debt of subnational entities that did not have good credit ratings from major rating agencies. The World Bank supported these reforms with the Decentralization Adjustment Loan, approved in December 1999, and they have helped improve the whole atmosphere for subnational finances, although the appropriate responses in the areas of tax and spending policy are still pending.

e) Fiscal Discipline and Transparency

21. Like all industrializing countries, especially those whose public finances depend heavily on mineral export revenues, Mexico has the problem that its public sector income fluctuates substantially and unpredictably within the budget year and within the execution time of many projects. Faced with such exogenous shocks, something must adjust—taxes, spending, or the deficit and borrowing—each has certain disadvantages. Changing taxes for short term adjustment would have long-term costs in destabilizing incentives for the private sector, whose

confidence is needed to sustain growth. Even when legal tax rates did not change, Mexico often changed their effect by making short-term enforcement and collection efforts to raise more revenue in times of fiscal emergencies, but then relaxed the effort when the crisis passed. Adjustment in spending is appropriate as long as the program is relatively flexible; investment is often cut or deferred, but this is more difficult with the wage bill. Borrowing would be an attractive means to smooth the finances, except that there are often credit constraints in truly bad times and temptations in good times to overuse credit. So the challenge was to develop fiscal control rules that provide adequate discipline, but also allow a reasonable degree of flexibility.

f) Budgetary Reform

22. In recent years, as the Mexican government has increased its fiscal discipline and transparency and as a more politically competitive Congress has taken an more active policy role, the budget as approved has become a more definitive document for public finances. For the same reasons of greater political competition, the process of determining the budget has become more time consuming and less predictable. Both of these trends are fundamentally favorable for the country. The implementation of the federal and subnational budgets has suffered, however, because the schedule and institutional details of budgeting remain the same as before. Federal agencies and the subnational governments, which depend heavily on transfers from the center, do not know until January how much money they will have for the year, and cannot predict what they will have for future years. Thus, Mexico needs to revise its budgetary procedures, in order to strengthen fiscal responsibility, reduce uncertainty, and improve transparency in the process of discussing and voting on the budget.

g) Energy Pricing Policy

23. The Mexican federal government has a monopoly in the main energy sectors—petroleum and electricity—which makes pricing and taxation in the energy sector critical for the fiscal reform program. About a fourth of public revenue comes from various taxes and fees on export and domestic sales of petroleum. The structure of fees and taxes is inefficient in several ways—discouraging potentially valuable exploitation, raising less revenue than they could, and not adequately encouraging conservation in consumption. There is a need to revise fundamentally the taxation of consumption, of extraction, and of the profits of PEMEX, the state oil company. The subsidies implicit in the pricing of electricity also drain public finances, and investment of the state enterprises for electricity and petroleum takes up about half of the government's total investment budget. Therefore, there is a need to put the energy sectors on a more commercial and autonomous basis, to make more efficient use of oil and gas resources, and overall to move toward a more transparent environment for the sector in dimensions such as taxation, competition, regulation, and auditing.

h) Spending Policy

24. The main objective of taxes in Mexico is to raise revenue to pay for spending programs, especially those that promote economic development and poverty reduction. Carrying out this objective in a way that is transparent to the population is essential to make tax and fiscal reform politically tenable in a democracy like Mexico. In the 1990s Mexico made important reforms to programs for poverty reduction. Social spending for basic education and health was increased

and decentralized to the states. There have been problems with the inequity of resources per capita available for these programs, with large and fast growing states not getting enough, and with the states' lack of authority and capacity to manage the programs. Spending for social safety nets was increased and moved toward a targeted context that gave incentives for poor families to make use of the education and health services available, particularly through a program known formerly as PROGRESA and now as *Oportunidades* (Opportunities). PROGRESA reached many rural areas in the previous decade, but not all, and did not address urban poverty. In the areas of economic infrastructure, investment in the electricity sector continued to be exclusively in the public sector and lagged seriously behind demand. Investment in roads increased, especially in private toll roads with public guarantees, but this mode of financing was not properly executed and usually required public bailouts. Thus, these programs need both additional resources in the aggregate and institutional improvements.

III. THE GOVERNMENT'S FISCAL REFORM PROGRAM

25. The Mexican Government is well aware of the remaining weaknesses in its fiscal situation and seeks to improve it in the six areas discussed above. The first phase is focusing on tax policy and tax administration. Part of this program, mainly reform of the income tax law, was enacted in December 2001, with implementation starting in 2002. Other parts of the program, including strengthening indirect taxes and devolving taxes to the states, as well as reforms to pricing and taxation in the energy sector, the Government intends to complete as the necessary political consensus emerges.

a) Macroeconomic Policy and Economic Prospects

26. Fiscal discipline is a key priority for the administration. As part of that discipline, the government proceeded with the publication of a broadened measure of the federal-level fiscal deficit, known as the Public Sector Borrowing Requirements (PSBR),[3] which is projected at 4 percent of GDP for 2002 (in contrast to the budget deficit target in its traditional definition at 0.65 percent of GDP). The shift of the attention to the PBSR was part of the motivation behind new tax legislation enacted in December 2001 that is expected to increase tax revenue by 1.05 percent of GDP in 2002. This additional income has been allocated to offset the low oil prices (projected at the time of the budget), and to finance priority social expenditures. The Government plans for further fiscal consolidation, to be reflected in a reduction of the public sector borrowing requirement in the medium term. Mexico has no active IMF program and no outstanding obligations to the IMF.

27. Over the next few years, the Mexican economy is expected to recover from its current, shallow recession toward the economy's medium term potential annual rate of growth of about 4-5 percent. Even though the recovery of demand for Mexican manufactured exports will initially be the driver of the economic expansion, the strong rebound expected as of the second half of 2002 is projected to be broad-based, i.e., a simultaneous and balanced growth of consumption, investment and export demand. According to Bank estimates, this growth pattern

3. The PSBR of the federal level includes some quasi-fiscal operations that are not or are only partially included under the traditional fiscal deficit measure, such as the total interest cost of liabilities related to bank and debtor support programs, the deferred cost of investment projects (PIDIREGAS) in the energy sector, the net financial intermediation by development banks, and the inflation component of indexed bonds. The PSBR excludes non-recurrent revenues from privatization and unrealized capital gains.

is expected to lead to an increase in the country's balance of payments' current account deficit from the current 2.8 percent of GDP to about 4 percent of GDP by 2004 and stabilizing at that level thereafter. Foreign direct investment flows will continue to finance the bulk of the country's external deficit. Further fiscal consolidation is projected to take place not only to make progress in attaining fiscal sustainability but also as a key instrument in aggregate demand management and price stability (Table 1).

Table 1: Mexico Macroeconomic Indicators

Indicator	Actual 1999	Actual 2000	Estimated 2001	Projected 2002
Gross Domestic Product (% growth)	3.6	6.6	-0.3	1.7
Consumption	4.4	7.5	2.8	1.2
Investment	7.7	11.4	-5.9	4.6
Exports	12.4	16.4	-5.1	2.4
Imports	14.1	21.5	-2.9	1.0
Balance of Payments				
Current Account (US$ billion)	-14.0	-17.8	-17.7	-21.1
Current Account (as % of GDP)	-2.9	-3.1	-2.9	-3.4
Foreign Direct Investment (US$ billion)	12.5	14.2	24.7*	13.0
Fiscal Balance (as % of GDP)				
Traditional definition	-1.1	-1.1	-0.7	-0.7
Broadened PSBR	-6.3	-3.7	-3.8	-4.0
Inflation (% year-end)	12.3	9.0	4.4	4.5

*Includes Banamex-Citibank transaction.

Sources: *Informes sobre la Situación Económica, las Finanzas Públicas y la Deuda Pública* (Reports on the Economic Situation, Public Finances and Public Debt), Fourth Quarter 2001, SHCP; 2002 approved budget published in the *Diario Oficial de la Federación* (Official Gazette of the Federation), January 1, 2002; *Programa Economico 2002* (Economic Program 2002), SHCP; *Banco de México*; INEGI.

28. The government is concerned to keep Mexico's economy competitive in the world market, while recognizing that as it develops the comparative advantage will shift out of some sectors and into others. The inflation rate, although declining, has exceeded the movement of the exchange rate over the past few years, leading to some real appreciation. The fiscal policy program aims to reduce this risk in both the short term and long term, by emphasizing fiscal restraint and thus reducing the need for tight monetary policy. In the short term, such a policy mix reduces the demand for loans and reduces interest rates, which has happened, and thus reduces the attraction for hot money—short-term deposits that could exit quickly and precipitate a crisis. In the longer term, the sustainability of the exchange rate depends on whether the capital that comes into Mexico finances investments that enhance the capacity to export goods and services. Beyond setting the appropriate macroeconomic environment, the government's policies aim to increase Mexico's competitive export capacity by reducing distortions, such as in the tax regime, and investing in appropriate economic infrastructure and human capital. The continued inflow of longer term and equity capital to Mexico indicates that financial markets also consider the risk from overvaluation to be manageable

29. Additional progress on the country's structural reform agenda is needed in order to attain the projected level of growth and raise the country's medium term economic growth potential further, without the creation of undue fiscal or external finance imbalances. The proposed operation assists the Government in implementing the fiscal reform part of that agenda and provides the public sector with resources to meet part of its external finance requirements. The

operation would thereby also indirectly facilitate the access of the private sector to domestic and foreign credit to finance the investments needed for growth and for adjustment to the structure of incentives modified by the tax reform.

30. The foreign private sector is expected to remain the main source of external financing for Mexico. By 2001, three quarters of the country's total financing requirements was being served by either private investment flows or private non-guaranteed debt. Maintaining adequate access to longer-term financing as provided by the IBRD and other international financial organizations will thus be an essential element in improving the maturity structure of Mexico's external debt and in reassuring private investors of the viability of its external accounts. Notably, all three major international credit rating agencies have upgraded Mexico sovereign risk rating to investment grade.

b) The Fiscal Reform Agenda

31. The first phase of the Fiscal Reform Program focuses on tax policy and administration. Raising more tax revenue cannot come from any major increases in the standard rates, for they are already in line with the major international comparators, and Mexico does not want to lose out to international competition for skilled labor, capital, or retail sales or see transfer pricing used to attribute expenses to Mexico and transfer income to other countries. Key reforms would broaden the tax base by eliminating exemptions and special regimes, so that revenue increases because more payers and transactions are subject to the same rates and enforcement is easier.

32. **Corporate income tax**. The most important reforms to the corporate income tax that took effect in 2002 make it more uniform across sectors, thus reducing distortions and evasion. The reforms are in line with the recommendations of the CEM. As a group they are expected to increase revenue by only about half a percent of GDP in the short run; some measures will reduce revenue and others will bring more. The medium-term revenue effects will be stronger because the reform reduces economic distortions and facilitates administration. The reform includes the trucking and agriculture sectors in a general system for calculating income, ending the special cash-flow regimes that favored them so heavily and required them to pay the income tax only if financial resources were withdrawn from the company. From now on, taxes in those sectors will be payable on income minus expenditures and deductions, which do not include financial investments and only include the present value of the straight-line depreciation of fixed investment. The 50 percent reduction in tax rate for publishing is being phased out over four years; the lower rate for agriculture remains. With these and the other changes, the inter-sector dispersion of marginal effective tax rates is reduced from 5.5 to 2.4 percent. The elimination of the negative effective marginal rate for trucking is especially important, since it was such a strong incentive for tax evasion through various tricks of corporate organization and pricing. The fiscal regime that will now apply to trucking and agriculture has clearer standard-depreciation and expensing rules, which will facilitate compliance by firms and enforcement by the Government. The reform expands the standard rate of 35 percent to all profits, eliminating the special rate of 30 percent for reinvested profits.

33. Part of the rationale (the good part) for the special cash-flow regime for agriculture and trucking was the difficulty that small operators have in documenting all their business costs. To

address this concern, the reforms allow simplified tax calculations and reporting in several ways. The trucking and agriculture may report on a simplified cash basis, but the deduction for investment is only the present value of future capital depreciation, not the whole value that they had in the cash-flow regime. There is a new simplified regime, without sectoral discrimination for individuals with entrepreneurial activities under 4 million pesos gross annual revenue, allowing them to pay tax on a cash-basis definition of income. For individual entrepreneurs whose income is lower (under 1.5 million pesos gross revenue) and who sell only to the general public, the reform modified the Small Taxpayer Regime, so that it allows payment of a flat-rate presumptive tax to the federal government—1 percent on gross revenue—which is simpler than the graduated rates previously charged. The reforms are designed to reduce the differences in effective tax rates and thus to deter taxpayers from inappropriately shifting from the general system to the simplified cash-basis regime. Also, requiring that the payments for purchases from firms belonging to the simplified regime will be deducted only after the payment is made (in accord with the cash-basis regime) maintains the fiscal symmetry and improves the timing of the revenue impact for the government. The expected gains in revenue and efficiency from better compliance and enforcement, due to simplicity, was felt to outweigh the losses from the lower legal rate. Making this happen will depend on actual improvements in the *Servicio de Administración Tributaria* (SAT), the institution in charge of collecting federal taxes.

34. The one percent federal rate on gross income of individuals with entrepreneurial activities is a lower rate on average than the progressive rates previously charged by the federal government, but the revenue law (*Ley de Ingresos*) for 2002 gives the state governments the right to put a tax of up to 5 percent on the net income of all individuals with entrepreneurial and professional activities whose revenue does not exceed 4 million pesos. For individuals who contribute in the Small Taxpayer Regime, the states could charge a rate up to 2 percent on gross income. The federal government has collected very little from these groups of potential taxpayers, and the authorities believe that bringing in the state governments, who know this populace better, will improve enforcement and collections. If this happens, it would be a creative and important way to strengthen the states' fiscal authority, although first the federal government needs to put into permanent law the option for states to introduce the these taxes.

35. **Personal income tax.** The main reforms to the personal income tax, taking effect starting in 2002, will charge more similar rates to people with similar incomes and will consolidate the taxable income of individuals from all sources. Consolidation addresses the previous problem that persons receiving total incomes that should be taxed at a high rate could receive income from various sources, some of which were taxed at lower rates. Tax on real-interest income will continue to be withheld, and credited against the tax owed on consolidated income when real-interest income exceeds 100,000 pesos annually. This reform largely eliminates the previous distortion of the effective tax rate on equity versus debt financing of corporate investment. The reforms introduce taxation of real interest earned on government bonds and of capital gains from some stock sales.[4] The reforms reduce the number of tax brackets from ten to five by 2005 (starting with eight rates in 2002 and dropping one rate bracket each year during the transition) and make the top rates consistent with the corporate tax, including the decline of the top rate from 35 to 32 percent by 2005. The reforms reduce the

4. Capital gains taxes will be levied on stock market transactions involving companies that have less than 35 percent of their stock traded on the Mexican exchange and that have been public for less that 5 years. This intends to deter evasion through schemes involving artificial trading in closely held stocks.

Government subsidy (*credito al salario*) for workers in the formal sector, and add a tax incentive for firms to continue paying the subsidy themselves, in the form of a penalty tax if they stop, in order to protect the workers. As noted above, the low-income wages in the long run will be determined by productivity (labor demand) and the wage levels in the informal sector (supply).

36. **Value-added tax**. The Government submitted to Congress in 2001 a package of proposed new tax laws, which included fundamental reforms to the value-added tax. Most importantly the proposal called for widening the base of the tax to include most foods and medicines, as well as published materials and private schooling. This would have brought in a major increase of tax revenue. Analysis by the Bank as well as the Government shows that most of the additional revenue from this measure would come from upper income households. Therefore, if the benefit of federal public expenditure is more equal per capita, as in basic education and health, the overall impact of such a measure would be substantially progressive. The proposal also called for sharply reducing the geographic areas eligible for the reduced border rate of 10 percent. These measures would both reduce the complexity of the law, facilitating enforcement and compliance.

37. **Excise and luxury taxes**. The new Law for Special Taxes Goods and Services raised the rates on cigarettes, to raise revenue and further discourage a socially undesirable activity. The tax on soft drinks using fructose, a protectionist measure for the domestic cane-sugar industry, was passed by Congress but has been temporarily suspended. The income law of 2002 also put a luxury tax of five percent on top of the regular 15 percent VAT on luxury goods and services, such as restaurants, luxury foods (smoked salmon, caviar, eels, etc), expensive automotives and accessories, sport boats, and recreational services (golf, horseback riding, polo, etc.). While these areas of consumption are not socially undesirable, putting an extra tax on them is a progressive way to raise the increased revenue that the Government needs to continue paying for its programs, most of which are in the social sectors and thus are pro-poor. This temporary measure does, however, complicate the rate structure of taxes on consumption, and the Government aims to replace it in future years with alternate way of indirect taxation.

38. **Tax administration**. The Government recognizes the need to strengthen tax administration, in particular as its fiscal goals include an additional 0.57 percent of GDP for 2002. Important steps already taken include: the creation in 1997 of SAT as an autonomous entity with potential for internal flexibility and competitive salaries; introduction of strategic planning; initial rationalization and training of staff; introduction of more transparent personnel selection methods; improved taxpayer services and physical infrastructure; establishment of a special unit for large taxpayers; simplified tax return and payment processes; and mechanisms to identify non-filing registered taxpayers. The Bank, with a proposed Tax Administration Institutional Development Loan of US$52 million, is supporting the Government in strengthening and implementing the administrative strengthening program of the SAT (total project size is US$82 million). Bank staff have consulted with the IMF during the development of this project.

39. The project has seven components:

a. *eSAT and taxpayer services.* This component aims at strengthening SAT's on-going efforts to provide better taxpayer service and increase the transparency of SAT. The project will further simplify taxpayers' filing of returns employing more advanced electronic means, including all web-based activities under SAT's e-business strategy. It will carry out surveys of

taxpayers and other stakeholders, create permanent focus groups, and establish service standards to increase SAT's efficiency and transparency.

b. *Management of human, financial and physical resources.* This component will help SAT establish a better framework for planning and managing its manpower, financial and physical resources: assessing SAT's staff, documenting the results in a Human Resource Management System, upgrading training, and introducing performance management policies and systems. These efforts will be brought together to form SAT's Integrated Resource Management System.

c. *Information hub.* This component aims to improve the communication, sharing and management of information within SAT. A Chief Information Officer will take charge of policy, coordination, quality assurance and security of information, and will implement a series of databases that will be optimized for access and security and will automatically receive data from the operational databases in the various areas. The information hub therefore consists of a collection of databases used for information access ("read only"), configured for multiple queries and retrievals of information, with sophisticated security measures and firewalls, thus leaving the operational databases insulated and optimized for updating rather than access.

d. *Technology services.* The component would finance consulting assistance to develop an information and communications technology strategy aligned with SAT's business strategy and goals, technical assistance for the development and implementation of an Internal Service Policy for information and communications technology services, and upgrade equipment to improve performance.

e. *Compliance process.* The component would focus on the complete Compliance Process, financing activities to improve SAT's units for Collections and Large Taxpayers, and elements of its Legal and Customs units. In addition, a management information system would be developed, performance indicators defined, baselines measured, and the Standard Notification System defined (with performance indicators and a control system). The component would finance the increase the coverage of the Taxpayer Registry and the creation of the single taxpayer account.

f. *Compliance control and enforcement.* The component would finance the integration elements of SAT's enforcement, auditing, legal and other functions directed at problems of evasion, non-payment etc. into a "Compliance Control and Enforcement" process.

g. *Planning and Quality Control.* SAT senior management last year carried out its first Strategic Planning Exercise (for 2001). This component will provide training, seminars and technical assistance on planning and performance indicators to senior and middle managers in order to carry the strategic planning exercise forward and to improve it as a means to achieve the necessary, but previously missing, coordination among administrative units.

40. **Fiscal Federalism.** During 2001 the Federal Government, the Congress, and the states explored several options for substantial devolution of taxes to the states. The proposal receiving the most attention was a devolution of a tax on final sales, with a corresponding reduction of the federal VAT at that final stage. Such a measure would substantially augment states' own revenue, often doubling it or more, and would create a framework and precedent for further devolution in the future. This proposal was originally linked with the expansion of the VAT base and was shelved with it, to be considered later. Nevertheless, the annual income law for 2002 gave states the option to impose a tax of up to 3 percent on final sales (with no

corresponding reduction of the federal VAT) and a surtax on the gross income of individuals with entrepreneurial activity in the small-taxpayer regime, mentioned earlier. These would need to be put into permanent laws before the states could use them, but even the temporary measures set important precedents and gave more concrete form to the expectations that such devolutions will be made workable in the near future. In a parallel development on the administrative side, SAT has increased its coordination with states in the tax-auditing process and plans further steps in this area, which both sides will need in order to reap the expected benefits from devolving taxes.

41. **Fiscal Discipline and Transparency**. To keep a stable incentive framework for the private sector, which is main engine of growth in the economy, Mexico changes tax policy rarely and mainly on the basis of longer term considerations, not as a short term management tool. In the area of borrowing, Mexico sets an annual deficit target, which is consistent with its medium term target of reducing the overall public sector borrowing requirement. To maintain fiscal discipline and a stable macroeconomic framework, the Government now keeps the deficit during the year within the limit specified in the budget approved by Congress, and therefore spending must adjust to offset any negative shock to revenue. To assure the achievement of its medium-term deficit-reduction targets, positive revenue shocks—windfalls—are partly used to reduce the deficit, with the rest going to increase the Petroleum Revenue Stabilization Fund and to fund infrastructure investment. The 2002 annual revenue law called for this procedure, which was started in practice in 2001, and the Government plans to codify it into permanent law. The Government has also increased the detail and regularity of it published fiscal accounts and financial balances.

42. **Budgetary Reform.** The package of Fiscal Reform (including the Tax Reforms) that the Government sent to Congress in April 2001 included a proposal for Budgetary Reform (Reforma Presupuestaria), aimed to improve transparency in the process of discussing and voting on the budget and to strengthen fiscal responsibility and reduce uncertainty on the part of those executing the spending programs. It called for more time for Congress to consider the budget and clear rules for the eventualities that the budget was not passed before January 1 or that the budget needed to be modified during the year. Congress has not approved the budgetary reform yet, but it remains on the policy agenda.

43. **Energy Pricing Policy**. In the area of energy policy, the Government recognizes the challenges for both petroleum and electricity. In terms of concrete actions, they took the political salient step in February 2002 of reducing the subsidy for residential electricity, by about 12 percent overall. To protect the standard of living of low-income persons, they increased the tariffs only for the 5.5 million households with more than the minimum standard amount of electricity consumption. For these households, the average bills will increase by almost US$100 for the year. Obviously, much remains to be done, and pressure from the private sector for improved service, and fiscal pressure for more revenue, will help make the necessary actions politically feasible.

44. **Spending Policy**. Even as it faces pressure for fiscal constraint, the Government is striving to protect spending for its social sector programs, particularly in the areas of education and social protection. These are an important justification for the effort to collect extra fiscal revenue through the tax policy measures supported in this proposed project and through the program to improve tax administration. As the urban areas were relatively neglected in the programs of the 1990s, like *Progresa,* the new programs like *Oportunidades* (the new name for

the expanded *Progresa*) and *ConTigo (with you)* aim to reach the urban population and to increase the transparency of rules for access in both urban and rural areas. Pilot programs to combat extreme urban poverty work through a broad range of actions in the areas of basic education, health and nutrition. Much-needed extra resources are also programmed for investments in electricity generation and road expansion, although some of the resources for that are expected through better cost recovery.

c) The Program's Outcomes

45. We can evaluate the expected outcome of the Government's program along five of the six target dimensions, with the dimension of political feasibility being left to the judgment of the authorities.

46. **Revenue collection**. The fiscal reform program will enhance revenue collection mainly through the tax policy and tax administration components. The tax policy reforms in the first phase, supported by this operation, will raise more revenue overall, although some effects cannot be readily estimated quantitatively, some revenue effects are negative (their main benefits are efficiency or simplicity), and some will only come after several years. The combination of all the tax measures starting in 2002 are forecast in the budget to raise an additional 1.05 percent of GDP in the first year. The income-tax measures at the focus of this operation are expected to raise additional revenue of about 0.9 percent GDP in 2002, with further additional effects in subsequent years. About two-thirds of this would come from the corporate tax measures—unifying the rate at 35 percent (0.4 percent of GDP) and eliminating the previous regime for agriculture and trucking (0.17 percent of GDP). From the personal income tax, implementing the substitute tax to neutralize the salary credit for low-wage workers would bring in additional revenue of about 0.35 percent of GDP. The changes to the excise taxes would increase revenues by about a fourth of a percent of GDP, while revenue will decline net by about a fourth of a percent due to some other changes, such as removing the social security and housing fund contributions from calculating the pre-subsidy wages of the low-income workers in the formal sector. The unification of personal taxable income from all sources will not bring in new revenue until people file their unified returns starting in 2003. The extra income from phasing out the income-tax preference for publishing will only come gradually, while the phased elimination of the three top rates for the income tax starting in 2003 will initially have a negative effect, but then should have a positive effect as they simulate economic growth and facilitate administration. Of course, the actual amount of collections depends on the growth of the economy (partly influenced by external shocks) and the effectiveness of tax administration efforts.

47. **Efficiency**. The proposed reform will improve the incentives for efficient resource allocation in the economy. The most obvious tax policy distortion for production allocation has been the special corporate income tax regimes, including cash-flow accounting, for agriculture and trucking, and lower rates for publishing. These will be ended, making the effective tax rates on investment more equal across sectors and more equal for different forms of financing, as shown in Annex 1. The tax-exemption for compensation provided in the form of fringe benefits has been another serious distortion that the 2001 reforms will reduce. A large distortion in practice has been evasion, corruption and uneven enforcement, which the Government will

reduce with its tax administration institutional development project, with support for the proposed Technical Assistance Loan that accompanies this adjustment operation.

48. **Equity**. The proposed reform will have its most important equity impact by reducing the disparity of the tax burden on persons with similar income levels. For the personal income tax, all income will be accumulated for a individual and then taxed at the appropriate rate for his income level, in contrast to the present system of taxing different income streams separately and often at different marginal rates. Interest from government bonds and stock-market capital gains would be included in this accumulated income for the first time. The revised laws will tax owner operators of small businesses more effectively, putting more nearly the same burden on them as on their salary-earning neighbors.

49. The tax reform will also help to increase the progressiveness of the public sector—its redistribution of resources toward the poorer persons in society. Mexico has developed an impressive array of spending programs for reducing poverty through developing human resources and alleviating some of the most severe incidences of poverty, especially in rural areas.[5] Public spending in Mexico is progressive on average—benefiting the poor more than the rich as a percent of their income. International evidence indicates that the best way to increase progressiveness of the public sector as a whole is to increase public spending for social programs with broad coverage. The Mexican tax system is progressive overall and the policy reforms and complementary improvements to administration will collect most of the additional revenue from the upper income groups. Raising revenue in this way and spending it progressively will increase the overall progressiveness of Mexico's public sector.

50. **Administrative simplicity**. The tax reform policy package will simplify administration in four main ways: phasing out the special sectoral regimes for the corporate income tax, simplifying the inflation adjustments in the corporate income tax, allowing individual with medium-sized entrepreneurial activity to use cash-basis accounting for their income tax, and allowing individuals with small entrepreneurial activities to pay a single flat rate on gross revenue for income tax, indexing the personal income tax brackets for inflation only twice a year (instead of monthly), and reducing the number of personal income tax brackets from ten to five by 2005.

51. **Federal consistency**. The effective devolution of new tax bases to the states has not yet been realized, although the temporary measures increase the likelihood of more progress in the future. For now the main assistance of the federal government to subnational taxation is through tax administration. This started in 2001 with improvements in the agreements for auditing by the states. It will continue in the context of the subnational components of the Government's program for institutional development of the tax administration, which would be supported by the proposed Tax Administration Technical Assistance Loan.

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5. World Bank 1999. *Mexico Poverty Assessment.*

IV. THE PROPOSED TAX REFORM ADJUSTMENT LOAN (TRAL)

a) Objective

52. The proposed loan will support the first stage of the Government's wider program of fiscal reform described above and in the Letter of Development Policy. Since most of the fiscal benefit of these measures will come in the medium term as the reduced tax distortions contribute to higher sustainable growth of private sector, the financing of the loan will help the Government assure fiscal sustainability and thus macroeconomic stability in the meantime. The eventual growth of fiscal resources will contribute to debt reduction, and in the short run the loan will help avoid a fiscal contraction, which would be counterproductive in the present environment. Raising more resources from a stronger tax system is essential for expanding the Government program of social sector services and infrastructure investment. Finally, by simplifying the tax policy to administer, the policy reforms will contribute to the Government's program of reform of the state and reduction of corruption.

b) Content

53. The operation will be based on the Government's matrix of fiscal reforms, as presented in Table 2. These include the tax reforms described above, and also targets for fiscal balances and social spending, which indicate how the tax reforms will contribute to improving the overall fiscal situation of the country and to sustaining key government programs for investment and poverty reduction. This loan will be disbursed in a single tranche, as the policy actions have all been completed, and the Government may seek adjustment lending support or technical assistance as it continues with the other aspects of its fiscal reform program.

Table 2. Mexico—Tax Reform Adjustment Loan (TRAL)
MATRIX OF POLICY COMMITMENTS FOR TRANCHE RELEASE

Policy area	Actions prior to Board presentation
Macroeconomic framework	1. The approved budget for 2002 has an overall fiscal deficit of no more than 0.65 percent of GDP.
Social sector and infrastructure spending	2. The approved budget for 2002 increases programmable spending for education, health, social safety nets, and investment in roads and electricity by at least 0.8 percentage points of GDP, compared to that of 2001.
Corporate income taxes	3. The new Income Tax Law i) eliminates the special cash-flow regime for calculating taxable income in the agriculture and road transport sectors; ii) simplifies the inflation adjustment regime, just using the annual price index to calculate the adjustment in the monetary liability and assets; iii) introduces the immediate deduction (net present value of the future capital depreciation) for investments done outside the metropolitan areas of Monterrey, Guadalajara and Mexico City and for firms anywhere whose production processes: (a) are labor intensive, (b) use clean technologies with respect to the emission of pollutants, and (c) do not require a significant use of water; iv) limits up the deduction of the cost of fringe benefits for non-union employees to the lesser of one minimum wage or 10 percent of taxable income; v) eliminates the reduced tax rate for reinvested earnings, thus unifying the corporate and personal tax rates at 35 percent, and reduces both rates gradually to 32 percent by 2005; vi) phases out the 50% reduction in the tax rate for the publishing industry, bringing the rate there up to the standard rate by 2006.
Personal income taxes	4. The new Income Tax Law i) expands the taxable income of physical persons (individuals) to include, real interest on government and corporate bonds, dividends, and capital gains on stock investments; ii) aggregates all the taxable income of an individual and taxes it at the corresponding progressive rate; iii) reduces the number of tax rate brackets and harmonizes the top rate with the corporate rate; iv) reduces the government subsidy for workers in the formal sector and provides an incentive for firms to continue paying; v) simplifies the regime for individuals with entrepreneurial activities, so that: (a) those with less than MxP 1.5 million in annual gross revenue that only sell non-imported products to the general public may pay a one percent presumptive tax on gross revenue (Small Taxpayer Regime); (b) the other individuals with entrepreneurial activity whose annual gross revenue is no more than MxP 4 million may calculate their taxable income on a cash flow basis and deduct their investments until the payment has been done; and (c) the individuals who render professional services or have entrepreneurial activity with more than MxP 4 million in gross revenue may also calculate their taxable income on a cash basis and will deduct their investments by the method of either straight-line depreciation or immediate deduction of the net present value of straight-line depreciation.

c) Risks

54. In the taxation area, there is little risk that the income tax reforms would be reversed legislatively. There is some risk that the Government will not be able to complete its initial objective of comprehensive fiscal reform, including broadening the base of the VAT. Even with the existing VAT, however, the income tax reforms have their full value in improving efficiency, equity, and simplicity. The greatest risk is that collections and enforcement would remain weak, or would weaken after an initial improvement. Then the reforms to the law would not have their desired effects in practice. To minimize this risk, the Government has requested technical assistance in tax administration from the Bank, which is being provided through the proposed Tax Administration Institutional Development Loan (US$52 million, with a total project size of US$82 million).

55. There is also a macroeconomic environment risk that the nominal exchange rate could depreciate suddenly after several years of stability. As discussed in the Macroeconomic section above, the government is doing all it can to reduce this risk by following a combination of fiscal and monetary policies that reduce the fiscal deficit, the rate of inflation, and the nominal and real interest rates. The policies supported by this loan, to enhance revenue and reduce tax distortions, will help reduce the risk.

d) Poverty Impact.

56. Evidence over the past two decades in Mexico shows that avoiding macroeconomic crises and recession is the best way to protect the poor, that education improves their earning power, and that the Government's major anti-poverty programs help alleviate its effects. As explained above in the Results section, the package of reforms to be supported by the proposed loan will help assure macroeconomic sustainability, will raise more resources for programs that reduce poverty, and will not increase the share of taxes paid by the poor. Thus, overall the program will contribute to poverty reduction in Mexico.

e) Loan Amounts, Conditions, and Arrangements.

57. The proposed US$303.04 million TRAL in the form of a single currency, US dollar loan will be made to the United Mexican States. Disbursements under the proposed TRAL will be made to an account ("Deposit Account") of the *Secretaria de Hacienda y Crédito Público* established at Banco de México for this purpose. The loan will have a bullet repayment of principal after ten years, and an interest rate for fixed-spread variable-rate US dollar single currency loans with an expected disbursement period of one year. The operation will close June 30, 2003.

58. **Disbursement and Procurement.** Loan disbursement will be made under simplified disbursement procedures. Proceeds will be disbursed against satisfactory implementation of the adjustment program, including compliance with stipulated effectiveness conditions. In accordance with the Operational Directive on the Simplification of Disbursement Rules under Structural Adjustment and Sectoral Adjustment Loans (February 8, 1996), disbursements will not be linked to specific purchases and, hence, there will be no procurement requirements. The standard prohibition remains against using proceeds to cover expenses incurred in the borrower's

currency, and the loan proceeds can be kept as the country's foreign reserves or used to finance imports other than the standard excluded expenditures. Once the loan becomes effective, the Borrower will open and maintain a corresponding Deposit Account in dollars at the Banco de Mexico (the central bank). When the Bank is satisfied that the Borrower has fulfilled the conditions for the tranche release, which is expected when the loan becomes effective, the Borrower will submit a simplified withdrawal application against which the Bank will disburse the corresponding loan proceeds into the Deposit Account for the Borrower's use. If, after deposit in this account, the proceeds of the loan are used for ineligible purposes as defined in the Loan Agreement, the Bank will require the Borrower to either: (a) return that amount to the account for use for eligible purposes; or (b) refund the amount directly to the Bank (in which case the Bank will cancel an equivalent undisbursed amount of the loan).

59. **Auditing**. Upon the Bank's request, the Borrower will have the Deposit Account audited by independent auditors acceptable to the Bank and in accordance with standard Bank requirements. Copies of any audit will be submitted to the Bank no later than four months after the date of the Bank's request for such an audit.

60. **Loan Management and Monitoring**. Loan administration will be the responsibility of a loan manager employed by the *Nacional Financiera* (NAFIN). The loan manager will be responsible for preparing the withdrawal application, maintaining the Deposit Account and arranging for its timely audit (if requested by the Bank), and monitoring overall loan implementation. The loan manager, appointed by NAFIN, will also be responsible for coordinating the preparation of the Borrower's contributions to the Implementation Completion Report and for writing those sections relating to loan administration.

61. **Environmental Assessment Requirements**. In accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.00, Annex A), the proposed operation has been placed in Category "U" and will not require an environmental assessment. The Bank maintains with Mexico an active policy dialogue and program in the environment area. As indicated in the 2002 CAS, the Government has a five-year environment action plan, involving both institutional reforms for decentralization and better enforcement and policy reforms, such as user charges, environmental taxes, and improved pricing for water and electricity. The Bank's program supports several aspects of the plan, including with an Environmental Support SAL (FY02 or FY03) and investment projects with GEF and in the areas of water, forestry, and air quality. The tax policy reforms supported in the operation include an investment incentive for environmentally friendly production processes.

V. BANK STRATEGY

a) The CAS and The Proposed TRAL

62. The TRAL will contribute to delivering World Bank support for four of the five objectives that drive the 2002 CAS (scheduled for discussion by the Board of Executive Directors on May 16, 2002). Consolidating macroeconomic gains and human capital development are the most prominent. The President, the Secretary of Finance, and many others have identified the reform of taxes as critical to the overall fiscal reform program—making the fiscal situation sustainable, while assuring the needed and promised fiscal resources for strengthening the Government's various programs in human capital development. By improving the tax system, including reduction of corruption with the strengthening of tax administration,

the loan and its proposed companion loan for institutional development will contribute to the objective of building an efficient, accountable and transparent government. The reduction in the distortions of incentives in the corporate tax regime will contribute to the objective of accelerating growth through enhanced competitiveness.

63. While there is more to do on the fiscal reform agenda, this operation will provide support for the achievements thus far and encourage the completion of the other steps. The operation was envisaged in the 1999 CAS, the 2001 CAS Update, and the 2002 CAS, and its amount lies within previously projected exposure limits and adjustment lending envelopes.

b) Complementarity With Other Operations by the World Bank.

64. The proposed TRAL relates most closely with the proposed Tax Administration Institutional Development Loan, as noted earlier. The simplification and rationalization of the tax regime will complement the Government's anti-corruption efforts, to be supported by the Anti-Corruption Technical Assistance project now being prepared. By improving revenue generation, it will complement all the other projects in the Bank's portfolio.

c) Complementarity With Operations by Other Institutions.

65. The IMF has long taken an interest in tax reform in Mexico and supported the tax proposals of the Government in 2001. The parts of the tax reform actually achieved and the program to strengthen tax administration figure prominently and positively in the Fund's consideration of Mexico for a Contingent Line of Credit. The IDB program does not include any projects related to tax reform, but the Bank and IDB staff coordinate in our related work on subnational finances.

VII. RECOMMENDATION

66. I am satisfied that the proposed loan complies with the Articles of Agreement of the Bank, and I recommend that the Executive Directors approve it.

James D. Wolfensohn
President

by Shengman Zhang

Washington, D.C.
May 20, 2002

SUBSECRETARIA DE HACIENDA Y CREDITO PUBLICO

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

ANNEX 1: Letter of Development Policy

México, D. F., 14 de mayo de 2002.

SR. JAMES D. WOLFENSOHN
Presidente
Banco Mundial
Washington DC, 20433
USA

Estimado Sr. Wolfensohn:

Por medio de la presente, me dirijo a usted para hacer de su conocimiento la intención de la presente Administración de avanzar en el programa de fortalecimiento del sistema tributario nacional. En tal virtud, el Gobierno de México solicita apoyo del Banco Mundial a través de los préstamos *Tax Reform Adjustment Loan y Tax Administration Institutional Development Project*, con el objeto de poder solventar los programas puestos en marcha recientemente en nuestro país.

Para resaltar la importancia que representa para México continuar con la agenda en materia tributaria, a continuación se presenta un breve resumen de lo más destacado de la evolución de la economía mexicana; lo más relevante de las reformas tributarias aprobadas recientemente por el H. Congreso de la Unión, y los temas principales en materia tributaria en los que el Gobierno de México planea enfocar sus esfuerzos en el mediano plazo.

I. Evolución macroeconómica

En los ultimos años, la economía mexicana se ha recuperado favorablemente de la crisis enfrentada a mediados de la década pasada, y avanza con paso firme hacia la integración con sus principales socios comerciales y la economía mundial. México ha recuperado la estabilidad de precios gracias a la disciplina fiscal adoptada por las autoridades y al prudente manejo de la política monetaria por parte del Banco Central. A pesar de los vaivenes del ciclo económico, las cuentas internas y externas se han mantenido en orden en todo momento, fortaleciendo así la confianza de los agentes económicos dentro y fuera del país. Esto ha permitido crear un entorno de estabilidad que ha favorecido la inversión, tanto nacional como extranjera.

La evolución de las variables macroeconómicas refleja el fortalecimiento de las bases de la economía nacional. En el periodo 1996-2000, el PIB registró una tasa de crecimiento real anual promedio de 5.6 por ciento, proceso que se interrumpió temporalmente en 2001 en sintonía con la desaceleración de la economía mundial.

La prudencia en el manejo de la política monetaria y la disciplina fiscal han coadyuvado a disminuir considerablemente la inflación. Durante 2001, por ejemplo, el Índice Nacional de Precios al Consumidor (INPC) alcanzó la menor tasa de crecimiento desde su creación en 1968, registrando un aumento de 4.4 por ciento anual, menor incluso que la meta oficial de 6.5 por ciento. Las tasas de interés nacionales también han registrado una clara tendencia a la baja, alcanzando niveles mínimos históricos en abril de 2002. Además, el tipo de cambio muestra fortaleza y estabilidad.

Las cuentas con el exterior han evolucionado de manera ordenada. El déficit de la cuenta corriente de la balanza de pagos se ha mantenido en niveles congruentes con la disponibilidad de ahorro externo de largo plazo.

Lo anterior ha sido posible gracias a la disciplina en el manejo de la política fiscal. Las autoridades han reaccionado oportunamente ante los vaivenes del ciclo económico y los cambios abruptos en el precio internacional del petróleo, manejo que ha permitido alcanzar las metas fiscales anunciadas en los últimos años. En este proceso, el déficit público ha disminuido de 1.3 por ciento del PIB en 1998 a 0.7 por ciento en 2001.

En materia de deuda pública el gobierno ha instrumentado una política proactiva que le ha permitido aprovechar distintas oportunidades para prepagar algunas emisiones, hecho que se ha traducido en ahorros a futuro y mejoras en el perfil de vencimientos.

Los retos que la economía mexicana tendrá que enfrentar en el corto y mediano plazos son mantener la disciplina en el manejo de la política económica para garantizar una recuperación ordenada y sostenible, así como avanzar en la agenda de reformas estructurales que permitan modernizar el marco regulatorio y mejorar la productividad y competitividad del aparato productivo.

II. Reforma Fiscal

Desde su inicio en diciembre de 2000, la actual Administración ha considerado la reforma fiscal como una alta prioridad. La creciente necesidad de recursos para cubrir satisfactoriamente las responsabilidades del Estado, requiere de un aumento en las fuentes permanentes de ingresos públicos, por lo que ha sido necesario implementar acciones en las siguientes tres áreas:

- Política Tributaria.- Reducir distorsiones y aumentar las fuentes permanentes de recaudación, avanzar en un esquema tributario más equitativo, simplificar y mejorar el cumplimiento fiscal, hacer el esquema fiscal más competitivo y cerrar los espacios para la evasión y elusión fiscales.

- Administración Tributaria.- Diseñar e implementar programas para aumentar la eficiencia en la recaudación y el cumplimiento fiscal, disminuir la corrupción y facilitar el cumplimiento de las obligaciones con el fisco, ampliar los mecanismos y la cobertura de la asistencia fiscal al contribuyente y fortalecer las facultades de la administración tributaria para combatir la evasión fiscal.

- Federalismo Fiscal.- Aumentar las potestades tributarias de los gobiernos estatales y municipales en forma congruente con la Federación.

Gracias al esfuerzo conjunto del Ejecutivo y del H. Congreso por trabajar constructivamente y buscar consensos entre sus representantes, el 31 de diciembre de 2001 se aprobaron importantes cambios en materia de legislación tributaria. A continuación se presentan algunos de los avances logrados.

Política Tributaria. Uno de los objetivos de la reforma es aumentar la recaudación sin introducir distorsiones. En este sentido, la reforma busca incrementar la captación tributaria, expandiendo la base gravable a través de la eliminación de exenciones y regímenes especiales.

La reforma fiscal aprobada contiene avances significativos, especialmente en materia del impuesto sobre la renta. Esta reforma elimina el régimen especial a los sectores agrícola, de autotransporte y editorial; unifica la tasa de gravamen para las utilidades de las empresas, independientemente de si se reparten o no; reduce gradualmente las tasas de gravamen, tanto para las empresas como para personas físicas, durante los siguientes 3 años; reduce el número de rangos de tasas para personas físicas; propone la acumulación total de ingresos gravables para personas física, incluyendo los intereses de bonos gubernamentales o corporativos, dividendos y utilidades bursátiles; elimina el costo del crédito al salario hasta en 3% de la nómina de las empresas; y simplifica el cálculo del ajuste inflacionario y el cumplimiento fiscal de pequeñas y medianas empresas. Asimismo, la reforma incluye cambios a las tasas de los impuestos especiales al tabaco y a las bebidas alcohólicas, e introduce nuevos gravámenes a los refrescos endulzados con fructuosa y a las telecomunicaciones. El impacto de estas reformas en los ingresos públicos comenzó desde su entrada en vigor en enero de 2002, y se espera que crezca en el mediano plazo conforme los contribuyentes asimilen por completo las mejoras regulatorias.

En relación con la agenda de política tributaria, en el mediano plazo se pretende continuar con el impulso de dar más peso a los impuestos indirectos sobre los directos, a efecto de seguir expandiendo la base gravable, minimizar las distorsiones y reducir la evasión y elusión fiscales, así como seguir fortaleciendo las finanzas de los gobiernos estatales y municipales.

Administración Tributaria. La mejora de la administración tributaria también forma parte de los objetivos de la reforma fiscal. En este sentido, se han instrumentado una serie de medidas para mejorar la eficacia y eficiencia de la administración tributaria, que a la fecha, han arrojado resultados favorables. Entre otras medidas, destacan las siguientes: mejorar la coordinación entre las unidades administrativas del Servicio de Administración Tributaria (SAT); mejorar los proceso de auditoría; reducir la corrupción; mejorar la captura, calidad y seguridad de la información dentro de la organización; intensificar la capacitación del personal; mejorar la atención y el servicio al contribuyente, y modernizar los programas y el equipo informático. El Gobierno de México planea continuar con esas tendencias de mejoras en el mediano plazo. El antes mencionado Tax Administration Institutional Development Project será una contribución importante en ese esfuerzo.

Federalismo Fiscal. En materia de federalismo, la reforma aprobada reconoce la necesidad de incrementar las potestades tributarias de los estados y municipios, toda vez que son éstos quienes, en buena medida, ejercen el gasto público. En este sentido, la reforma otorga a los estados nuevas potestades, para que previa autorización de sus respectivos Congresos Estatales, fortalezcan sus ingresos propios. En particular, la Ley de Ingresos 2002 faculta a los estados para establecer una tasa adicional máxima a las ventas finales de bienes y servicios y para gravar en base neta a las personas físicas con actividades empresariales y profesionales con ingresos de hasta 4 mdp, con una tasa de hasta 5%, y de 2% sobre base bruta cuando los ingresos por actividades empresariales no rebasen los 1.5 mdp. Se debe mencionar que los ingresos adicionales que recauden los estados por estos conceptos no se comparten con el Gobierno Federal. En adelante, el Gobierno Federal continuará con el esfuerzo para mejorar la coordinación fiscal entre los gobiernos locales y la Federación (SAT) y mantendrá el apoyo para que los gobiernos locales fortalezcan sus fuentes de ingresos propias, y así consoliden la estabilidad en sus finanzas locales.

III. Otras Medidas

Una de las prioridades de la presente Administración es fortalecer las finanzas públicas. En este sentido, el gobierno ha instrumentado una serie de medidas, adicionales a la reforma tributaria aprobada recientemente por el H. Congreso, orientadas a garantizar la sostenibilidad de la postura fiscal. Entre otras, destacan las siguientes:

- Disciplina y Transparencia Fiscal.- Con el objeto de preservar la estabilidad y certidumbre en el entorno macroeconómico, el gobierno ha mantenido la disciplina fiscal. En este sentido, y para garantizar el cumplimiento de las metas fiscales aprobadas por el H. Congreso, se han incluido en el Presupuesto de Egresos de la Federación una serie de ajustadores automáticos. En particular, el Presupuesto de Egresos para 2002 dispone que en caso de que los ingresos sean menores de lo estimado es necesario ajustar el gasto presupuestario. Por el contrario, si los ingresos obtenidos son mayores de lo previsto, los recursos adicionales deben destinarse, en iguales proporciones, al Fondo de Estabilización de los Ingresos Petroleros (FEIP), a mejorar el balance del sector publico y al impulso de programas de infraestructura. Asimismo, el gobierno continúa con el esfuerzo de mejorar la transparencia fiscal, publicando periódicamente los principales resultados fiscales y de deuda publica, así como indicadores fiscales ampliados que revelan fehacientemente las necesidades de financiamiento del sector publico (RFSP). Gracias al cumplimiento de metas fiscales y a la transparencia fiscal, entre otros logros, es que México ha obtenido recientemente el grado de inversión por las principales corredurías internacionales.

- Reforma Presupuestaria.- Como parte de la iniciativa de reforma para la Nueva Hacienda Publica enviada al H. Congreso en 2001, el Ejecutivo envió una propuesta de reforma presupuestaria, que tiene por objeto reducir la incertidumbre de los procesos de discusión y aprobación del presupuesto, así como facilitar la ejecución de proyectos de inversión multianuales.

- Política de Gasto Publico.- Es un compromiso del Gobierno de México continuar con el esfuerzo por atender las necesidades de salud, educación, seguridad social e infraestructura básica de todos los grupos de la población, y en especial, de los más necesitados. Para ello, se han instrumentado una serie de programas sociales —incluyendo *Contigo* y *Oportunidades*— que tienen por objeto combatir la pobreza, especialmente en zonas urbanas. Sin embargo, debido a las crecientes necesidades en materia social, es imperativo continuar impulsando medidas que permitan fortalecer los ingresos permanentes del Estado y así poder asignar mayores recursos al combate a la pobreza.

- Política de Precios Energéticos.- Reconociendo la importancia del sector energético en las finanzas publicas, y con el objeto de promover la conservación, en febrero de 2002 el gobierno anunció la reducción del subsidio a las tarifas eléctricas residenciales. Esta política se tradujo en un incremento en las tarifas para aquellos hogares con consumos mayores al mínimo, a efecto de proteger el ingreso de las familias con menores recursos.

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IV. Apoyo del Banco Mundial

Si bien la reforma fiscal aprobada representa avances importantes en todas las áreas tributarias, se reconoce que aún queda mucho por hacer, especialmente en materia de administración tributaria. Para ello, el Gobierno de México solicita al Banco Mundial de su apoyo a través del *Tax Reform Adjustment Loan*. De la misma manera, se pretende continuar con las mejoras en materia de administración tributaria, proceso para el cual México solicita apoyo técnico y financiero del Banco Mundial a través del *Tax Administration Institutional Development Project*.

SECRETARIA
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HACIENDA Y CREDITO PUBLICO

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Consciente de la importancia de mantener una postura fiscal sana y sostenible, el Banco Mundial ha mostrado un especial interés en el tema de Reforma Fiscal. En virtud de lo anterior, el Gobierno de México solicita al Banco Mundial de su apoyo técnico y financiero para la consolidación de los programas antes mencionados, considerados por las autoridades nacionales de suma importancia para continuar con el Programa de Reforma Fiscal durante los próximos cuatro años.

Atentamente,
SUFRAGIO EFECTIVO, NO REELECCION.
El Subsecretario,

DR. AGUSTIN GUILLERMO CARSTENS CARSTENS

C.c.p. Dirección General de Crédito Público. Presente.

SECRETARIAT OF FINANCE AND PUBLIC CREDIT
Mexico City

Mr. James D. Wolfensohn
President
World Bank
Washington DC, 20433
USA

Dear Mr. Wolfensohn,

I would like to bring to your attention the intention of the present administration to move ahead with the program of strengthening the national system of taxation. For the sake of this, the Government of Mexico requests the support of the World Bank by means of the *Tax Reform Adjustment Loan* and the *Tax Administration Institutional Development Loan*, with the objective to facilitate the programs recently put in motion in our country.

To emphasize the importance for Mexico of continuing with the agenda of taxation matters, a brief summary is presented of the highlights in the evolution of the Mexican economy, the most relevant aspects of the tax reforms recently approved by the Federal Congress, and the main themes in the tax area on which the Government of Mexico plans to focus its energies in the medium term.

I. Macroeconomic Situation

In recent years, the Mexican economy has recovered favorably from the crisis faced in the middle of the previous decade and is advancing with firm steps toward integration with its main commercial and economic partners in the world. Mexico has recovered price stability, thanks to the fiscal discipline adopted by the authorities and to the prudent management of monetary policy on the part of the Central Bank. Despite the fluctuations of the economic cycle, the internal and external accounts have been maintained in order at all times, thus strengthening the confidence of economic agents within and outside the country. This has made it possible to create a framework of stability that has favored investment by domestic and foreign firms.

The evolution of macroeconomic variables reflects the strengthening of the national economy. In the period 1996-2000, the gross domestic product recorded an average annual growth rate of 5.6 percent, a process that was interrupted temporarily in 2001 along with the deceleration of the world economy.

The prudent management of monetary policy and fiscal discipline have been helping to reduce inflation considerably. During 2001, for example, the national index of consumer prices reached is lowest rate of increase since the time it was created in 1968, registering an increase of 4.4 percent annually, lower than the official target of 6.5

percent for the year. The domestic interest rates also registered a clear downward trend, reaching historic lows in April 2002. Furthermore, the exchange rate is showing strength and stability.

The external accounts have evolved in an orderly manner. The deficit of the current account of the balance of payments has been maintained at levels congruent with the availability of long-term foreign savings.

The above has been possible thanks to the discipline in the management of fiscal policy. The authorities have reacted opportunely in the face of the fluctuations of the economic cycle and the abrupt changes in the international price of petroleum—management that made it possible to achieve the fiscal goals announced in recent years. In this process, the public budget deficit has declined from 1.3 percent of GDP in 1998 to 0.7 percent in 2001.

In matters of public debt the government has used a proactive policy that has permitted it to utilize certain opportunities to repay some debt, which translated into future savings and improvements in the maturity profile.

The challenges that the Mexican economy will face in the short and medium term are to maintain discipline in economic policy management in order to guarantee an orderly and sustainable recovery, as well as to advance with the agenda of structural reforms that will modernize the regulatory framework and improve the productivity and competitiveness of the production system.

II. Fiscal Reform.

From its beginning in December 2000, the present administration in Mexico has accorded high priority to fiscal reform. The growing necessity for resources to cover satisfactorily the responsibilities of the State require an expansion of the permanent sources of public revenues, for which it has been necessary to implement actions in the three following areas:

- Tax Policy— To reduce distortions and increase the permanent sources of tax revenue, to advance a more equitable tax scheme, to simplify and improve the tax compliance, to make the tax system more competitive, and to close the gaps for tax evasion and avoidance.
- Tax Administration— To design and implement programs to increase the efficiency in tax collection and compliance, to reduce corruption and facilitate the compliance of obligations to the Treasury, to expand the mechanisms and the coverage of the assistance to taxpayers, and to strengthen the powers of the tax administration to combat tax evasion.
- Subnational Finances— To increase the tax bases of the state and municipal governments in a form that is consistent with the Federal System.

Thanks to the combined effort of the Executive and the Congress to work constructively and seek consensus among their representatives, important changes were approved on December 31, 2001, in the tax legislation. The following are some of the advances that were achieved.

Tax Policy. One of the objectives of the reform is to increase collections without introducing distortions. In this sense, the reform seeks to increase the tax receipts, expanding the taxable base through the elimination of exemptions and special regimes.

The tax reforms that were approved contain significant advances, especially in the area of income taxes. This reform eliminates the special regimes for the agriculture, trucking, and publishing sectors; unifies the tax rate for corporate earnings, independently from whether they are distributed or not; reduces gradually the tax rate for corporations and individuals over the next 3 years; reduces the number of personal income tax brackets; sets forth the combination of all personal income into one taxable sum, including government and commercial bond interest, stock profits, and dividends; eliminates the cost to the government of salary subsidies up to 3 percent of the payroll of firms; and simplifies the calculation of the inflation adjustment and the tax compliance of small and medium enterprises. Also, the reform includes changes in the rates of excise taxes on tobacco and alcoholic beverages and introduces new taxes on beverages sweetened with fructose and on telecommunications. The impact of these changes on public revenue started when they came into effect in January 2002, and it is expected that it will grow in the medium term as the taxpayers assimilate completely the regulatory improvements.

With relation to the agenda of tax policy reform, in the medium term, the drive will be continued to put more emphasis on indirect taxes relative to direct taxes, with the object to continue expanding the taxable base, to minimize the distortions and to reduce tax evasion and avoidance, as well as to continue strengthening the finances of the state and municipal governments.

Tax Administration. The improvement of tax administration is also part of the objectives of the fiscal reform. In this sense, a series of measures have been orchestrated to improve the efficacy and efficiency of tax administration, which to date have indicated favorable results. Among other measures, the following stand out: to improve the coordination between the administrative units of the Tax Administration Service (SAT); to improve the process of auditing; to reduce corruption; to improve the capture, quality, and security of information within the organization; to intensify the training of personnel; improve the attention and service to the taxpayers; and to modernize the informatics programs and equipment. The Government of Mexico plans to continue with these improvements in the medium term. The previously mentioned Tax Administration Institutional Development Project will make an important contribution to that effort.

Fiscal Federalism. Concerning federalism, the reform that was approved recognizes the necessity to increase the tax bases of the states and municipalities, since they are the ones that to a great extent carry out the spending of the public sector. In this sense, the

reform grants to the states new tax bases, in order to strengthen their own revenues, for which their respective state congresses would provide the authorization. In particular, the 2002 Revenue Law empowered the states to establish an additional tax, up to a certain maximum, on the final sales of goods and services. And it empowered states to tax the income of individuals with entrepreneurial activity, at a rate up to 5 percent on the net income of those with annual revenue up to 4 million pesos and at a rate up to 2 percent on the gross income of those with annual revenue not exceeding 1.5 million pesos. It should be mentioned that the additional revenues that the states collect with these measures are not shared with the Federal Government. In the future, the Federal Government will continue the efforts to improve the coordination of tax enforcement between the local governments and the Federation (SAT) and will maintain the assistance for local governments to strengthen their sources of own income, and thus to consolidate the stability of their local finances.

III. Other Measures

.One of the priorities of the present administration is to strengthen public finances. In this sense, the government has orchestrated a series of measures, in addition to the tax reform recently approved by Congress, oriented to guarantee the sustainability of the fiscal stance. Among others, the following stand out:

Fiscal Discipline and Transparency. With the objective to preserve the stability and certainty in the macroeconomic framework, the government has maintained fiscal discipline. In this sense, and in order to guarantee the compliance with the fiscal targets approved by Congress, a series of automatic adjustment procedures have been included in the Expenditure Budget. In particular, the 2002 Expenditure Budget provides that it is necessary to adjust the budgeted expenditure in the event that revenues are less than estimated. On the other hand, if the revenues are greater than forecast, then the additional revenues need to be destined, in equal proportions, to the Stabilization Fund for Petroleum Revenues, to improve the public sector balance, and to support infrastructure investment programs. Likewise, the government is continuing with the effort to improve fiscal transparency, publishing at regular periods the principal fiscal outcomes and the public debt, and also expanded fiscal indicators that reveal reliably the public sector borrowing requirement (PSBR). Thanks to the achievement of its fiscal targets and to the fiscal transparency, among other things, Mexico has recently obtained investment-grade credit ratings from the principal international rating agencies.

Budget Reform. As part of the reform initiative for the New Public Finances, submitted to Congress in 2001, the executive sent a proposal for budgeting reform, that has as its objective to reduce the uncertainty in the process of discussing and approving the budget, as well as to facilitate the execution of multi-year investment projects.

Public Spending Policy. It is a commitment of the Government of Mexico to continue the effort to attend to the needs of health, education, social security and basic infrastructure of all groups of the population, and especially those most in need. For that, a series of social programs has been instrumented, including *Contigo* and *Oportunidades*,

that have the objective to combat poverty, especially in urban areas. Nonetheless, due to the growing social needs, it is imperative to continue promoting measures that strengthen the permanent revenues of the State, to be able to assign more resources to combat poverty.

Energy Pricing Policy. Recognizing the importance of the energy sector for public finances, and with the objective to promote conservation, the government announced in February 2002 the reduction in the subsidy for residential electricity tariffs. This policy translated into an increase in tariffs for the households with more than minimum power consumption, for the purpose of protecting the income of families with less resources.

IV. World Bank Support

Even though the fiscal reform that was approved represents important advances in all the taxation areas, it is recognized that there is much remaining to be done, especially in the area of tax administration. For that, the Government of Mexico is asking the World Bank for its help through the Tax Reform Adjustment Loan. In the same way, it is the intention to continue with improvements in the area of tax administration, a process for which Mexico is asking technical assistance and financing from the World Bank through the Tax Administration Institutional Development Project.

Conscious of the importance of maintaining a healthy and sustainable fiscal stance, the World Bank has shown special interest in the theme of fiscal reform. By virtue of the above, the Government of Mexico is asking the technical and financial support of the World Bank for the consolidation of the programs mentioned above, and considered by the country authorities as being of highest importance, in order to continue the Program of Fiscal Reform during the next four years.

Sincerely.
Effective suffrage, no reeleccion.
The Undersecretary,

Dr. Agustin Guillermo Carstens Carstens

Cc: General Directorate of Public Credit

ANNEX 2: Fiscal Policy Reforms

Fiscal Policy reforms taken prior to Board Presentation and planned for the future

Program Area	Actions prior to Board Presentation	Planned Future Agenda
Tax Policy	Corporate income tax: reduced sectoral distortions, simplified the rules for the inflation adjustment to valuation of nominal assets and liabilities, gave an investment incentive for area outside the largest cities and for firms using eco-friendly technology, limited deductions for payment of fringe benefits, unified the corporate tax rate and gradually reduced it. Personal income tax: included more assets income as taxable, aggregated all taxable in come of an individual, reduced the number of tax bracket, ended the government subsidy for workers' salaries, simplified the regimes for small tax payers.	Strengthen indirect taxation, through broadened coverage and reduced exemptions.
Policies outside the area supported by the proposed operation:		
Tax Administration	Launched Tax Administration Institutional Development Project (to be supported with a proposed $52 m. loan of the same name): improving taxpayer service through training, customer communication, and electronic means; improving the quality of human and physical resources in SAT and organizing them with an Integrated Resource Management System; improving the quality, organization and accessibility of databases; organizing better the taxpayer registry, collection, auditing and enforcement processes; improving strategic planning and the coordination between the various management units of SAT.	Implement the reforms supported by the Tax Administration Institutional Development Project. These are expected to yield additional revenue, reduce corruption, and make the tax system fairer in its application and appearance.
Subnational Finances	Eliminated discretionary transfers by the Federal Government to states. Eliminated effective federal guaranteed for subnational debt and implemented financial-sector regulations, so that creditworthiness would have important effects on accessibility and cost of loans. Made transparency of subnational finances a condition for cost-effective borrowing by states and municipalities. (Decentralization Adjustment Loan, $600m, approved December 1999, supported these reforms.) The Revenue Law for 2002 gave to states the	Strengthen subnational taxation capacity, including devolving to states on a permanent basis the taxes on final sales and on income of small taxpayers. Improve allocation of federal transfers to states and municipalities for revenue sharing and for social sector spending.

	power in that year to levy a tax of up to 3 percent on final sales and a tax up to 2 percent on the gross income of individuals with small entrepreneurial activity.	
Fiscal Discipline and Transparency	Followed budget implementation practices that make expenditure adjust for any revenue shortfalls during the year (preventing any unforeseen expansion of the deficit) and use any positive revenue windfalls to reduce the deficit, build reserves, and finance infrastructure investment. Increased the detail and regularity of it published fiscal accounts and financial balances	Codify conservative fiscal practices into a permanent law.
Budgetary Reform		Improve rules for the timing of the budget process, for the eventuality that the approval of the budget is delayed beyond the start of the year, and for adjusting the budget during the year.
Energy Policy	Reduced of electricity subsidy in February 2002 and consequently increased tariffs for households with more than minimal consumption levels.	Rationalize pricing and tax and incentive structure for public entities in electricity and petroleum sectors; Expand options for private-sector participation.
Public Spending	Sustained spending for education, health, social safety nets and investment in economic infrastructure (roads and electricity). Expanded the *Oportunidades* program (previously known as *Progresa*) to include a pilot program for an improved social safety net for the urban poor, which the government intends to expand. (A major loan from the IDB, approved in December 2001 supports this.) Introduced a regional anti-poverty program (*ConTigo*) that integrates exiting programs, customizes them for local needs and lays the basis for subsequent expansion.	Increase the progressivity of the overall public sector by increasing the amount, efficiency and equity of public spending: Strengthen anti-poverty programs, especially in urban areas. Make the allocation of resources for education and health sectors more equitable per capita and improve local accountability. Expand spending for both investment and maintenance for highway and road infrastructure.

ANNEX 3: Statement of Loans and Credits

02-May-2002

Project ID	FY	Purpose	Original Amount in US$ Millions IBRD	IDA	GEF	Cancel.	Undisb	Difference between expected and actual disbursements* Orig	Frm Rev'd
P057531	2002	MX Basic Ed Dev Phase II	300.00	0.00	0.00	0 00	300 00	0 00	0 00
P060577	2002	MX Southeast Reg'l Development LIL	5.00	0 00	0 00	0 00	5 00	0 08	0 00
P065988	2002	GEF MX-Consolidation of Protected Areas	0 00	0 00	16 10	0 00	0 01	0 00	0 00
P064887	2001	DISASTER MANAGEMENT (ERL)	404 05	0 00	0.00	0 00	395 74	58 36	0 00
P063463	2001	METHANE CAPTURE & USE AT A LANDFILL	0 00	0 00	6 27	0 00	6 35	1 94	0 29
P060908	2001	GEF MX-MESO AMERICAN CORRIDOR	0 00	0 00	14.84	0 00	13 85	3 07	0 00
P065779	2001	FEDERAL HIGHWAY MAINTENANCE PROJECT	218.00	0 00	0 00	0 00	203 93	-14.07	0 00
P066321	2001	MX. III BASIC HEALTH CARE PROJECT	350.00	0.00	0.00	0 00	350 00	0 00	0 00
P066674	2001	GEF MX-Indigenous&Community Biodiversity	0 00	0 00	7 50	0 00	6 84	2.22	0 00
P071323	2001	Bank Restructuring Facility II	505 06	0.00	0 00	0 00	350 01	0 01	0 00
P057530	2000	RURAL DEV MARG ARII (APL)	55.00	0 00	0 00	0 00	38 92	3 25	0 00
P060718	2000	ALTERNATIVE ENERGY	0.00	0 00	8 90	0 00	6 98	6 92	0 00
P066938	2000	MX GENDER (LIL)	3 07	0.00	0 00	0 00	3 07	1 63	0 00
P048505	1999	AGRICULTURAL PRODUCT	444.45	0 00	0 00	0 00	139 94	50 19	-27 05
P007610	1999	FOVI RESTRUCTURING	505.50	0 00	0 00	0 00	312 00	312 00	0 00
P007711	1998	MX RURAL DEV MARG.AREA (APL)	47 00	0.00	0 00	0 00	29 07	22 75	0 00
P007720	1998	MX HEALTH SYSTEM REFORM - SAL	700 00	0 00	0 00	0 00	150 00	150 00	50 00
P044531	1998	KNOWLEDGE & INNOV.	300.00	0 00	0 00	0 00	195 37	78 71	0 00
P055061	1998	MX HEALTH SYSTEM REFORM TA	25 00	0.00	0 00	0 00	1 31	1 31	0 00
P049895	1998	MX. HIGHER ED FINANCING	180 20	0 00	0.00	0 00	140 19	75 92	0 00
P007700	1997	COMMUNITY FORESTRY	15 00	0 00	0 00	0 00	6 07	5 59	0 00
P007713	1996	WATER RESOURCES MANA	186 50	0 00	0 00	0 00	117 29	101 96	44 17
P007689	1996	MX: BASIC HEALTH II	310 00	0 00	0 00	0 00	23 83	23 83	23 83
P034490	1995	MX: TECHNICAL EDUC/TRAINING	265 00	0 00	0 00	69 69	48 07	117 75	87 72
P007710	1994	N BORDER I ENVIRONM	368.00	0.00	0 00	313 36	22 03	335 40	62 00
P007648	1993	MX MEDIUM CITIES TRANSP	200.00	0 00	0 00	65 50	40 93	106 43	83 43
		Total.	5386.83	0.00	53.61	448.55	2906 81	1445 28	324 39

ANNEX4: Statement of IFC's Held and Disbursed Portfolio

Jan - 2002
In Millions US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1988/91/92/93/95	Apasco	10.80	0.00	0.00	43.20	10.80	0.00	0.00	43.20
1998	Ayvi	8.57	0.00	0.00	0.00	8.57	0.00	0.00	0.00
1990/92/96	BANAMEX	75.71	0.00	0.00	5.49	75.71	0.00	0.00	5.49
0	BBVA-Bancomer	86.47	0.00	0.00	0.00	86.47	0.00	0.00	0.00
1995/99	Baring MexFnd	0.00	2.73	0.00	0.00	0.00	1.90	0.00	0.00
1998	CIMA Mexico	0.00	4.80	0.00	0.00	0.00	4.80	0.00	0.00
1998	CIMA Puebla	7.00	0.00	0.00	0.00	3.50	0.00	0.00	0.00
1994	CTAPV	2.88	0.00	1.69	0.00	2.88	0.00	1.69	0.00
0	Chiapas-Propalma	0.00	0.82	0.00	0.00	0.00	0.82	0.00	0.00
1997	Comercializadora	2.41	0.00	1.72	4.38	2.41	0.00	1.72	4.38
2001	Compartamos	1.00	0.66	0.00	0.00	1.00	0.66	0.00	0.00
1999	Corsa	11.14	3.00	0.00	0.00	11.14	3.00	0.00	0.00
2001	Ecomex	5.00	0.00	1.50	0.00	3.00	0.00	1.50	0.00
2000	Educacion	6.50	0.00	0.00	0.00	4.90	0.00	0.00	0.00
1997	Fondo Chiapas	0.00	4.18	0.00	0.00	0.00	0.54	0.00	0.00
1998	Forja Monterrey	12.07	3.00	0.00	12.07	12.07	3.00	0.00	12.07
1991/96	GIBSA	18.93	0.00	10.00	63.67	18.93	0.00	10.00	63.67
1993	GIDESA	2.50	0.00	0.00	0.00	2.50	0.00	0.00	0.00
1996/00	GIRSA	45.00	0.00	0.00	60.00	45.00	0.00	0.00	60.00
1993	GOTM	0.49	0.00	0.00	0.00	0.49	0.00	0.00	0.00
1997/98	Gen. Hipotecaria	0.00	1.20	0.00	0.00	0.00	1.20	0.00	0.00
0	Grupo BBVA	0.00	2.67	0.00	0.00	0.00	2.67	0.00	0.00
1998	Grupo Calidra	10.00	6.00	0.00	7.50	10.00	6.00	0.00	7.50
	Grupo FEMSA	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1989	Grupo Minsa	12.00	10.00	0.00	18.00	12.00	10.00	0.00	18.00
1997	Grupo Posadas	25.00	0.00	10.00	0.00	25.00	0.00	10.00	0.00
1992/93/95/96/99	Grupo Sanfandila	8.09	0.00	0.00	3.61	6.76	0.00	0.00	2.95
1998	Heller Financial	0.00	0.32	0.00	0.00	0.00	0.32	0.00	0.00
1994/96/98/00	Hospital ABC	30.00	0.00	0.00	14.00	1.76	0.00	0.00	1.24
2000	ITR	14.00	0.00	0.00	4.00	14.00	0.00	0.00	4.00
2000	Innopack	0.00	15.00	0.00	0.00	0.00	15.00	0.00	0.00
2000	Interceramic	5.00	0.00	4.00	0.00	5.00	0.00	4.00	0.00
1994	InverCap	0.00	0.07	0.00	0.00	0.00	0.06	0.00	0.00
2000/01	Merida III	29.59	0.00	0.00	72.15	29.59	0.00	0.00	72.15
1998	Mexplus Puertos	0.00	1.41	0.00	0.00	0.00	1.41	0.00	0.00
1995/99	NEMAK	0.00	0.00	1.51	0.00	0.00	0.00	1.51	0.00
1996/99/00/01	Pan American	0.00	9.00	0.00	0.00	0.00	9.00	0.00	0.00
2000	Rio Bravo	50.00	0.00	0.00	59.50	50.00	0.00	0.00	59.50
2000	Saltillo S.A.	35.00	0.00	0.00	43.00	35.00	0.00	0.00	43.00
2000	Servicios	10.50	1.90	0.00	10.00	10.50	1.90	0.00	10.00
2000	Su Casita	0.00	10.62	0.00	0.00	0.00	10.62	0.00	0.00
2001	Sudamerica	0.00	15.00	0.00	0.00	0.00	15.00	0.00	0.00
1999	TMA	2.58	0.00	2.60	8.95	2.58	0.00	2.60	8.95
1997	Toluca Toll Road	4.83	0.00	0.00	0.00	4.83	0.00	0.00	0.00
1992									
	Total Portfolio:	533.06	117.68	33.02	429.52	496.39	102.67	33.02	416.10

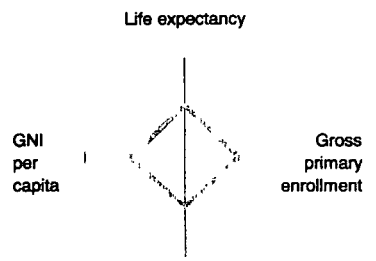
		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic
1999	BANAMEX LRF II	50.00	0.00	0.00	0.00
2001	BBVA-Bancomer CL	100.00	0.00	0.00	0.00
1998	Cima Hermosillo	7.00	0.00	0.00	0.00
2002	Coppel	30.00	0.00	0.00	0.00
2001	Ecomex	3.50	0.00	0.00	0.00
2000	Educacion	3.20	0.00	0.00	0.00
2001	GFNorte-CL	50.00	0.00	0.00	100.00
2001	Greenmanor	7.00	0.00	0.00	0.00
2001	La Colorada	4.30	6.00	0.00	18.30
2001	PanAme-La Colora	0.00	0.00	1.20	0.00
2002	Puertas Finas	13.00	0.00	0.00	0.00
2001	Su Casita	0.00	2.40	0.00	0.00
	Total Pending Commitment:	268.00	8.40	1.20	118.30

ANNEX 5:

Mexico at a glance

POVERTY and SOCIAL	Mexico	Latin America & Carib.	Upper-middle-income
2000			
Population, mid-year *(millions)*	98.0	516	647
GNI per capita *(Atlas method, US$)*	5,080	3,680	4,620
GNI *(Atlas method, US$ billions)*	497.0	1,895	2,986
Average annual growth, 1994-00			
Population *(%)*	1.5	1.6	1.3
Labor force *(%)*	2.5	2.3	2.0
Most recent estimate (latest year available, 1994-00)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	74	75	76
Life expectancy at birth *(years)*	72	70	69
Infant mortality *(per 1,000 live births)*	29	30	28
Child malnutrition *(% of children under 5)*	8	9	..
Access to an improved water source *(% of population)*	86	85	87
Illiteracy *(% of population age 15+)*	9	12	10
Gross primary enrollment *(% of school-age population)*	114	113	107
Male	116	.	106
Female	113	..	105

Development diamond*



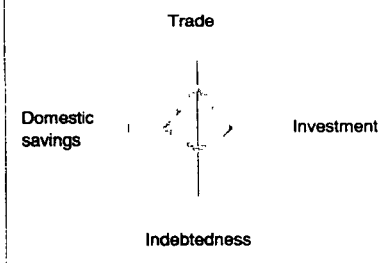
Mexico
Upper-middle-income group

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1980	1990	1999	2000
GDP *(US$ billions)*	223.5	262.7	479.4	579.9
Gross domestic investment/GDP	27.2	23.1	23.5	23.1
Exports of goods and services/GDP	10.7	18.6	30.9	31.1
Gross domestic savings/GDP	24.9	22.0	21.9	21.3
Gross national savings/GDP	22.4	20.3	20.5	20.1
Current account balance/GDP	-4.7	-2.8	-3.0	-3.1
Interest payments/GDP	2.0	2.2	2.1	2.0
Total debt/GDP	25.7	39.8	35.0	28.4
Total debt service/exports	45.4	20.9	25.8	34.0
Present value of debt/GDP	..	..	33.9	26.1
Present value of debt/exports	..	..	102.6	77.8

	1980-90	1990-00	1999	2000	2002-04
(average annual growth)					
GDP	1.1	3.1	3.8	6.9	3.3
GDP per capita	-1.0	1.4	2.3	5.4	1.9
Exports of goods and services	7.0	14.6	12.4	16.0	4.9

Economic ratios*

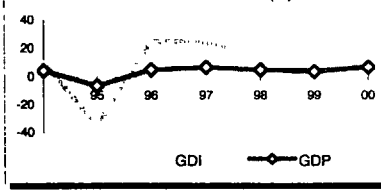


Mexico
Upper-middle-income group

STRUCTURE of the ECONOMY

	1980	1990	1999	2000
(% of GDP)				
Agriculture	9.0	7.8	4.7	4.2
Industry	33.6	28.4	28.8	27.9
Manufacturing	22.3	20.8	21.1	20.4
Services	57.4	63.7	66.5	67.8
Private consumption	65.1	69.6	67.1	67.5
General government consumption	10.0	8.4	10.9	11.0
Imports of goods and services	13.0	19.7	32.4	32.8

Growth of investment and GDP (%)



	1980-90	1990-00	1999	2000
(average annual growth)				
Agriculture	0.8	1.8	2.0	2.1
Industry	1.1	3.8	4.2	6.6
Manufacturing	1.5	4.4	4.2	7.1
Services	1.4	2.9	3.7	7.4
Private consumption	1.4	2.4	4.3	9.5
General government consumption	2.4	1.8	3.9	3.5
Gross domestic investment	-3.3	4.6	4.1	8.8
Imports of goods and services	1.0	12.3	13.8	21.4

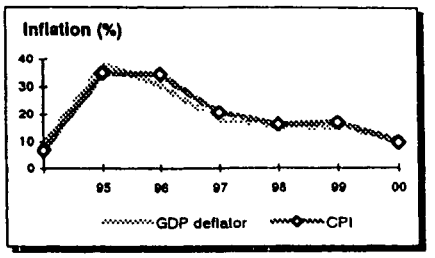
Growth of exports and imports (%)

Note. 2000 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

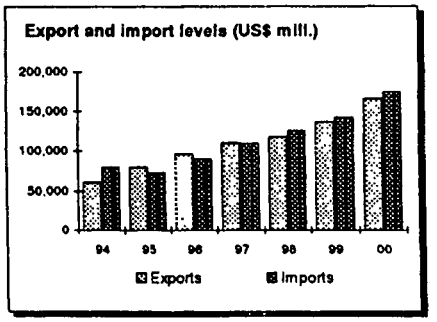
PRICES and GOVERNMENT FINANCE

	1980	1990	1999	2000
Domestic prices				
(% change)				
Consumer prices	..	26.7	16.6	9.5
Implicit GDP deflator	33.4	28.1	14.9	10.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	27.4	25.3	20.9	21.8
Current budget balance	4.1	0.9	1.5	2.0
Overall surplus/deficit	-3.6	-2.6	-1.1	-1.1



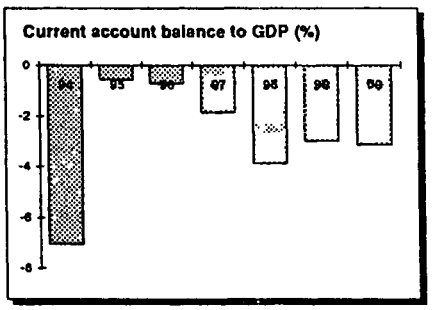
TRADE

	1980	1990	1999	2000
(US$ millions)				
Total exports (fob)	16,284	40,711	136,391	166,455
Oil	10,441	10,104	9,928	16,383
Agriculture	1,528	2,162	3,926	4,217
Manufactures	3,802	27,828	122,085	145,334
Total imports (cif)	19,342	41,593	141,975	174,458
Consumer goods	2,448	5,099	12,175	16,691
Intermediate goods	11,720	29,705	109,270	133,637
Capital goods	5,174	6,790	20,530	24,130
Export price index *(1995=100)*	134	99	98	106
Import price index *(1995=100)*	67	90	99	102
Terms of trade *(1995=100)*	201	110	99	103



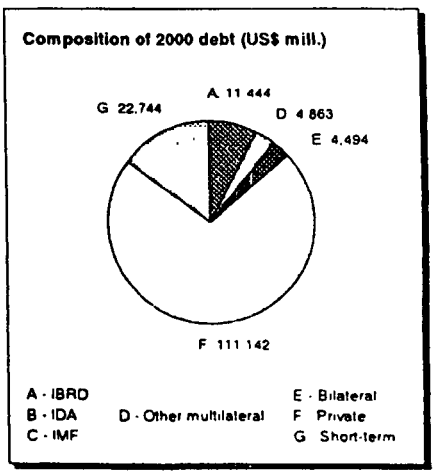
BALANCE of PAYMENTS

	1980	1990	1999	2000
(US$ millions)				
Exports of goods and services	22,600	48,732	148,083	180,167
Imports of goods and services	27,430	51,535	155,465	190,494
Resource balance	-4,830	-2,803	-7,382	-10,326
Net income	-6,438	-8,626	-13,306	-14,747
Net current transfers	833	3,978	6,313	6,994
Current account balance	-10,434	-7,451	-14,375	-18,079
Financing items (net)	11,453	10,999	14,969	20,901
Changes in net reserves	-1,019	-3,548	-594	-2,822
Memo:				
Reserves including gold *(US$ millions)*	3,052	9,909	31,829	33,595
Conversion rate *(DEC, local/US$)*	2.00E-2	2.8	9.6	9.5



EXTERNAL DEBT and RESOURCE FLOWS

	1980	1990	1999	2000
(US$ millions)				
Total debt outstanding and disbursed	57,378	104,442	167,626	154,687
IBRD	2,063	11,030	11,027	11,444
IDA	0	0	0	0
Total debt service	10,958	11,311	39,760	63,038
IBRD	255	1,552	2,155	2,220
IDA	0	0	0	0
Composition of net resource flows				
Official grants	14	54	..	..
Official creditors	795	4,168	-1,708	-525
Private creditors	-524	-582	13,181	-5,059
Foreign direct investment	2,156	2,549	11,915	13,286
Portfolio equity	0	563	3,901	478
World Bank program				
Commitments	625	2,562	1,671	1,130
Disbursements	422	3,326	844	1,647
Principal repayments	89	801	1,323	1,330
Net flows	333	2,525	-479	318
Interest payments	166	751	832	890
Net transfers	167	1,774	-1,311	-573



MAP SECTION

IBRD 23547

The boundaries and names shown and the designations used on this map do not imply, on the part of The World Bank Group, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.

FEBRUARY 1992

MAP SECTION