



ANNUAL MEETING OF THE BOARDS OF GOVERNORS

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**ADDRESS BY THE GOVERNOR FOR MEXICO
AT THE SECOND PLENARY SESSION**

Francisco Gil Díaz

1. I am very pleased to take part in this Annual Meeting of the Boards of Governors of the Inter-American Development Bank and the Inter-American Investment Corporation. I would like to add my congratulations and thanks to the Government of the Federative Republic of Brazil for its warm hospitality and excellent organization of this event in the beautiful city of Fortaleza. I am certain that this meeting will be extremely useful and important, particularly in light of the current economic climate.
2. The synchronization of the economic cycle among the main economic blocks observed this past year confirms the close inter-dependency that exists in the world of today. Furthermore, the tragic events of September 11th have had an impact on the international community as a whole and on the very foundations on which the world economy has been built.
3. Growth in world trade, for example, shrank dramatically, from 13 percent in 2000 to just 1 percent in 2001, according to World Bank estimates. The increase in the cost of transportation and transaction costs in general, associated with closer international scrutiny for security reasons, will undoubtedly have a permanent impact on the free movement of goods, services and people in the coming years.
4. However, and as a counterweight to these negative developments, the macroeconomic coordination observed in the world in the final quarter of last year, particularly the widespread drop in interest rates, had a direct influence on the prospects for global economic recovery.
5. The market consensus suggests that the United States economy could recover more quickly than expected and the Federal Reserve has estimated real GDP growth of between 2.5 and 3 percent in 2002. This favorable outlook appears to be backed by some recent economic indicators, including the clear-out of inventories and renewed consumption and investment in the same sectors that had previously accelerated the recession, such as the high-technology

industry. However, risk factors still exist, such as high consumer and corporate debt and a volatile stock market in the wake of egregious corporate failures and accounting scandals.

6. As a result of the growing convergence between the Mexican and U.S. economies, the Mexican economy is today closely linked to the economic cycle of its main trading partner. The differential between the interest rates of both countries has fallen to its lowest level in history. In 2001, inflation in Mexico was just 2 percentage points higher than in the United States.

7. For the first time in three decades, the Mexican economy has gone through the ups-and-downs of a traditional economic cycle, in the midst of unprecedented financial and price stability. The Economic Program for 2002 is intended to preserve this macroeconomic stability and lay the groundwork for orderly recovery.

8. Granting Mexico investment-grade status is a recognition of the progress made through more transparent and accountable economic management.

9. Approval by Congress of the target proposed by the executive branch to maintain a fiscal deficit of 0.65 percent of GDP in 2002, fully financed with domestic resources is an encouraging sign of a growing political consensus regarding the need to continue with responsible fiscal policy and achieve a balanced budget in the medium term.

10. This progress is particularly noteworthy, given the growing political pluralism in Mexico today. It was in these very circumstances that Congress passed changes to the fiscal regime at the end of last year, broadening the tax revenue base.

11. Consistency between fiscal and monetary policy has been crucial for weathering an unfavorable international economic climate. Convergence in inflation levels with our main trading partners continues to be a steadfast objective. Lower inflation brings lower interest rates and therefore lower financing costs, which will lead to a recovery in lending by banks.

12. The Mexican banking system is facing the challenge of becoming a driving force for economic growth. The changes made in recent years have consolidated sound, more competitive and better-regulated banks. According to an evaluation made under the financial sector assessment program sponsored by the World Bank and the IMF, private banks have ceased to be a risk factor for the stability of the Mexican economy.

13. I would also like to touch briefly on the importance of this assessment—known as FSAP in English—in promoting a package of financial reforms approved last year, which will strengthen the Mexican financial system and spur domestic savings:

- First, we sought to establish a new operating framework for banking institutions, while reforming bank regulation and supervision to make it more effective and less expensive.
- Second, we passed legislation to strengthen the stock market and make it a solid alternative source of financing for enterprises. The promotion and development of investment companies and the introduction of better corporate governance

practices, including enhancing the rights of minority shareholders, are worth mentioning.

- Last, we passed a new Public Credit and Savings Act and created the National Savings and Financial Services Bank (BANSEFI). These two instruments will extend the coverage of financial services to the entire population, particularly low-income Mexicans, through different non-bank intermediaries that we have grouped under the concept of people's banks.

14. Today, relations between the IDB and Mexico are closer than ever and have taken on particular relevance. The Bank has supported the process of economic and social change in our country, responding to the changing needs of an economy that is consolidating macroeconomic foundations, boosting competitiveness and seeking to overcome social lags to offer better development opportunities to its people.

15. From the start of President Vicente Fox's administration, Mexico's operations with the Bank have focused on improving and consolidating a social safety net that offers health, education and housing benefits to the most vulnerable groups in our country. We have also worked to support job training, promote productive activities in the countryside and strengthen the capacity of states and municipalities to make productive investments. All this by focussing the allocation of public resources in a transparent, accountable and effective manner.

16. Today, we seek in the IDB a partner to support us in the design and development of innovative projects to strengthen public institutions and provide legal assurances, with a view to promoting a context that fosters private investment, higher levels of savings and more accessible financial services that are better regulated and more competitive.

17. I would like to turn to the Bank's internal work and express our satisfaction over the recent approval of a new lending framework for the Bank. The agreement is the result of intensive analysis and consultation by the Board of Executive Directors and the Committee of the Board of Governors in compliance with a resolution we approved one year ago in Santiago, Chile.

18. The decision permits our institution to continue offering loans to support policy reforms, maintain and increase the level of investment operations, reinforce the development effectiveness and impact of Bank operations and begin to establish a culture geared to measurement of results.

19. Another particularly important aspect of the new lending framework is institutionalization of the Emergency Lending Facility. It should be a clearly-differentiated and defined financial product intended to cushion the impact of international financial crises, protect social programs and avoid setbacks in economic reforms of the member countries that make use of it. These loans will complement the funds provided by other multilateral lending agencies for macroeconomic stabilization programs endorsed by the International Monetary Fund.

20. Mexico has pointed out the importance of expanding the Bank's portfolio of financial products to include innovative instruments that are responsive to the development priorities of our countries. Products that will reduce the vulnerability of countries to external shocks

through contingent lines of credit that include the private sector are of particular interest. Instruments that help to mitigate our countries' financial and exchange risks, based on the Bank's credit worthiness, are equally necessary.

21. It is particularly important for the IDB to make progress in this direction, owing to the well-known fact that capital inflows to the emerging countries have been declining since 1999, and in 2001 they became net exporters of resources.

22. In a context of scarce resources and pressing social demands, our region needs to substantially improve the efficiency and transparency of public spending. We therefore urge the IDB to intensify its work in this area by providing technical assistance and training, in addition to financial resources. To raise the subject of the current debate on the provision of what has been called global public goods, in our opinion, this area should be recognized as a regional public good.

23. It is our understanding that the Board of Executive Directors is about to embark upon an orderly process of detailed review of proposals for these and other new financial instruments, which are intended to expand the Bank's capacity to serve the development needs of its member countries. This process complements and enriches the recently-approved lending framework and we urge the Board to arrive at concrete results as quickly as possible.

24. In parallel to the negotiation of the agreement I have just referred to, and under the coordination of by the External Advisory Group established by President Enrique Iglesias, the IDB carried out an exercise to examine the challenge of how to continue being a relevant player in the region's development. In this regard, I would like to underline four issues that are included in the group's report and which merit a more detailed analysis by the Bank.

25. The first refers to the support that the IDB can provide for boosting the competitiveness of our countries, in a climate of financial stability and integration into the world economy. Particularly important are actions to establish a predictable and transparent regulatory framework that is conducive to public and private investment.

26. The second is to strengthen the Bank's interventions during economic crises in the countries of the region, by designing preventive mechanisms that include private sources of financing.

27. The third is to step up the Bank's activities with the private sector, focusing on the development of domestic capital markets and the expansion of activities to mitigate risk. More work on new types of guarantees would also be desirable.

28. The fourth refers to the support that the Bank provides for regional integration processes. I would like to point out here that the IDB has accepted the challenge of turning the Puebla-Panama Plan, launched by President Vicente Fox and the seven Central American presidents, into concrete projects to create a meso-American corridor of economic development and political cooperation. We applaud the recent approval of the first regional operation under the Puebla-Panama Plan, which is a project to interconnect the electric grids of the Central American countries, also to be connected to the Mexican electric grid.

29. I would like to turn briefly to the other two components in the IDB Group: the Inter-American Investment Corporation and the Multilateral Investment Fund.
30. The Corporation is an indispensable complement for financing small and medium-sized enterprise in the region. The current economic context has placed some of the enterprises financed by this institution in a difficult position. We believe that the Corporation should seek creative formulas to enable it to maintain its financial returns, without losing sight of the development objectives of the entrepreneurial sector it serves.
31. The Multilateral Investment Fund has developed innovative projects in Mexico in areas such as consolidation of the people's savings system, the productive use of remittances and the creation of risk capital funds for productive projects in marginal areas. We are therefore pleased that the Donors Committee has decided to extend the Fund's mandate, allowing it to use up its resources and adequately evaluate and disseminate its operations. We invite the Bank's members who are still not part of the fund to join this innovative and valuable instrument for promoting private-sector development in our countries.
32. In 2001 we unanimously approved the plan that formalized the Bank's participation in the Heavily Indebted Poor Countries Initiative. This has allowed the beneficiary countries to begin to individually present their debt-reduction requirements with the IDB and with subregional financial institutions. We urge the Bank to continue this process with a view to channeling these resources in a suitable and timely manner.
33. Last, I would like to reiterate the solidarity of the Mexican people and government with Argentina at this difficult time. We support the Bank's participation in the efforts to enable Argentina to return to the path of economic growth as quickly as possible.
34. The Bank has built channels for action and discussion, acting as a true partner in the transformation of our countries and as the main source of multilateral funding to finance the region's development.
35. In these last years, the IDB has clearly demonstrated its commitment to adapt to the new needs and challenges facing Latin America and the Caribbean. President Iglesias, allow me once again to acknowledge your efforts and dedication in consolidating the leadership role of the IDB as a model regional development bank.