



External finance for rural development

Country case study: Mexico

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Key messages

- The Government of Mexico has prioritised agriculture and rural development in national and sectoral strategies, with the sector seen as important for tackling poverty and inequality.
- The government has protected the budget for priority projects and programmes from the impact of the Covid-19 crisis, but has frozen operational budgets for other activities. This will affect agriculture and rural development projects that are not defined as government priorities, including forestry and rural development projects supported by development partners.
- Demand for external borrowing from development partners is likely to coalesce around the government's priority projects and programmes, and demand for external borrowing for agriculture and rural development will remain static or contract.
- The government values the technical expertise provided by development partners, support to build the capacity of government counterparts and the introduction of improved approaches to agriculture and rural development.

Introduction

Background

Rural development worldwide relies heavily on private funding. Yet the public sector has a key role to play in providing both investment and policy support to tackle persistent market failures. These include the under-provision of public goods (such as infrastructure, and research and development), negative externalities (such as the need to adapt to and mitigate the effects of climate change), informational asymmetries (e.g. the development of rural financial services) and the lack of protection for vulnerable people through, for example, social protection.

Far more finance is needed to achieve food security and promote sustainable agriculture in line with Sustainable Development Goal (SDG) 2. The United Nations (n.d.) estimates that an additional \$267 billion per year is needed to achieve every SDG 2 target: almost twice as much as total official development assistance (ODA) each year from all donors combined. Official development finance (ODF)¹ to agriculture and rural development rose slightly from \$10.2 billion in 2015 to \$10.9 billion in 2018. This is only a fraction of the total ODF disbursements of \$254 billion in 2018. Public expenditure on agriculture development also remains low: since 2001, governments have spent, on average, less than 2% of their central budgets on agriculture (FAO, 2019).

Objectives, definitions and methodology of this country case study

This country case study summarises key findings from a country analysis of financing for rural development in Mexico. It is one of 20 analyses that is synthesised for comparison in Prizzon et al. (2020).

The case study has two main objectives:

- to map demand from the Government of Mexico over the next five to 10 years for external development assistance to support public investment in inclusive and sustainable rural development
- to analyse the financial and non-financial terms and conditions of such demand, its main preferences and the type of instruments that the government wishes to access or scale-up to support public investment in rural development.

Definitions

What we mean by public investment in inclusive and sustainable rural development (see Prizzon et al., 2020, for more details): Our research has focused on six areas that contribute to such investment: access to agricultural technologies (research and development) and production services; agricultural value chain development (e.g. crops, livestock, fisheries); climate-resilient agricultural practices; rural basic infrastructure (e.g. water and irrigation systems, local roads, local energy generation and storage facilities); rural financial services; and rural investment environment (e.g. policy, legal and regulatory frameworks).

What we mean by external assistance for inclusive and sustainable rural development: We look beyond ODA to include government-to-government funds from bilateral and multilateral donors that do not meet concessionality criteria² (usually defined as other official flows, or OOFs). We call this official development finance (ODF). As a proxy for financing rural development, we examine data on external assistance to the agriculture sector and rural development (cross-cutting) based on an Organisation for Economic Co-operation and Development (OECD) definition.

1 The sum of ODA and OOFs: the latter flow from bilateral and multilateral donors that do not meet the concessionality criterion for ODA eligibility.

2 The definition of concessionality is based on the share of the grant element. With the 2014 OECD reform, the grant element varies according to the income per capita of the ODA eligible country to be counted as ODA: at least 45% for low-income countries (LICs), 15% for lower-middle-income countries (LMICs) and 10% for upper-middle-income countries (UMICs). The International Monetary Fund (IMF) discount rate (5%) is also adjusted by income per capita group: 1% for UMICs, 2% for LMICs and 4% for LICs, including least-developed countries (LDCs).

This is not a perfect measure, but given the lack of a sectoral definition or attribution to rural development as such, it is the closest we can get to a consistent, cross-country mapping external assistance from development partners. As a second-best option, we rely largely on quantitative and qualitative data on agricultural development. While the agriculture sector is a major component of rural development, data on agriculture alone cannot capture important non-farm activities.

Research questions

This country case study reflects our four main research areas:

- the government's priorities for public investment in inclusive and sustainable rural development
- financing for public investment in inclusive sustainable rural development
- borrowing (external development assistance) for this public investment
- the government's preferences in relation to external development assistance for public investment, including its demand for specific types of instruments.

As this project took place during the early stages of the Covid-19 pandemic, we also reflect the short- and medium-term implications of the crisis for government priorities and preferences for public investment, as well as the amount and type of external assistance demanded.

Methodology

We used a qualitative case study approach, with the analysis of individual countries informed by a political economy framework, as developed by Greenhill et al. (2013) for aid negotiations (see Prizzon et al., 2020).

Our approach comprised a critical review of relevant policy literature³ and data analysis,⁴

which also helped us to identify country stakeholders. This was followed by interviews with key informants, informed by an electronic questionnaire submitted before each interview. For Mexico, we held nine interviews between June and July 2020, and received 24 questionnaires (see Annex 1 for a list of those interviewees who agreed to their names being shared).

Mexico: country context

Mexico has been classified as an upper-middle-income country (UMIC) since 1990 and has been a member of the OECD since 1994. The country is only eligible for loans from the International Bank for Reconstruction and Development (IBRD).

The country is eligible for finance from the Inter-American Development Bank (IDB) through its flexible financing facility (FFF) (IDB, 2011). Mexico is the third largest borrower of the IBRD and the second largest borrower of the IDB (Engen and Prizzon, 2018). The active portfolio of the World Bank in Mexico in mid-2020 stood at \$3.2 billion (World Bank, 2020b), while the IDB portfolio contains a further \$2.8 billion in active operations (IDB, 2020).

The country faces weak economic growth and structural problems. Mexico's gross domestic product (GDP) growth averaged just above 2% a year between 1980 and 2018 (World Bank, 2020a). Rates show a similar trend over recent years, with a slow-down in 2017 and 2018 and a projected growth rate of only 0.4% in 2019 (IMF, 2019).

With a population growth rate of 1.1% (IFAD, 2020b), GDP per capita has grown at approximately 1%, and its low per-capita growth helps to explain why Mexico has failed to converge with other OECD members. The country has a strong financial sector and is open to trade and investment, but structural problems in the form of corruption, informality and crime have eroded confidence among investors (IMF, 2019).

3 The government development plan, sectoral plans, debt management policies, and IMF Article IV papers.

4 Spanning IMF, OECD and World Bank sources.

The crisis of the national oil company Pemex⁵ has also reduced government revenues (ibid.).

Despite qualifying as a UMIC in terms of income per capita, Mexico has major pockets of poverty, as well as regional disparities. The economy of the north has been thriving, with an annual average growth rate of 3.3 % since 2015, while the south has been in recession (ibid.). This has important implications for the distribution of poverty. Poverty levels across the country have barely changed in the last decade (CONEVAL, 2019). In 2019, 48.8% of the population was defined as poor by national standards – with barely any difference since 2008, when the figure was 49.0% (ibid.). Extreme poverty levels remained stable at 16.8% over the same period. Poverty is highly concentrated in a small number of states in the south of the country or in states that have large populations of Indigenous people (IFAD, 2020b).

Agriculture remains an important economic activity in rural Mexico. In 2018, agriculture employed 13% of the population and contributed 3.4% of the country's GDP (World Bank, 2020c). More than 75% of agricultural producers are smallholders with less than 5 hectares, and productivity levels are low (IFAD, 2020b).

Forest management is also an important activity for rural communities and is carried out mainly by owners and titleholders of communal lands (*ejidos*) (ibid.). Approximately 12 million people live in forest areas, and 60% of forests belong to communities (ibid.).

There are high rates of poverty among those living in Mexico's forest areas (World Bank, 2018). There is no significant gender gap in the poverty rate (44% of women versus 43% of men), but women experience greater levels of deprivation in terms of food, health and education (IFAD, 2020b). The highest percentage of women living in poverty is found among those living in rural areas who speak an Indigenous language (80%) (ibid.).

Mexico is seen as a low-vulnerability country in the ND-GAIN index (ND-GAIN, 2020), but is exposed to extreme weather events and other

natural phenomena (earthquakes, etc.) (Calleja and Prizzon, 2019). Agriculture remains very sensitive to climate change and extreme weather events, and this has a direct impact on the food security and livelihoods of both rural and urban populations (IFAD, 2020b).

Government priorities for rural development

The agriculture and rural development sector faces challenges that, in general, reflect the geographical north–south divide discussed above. The overall productivity of the agricultural sector is low, especially among smallholders (IFAD, 2020b).

The government has redefined development priorities. In July 2018, Andrés Manuel López Obrador won the presidential elections, having promised new pro-poor programmes during his campaign, as well as advances in food sovereignty (ibid.). On coming to power, the government approved a new National Development Plan (PND) for the period 2019–2024 (Presidencia de la República, 2019). The PND is built around 30 priority projects and programmes that cover different areas (GoM, 2020e). The PND does refer to gender and to youth, but not in the context of agricultural and rural development programmes.

The PND is being developed through sectoral strategies (*programas*) that were approved in mid-2020. There is a Sectoral Strategy for Agriculture and Rural Development 2020–2024 (GoM, 2020a), which focuses on small and medium-sized producers. The strategy has three main objectives: increase production to achieve food sovereignty; reach out to marginalised producers in rural areas; and make production more sustainable. The Sectoral Strategy is based for the most part on four priority projects proposed in the PND (see Table 1).

Another sectoral strategy that has a significant impact on agriculture and rural development is the Sector Strategy for Wellbeing (GoM, 2020b). This aims to reduce poverty and inequality and

5 Pemex has suffered from a steep decline in production, exacerbated by the collapse in crude oil prices from the mid-2010s. The government had to step in with a bailout of \$4.4 billion in 2016. The company has also experienced a series of fatal accidents in recent years.

Table 1 Selected projects and programmes related to agriculture and rural development

Ministry (<i>Secretaría</i>)	Key projects/programmes	Summary
Agriculture	<i>Crédito Ganadero a la Palabra</i>	In-kind credit scheme: farmer receives cattle as a loan and returns the same number of heads of cattle after a given period of time
	<i>Fertilizantes para el bienestar</i>	Free fertilisers for farmers in marginalised communities, initially in the State of Guerrero
	<i>Producción para el Bienestar</i>	Direct economic support to small- and medium-sized farmers of corn, wheat, beans, rice, coffee and sugar cane
	<i>Precios de Garantía a Productores del Campo</i>	Promotion of national production and increase of the income of small dairy and basic crops farmers
Wellbeing	<i>Sembrando Vida</i>	Poor households and indigenous populations targeted in the south and south-eastern regions, mainly Chiapas, Oaxaca, Guerrero, Puebla and Veracruz
	<i>Programa de Fomento a la Economía Social</i> (not a priority project in the PND)	Increase of incomes in poor communities through financial and economic inclusion initiatives. Focused on poor, rural, marginalised and indigenous communities
Communications	<i>Carreteras Rurales</i>	Improvement of access roads to indigenous communities in the State of Oaxaca

Source: GoM (2020a)

includes a programme that targets smallholders (*Sembrando Vidas*) and another that focuses on the economic inclusion of poor communities (see Table 1). In addition, the Sectoral Strategies for Agricultural, Territorial and Urban Development (GoM, 2020d) and Environment and Natural Resources (GoM, 2020c) contain actions and objectives that are linked to the agriculture and rural development sector.

The PND and sectoral strategies have a stronger focus on productive inclusion, rural areas, poor households and Indigenous communities than previous strategies. Past administrations emphasised compensatory subsidies for rural areas (IFAD, 2020b). In addition, according to our interviewees, a large share of government spending in the sector was rather ‘regressive’ and did not reach smallholders or poor communities.

In this context, the stronger focus on social inclusion, combined with a focus on the poorest and most marginalised groups, is seen as a step in the right direction by several stakeholders interviewed by the team. However, it is still too early to make a comprehensive analysis as the PND is relatively new and the sectoral strategies have only just been approved. In addition, the Covid-19 crisis has had a significant impact on the government budget.

While the Covid-19 crisis has not affected the government’s priority projects and programmes, it is having a significant impact on other projects and initiatives in the agriculture and rural development sector. On 23 April 2020, the government passed a decree with a set of financial and fiscal measures in the context of the Covid-19 crisis (Presidencia de la República, 2020). The decree freezes government spending except for the government’s priority projects and programmes; removes 10 sub-secretaries; and commits to the strict implementation of the Federal Austerity Law in public finances. The freeze will reduce the operations spending of affected departments by 75%. Savings in the public budget would go to priority projects and programmes, as well as social and economic reactivation measures (credits to businesses, etc.).

Budget cuts have affected, for example, the Comisión Nacional Forestal (CONAFOR), an agency working on forestry and rural development, which has active programmes with the World Bank or the International Fund for Agricultural Development (IFAD). CONAFOR has signed memoranda of understanding and works closely with the Agriculture and Environment departments. Budget cuts are also likely to affect the *Programa de Fomento a la Economía Social* as it is not one of the

priority projects and programmes defined by the government (see Table 1). The implications for the implementation of projects in the agriculture and rural development sector are discussed below.

Mexico has several public development finance institutions that are active in the agricultural and rural development sector, and they play a key role in the implementation of the government's sectoral priorities. *Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero* (FND) aims to increase access to finance in rural areas, providing financial services directly or through credit institutions. *Banco del Bienestar* is a key entity in social transfer programmes in Mexico, and promotes access to finance across the country. *Fideicomisos Instituidos en Relación con la Agricultura* (FIRA) is a trust fund that provides financial (credit, guarantees, grant, etc.) and non-financial services (technical assistance, capacity building, etc.) to companies that are active in the agriculture, rural, forestry and fishing sectors. Compared to the FND, FIRA products tend to target larger producers. There are also ongoing discussions about the creation of a new institution (*Financiera Nacional Agropecuaria* (FINAGRO)) that would merge FND and some smaller trust funds.

Rural development efforts are pursued in a complex institutional environment. The PND programmes and priorities have been assigned to individual government ministries (*Secretarías*) or agencies. As a result, the main competences in issues related to agriculture and rural development currently involve six different ministries (GoM, 2020a).

The actual budget for rural development is reflected in the Special Concerted Programme for Sustainable Rural Development (PEC), a technical annex to the national budget, and includes a complex web of government institutions (CEDRSSA, 2019). In addition, Mexico is a heavily decentralised country, with states having significant operational freedom. The implementation of projects at the local level requires the coordination of several entities at different levels.

Not surprisingly, this complex institutional environment creates coordination challenges. In this context, some initiatives have emerged

that aim to improve coordination, such as the Intersectoral Group on Health, Food and Environment (GISAMA).

Financing rural development

Public finance

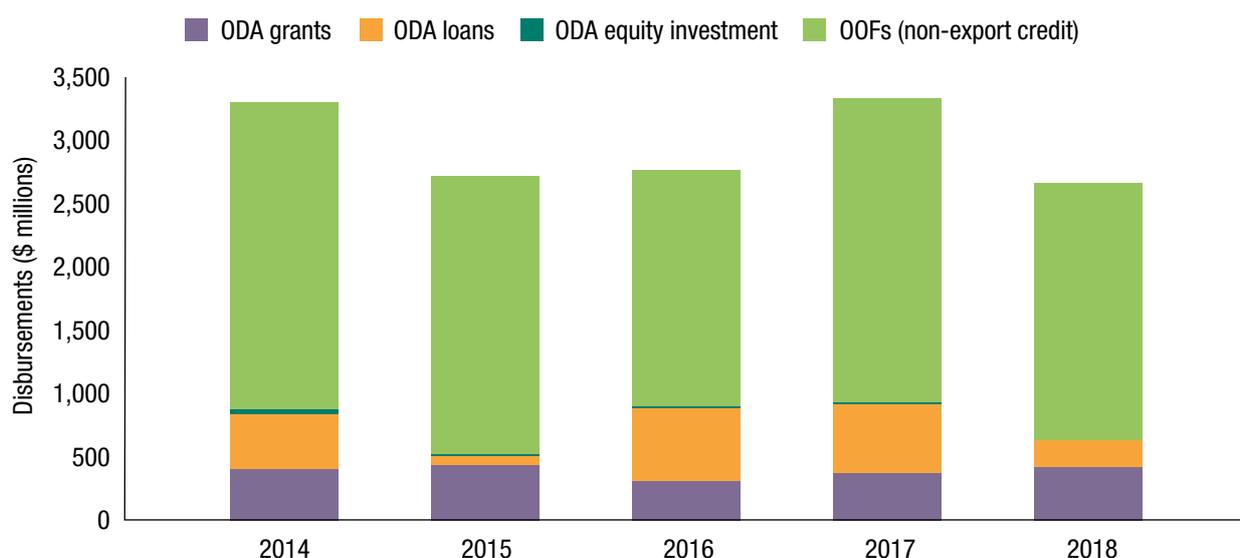
Mexico's expected economic recovery is now under threat as a result of the Covid-19 pandemic. Following poor economic growth in 2019 of just 0.9% of GDP, the economy was expected to recover to growth rates of 2.4% in the medium term. Combined with prudential debt management, the government expected to improve the fiscal situation and committed to raise tax revenues (IMF, 2019). According to our interviewees, tax revenues have increased in 2020 compared to the previous year. However, Mexico's economic recovery and its fiscal situation were seen as vulnerable to external shocks and the macroeconomic environment (*ibid.*).

The Covid-19 crisis has now shattered the economic forecasts for 2020, with government estimates for the year indicating that the economy is likely to contract by 2.4%. Even after tapping into reserves and emergency funds, the government foresees a significant drop in revenues as a result of the economic impact of the pandemic and lower exports (*Secretaría de Hacienda, 2020a*). When these forecasts are combined with strict fiscal discipline, it seems likely that the government will adopt a conservative budget for 2021.

Public funding for agriculture and rural development shows a downward trend, but this is not perceived as a major concern. Looking at the budget for rural development as reflected in the PEC, funding has fallen by 25% since its peak in 2013 (CEDRSSA, 2019; IFAD, 2020b). This trend has not been reversed in the new administration's first full year of government (CEDRSSA, 2019).

According to some interviewees, previous programmes were profligate, but the share of PEC spending that reached smallholders and poor communities was relatively small. The stronger focus on economic inclusion and the poorest communities now proposed by the government means that more can be done with

Figure 1 Official development finance disbursements to Mexico, across all sectors



Note: 2017 constant prices. ODA, official development assistance; OOF, other official flow.

Source: OECD (2020)

less. By reviewing existing programmes and creating new ones, it is possible to reduce the budget while increasing the volume of finance that targets poor communities, including those in rural areas. In addition, targeted productive and financial inclusion initiatives (e.g. access to credit, support for smallholder groups, etc.) can be more efficient and better tailored to local needs than previous schemes based on subsidies and transfers.

Budget cuts following the Covid-19 crisis could lead to further reductions in the overall budget for agriculture and rural development. As discussed above, policies adopted by the government protect priority projects and programmes but freeze operational expenditure in every other area (Presidencia de la República, 2020). As a result of these measures, public investments in agriculture and rural development that fall outside the scope of the priority projects and programmes will face severe constraints.

The budgetary outlook discussed above suggests that this trend is likely to continue in 2021. At the same time, the measures adopted by the government do guarantee the budget for priority projects and programmes and some interviewees believe that initiatives such as *Sembrando Vidas* could even be expanded

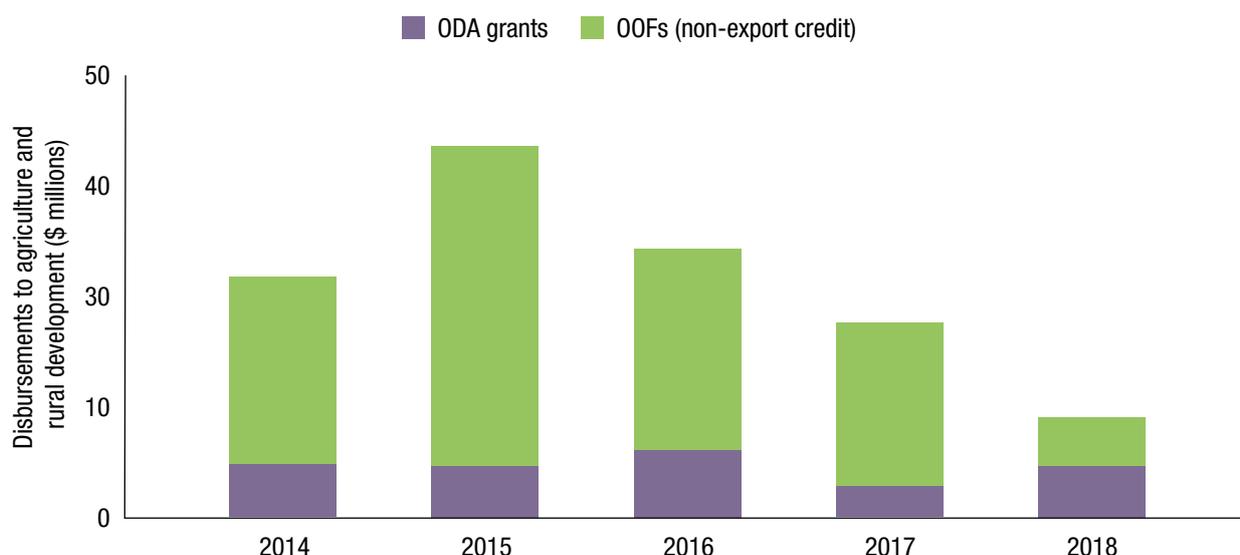
to tackle the social impact of the Covid-19 pandemic across the country.

External development assistance

Mexico is a large recipient of OOFs, with rising ODA until 2018. OOFs to Mexico averaged \$2.2 billion over the period 2014–2018, largely the result of the country’s many operations with the World Bank and IDB (see above). ODA flows to Mexico averaged \$750 million a year over the same period (Figure 1). This represents only 0.045 % of the country’s gross national income (GNI) (World Bank, 2020c), but it is still significant in absolute numbers and has increased since the early 2000s (Calleja and Prizzon, 2019). There are two main drivers for this trend in Mexico: the war on drugs and the importance of Mexico in the climate change agenda (ibid.).

On average, ODA flows are split almost evenly between grants (\$390 million in 2014–2018) and loans (\$365 million in 2014–2018). ODA loans are generally more variable across years. The largest donors of ODA by order of importance are: Germany, France, the United States and the European Union institutions. Germany has a long history of cooperation in Mexico and is currently active on climate change, environmental conservation and

Figure 2 Official development finance disbursements to agriculture and rural development



Note: 2017 constant prices. ODA, official development assistance; OOF, other official flow.
Source: OECD (2020)

sustainable energy (GIZ, 2019). France is also active in the same sectors (AFD, 2018).

It is difficult to estimate ODF flows to agriculture and rural development in Mexico. As shown in Figure 2, the volume of ODF flows to agriculture and rural development is small and varies between \$40 million and \$11 million. However, these figures are unlikely to capture all development assistance flows going to the sector, given the limitations of the OECD coding systems and the multi-dimensional nature of many of the interventions. One example is CONAFOR, as mentioned above, which touches on aspects linked to sustainability, conservation, forestry and agriculture.

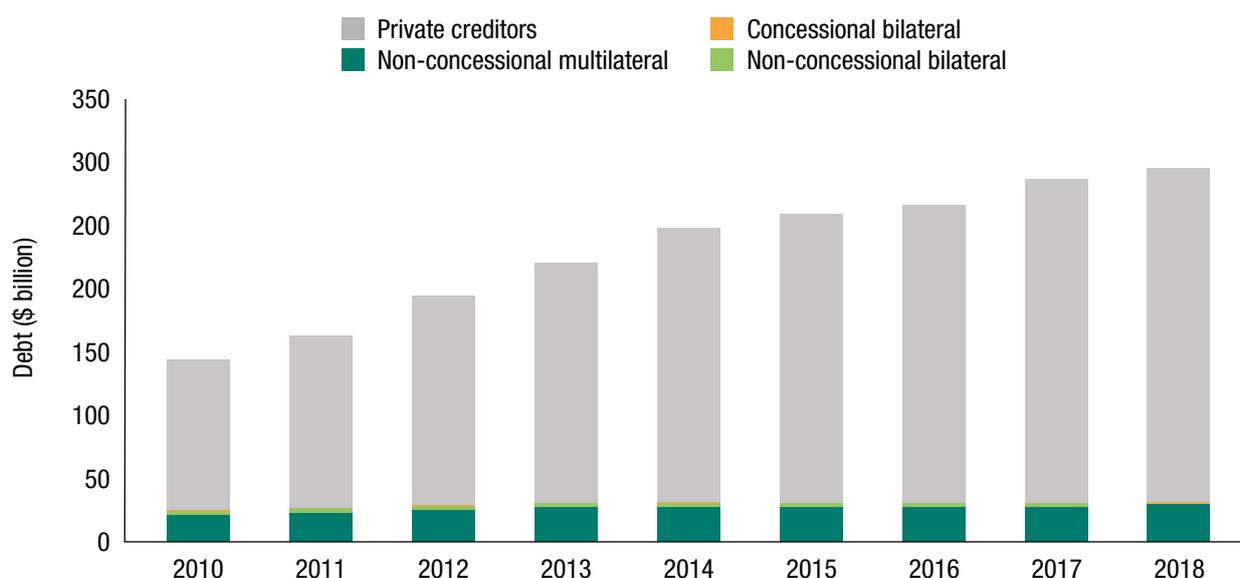
The actual volume of ODF that targets the agriculture and rural development sector is likely to be much larger. Between 2010 and 2017, IDB approved approximately \$2.1 billion in finance for projects related to agriculture, rural development, climate change and sustainability in Mexico (IFAD, 2020a). The World Bank approved a further \$500 million for agriculture, rural development and forestry in the same period, while IFAD provided \$133 million from 2007 to 2018 (ibid.).

While it may not be entirely accurate, Figure 2 does confirm information gathered during our interviews that most of the external finance for the sector comes in the form of

non-concessional loans. According to our interviewees, this is often combined with grants for technical assistance (ODA) to support project implementation.

Mexico's budgetary and normative framework poses challenges for development partners. External credit operations are subjected to the 'no additionality' principle. According to this principle, external credit does not change the budget allocation of implementing agencies and partners (it is not additional). Once the project has been implemented, external credit is transferred to the Treasury (ibid.). Other challenges include yearly budget commitments that exacerbate the problem of 'no additionality' by not allowing multi-annual allocations; and strict budget rules that limit flexibility when it comes to booking expenses. In addition, external finance cannot be used to cover running costs, which means that implementation is dependent on the institutional budget or technical assistance grants to pay for project implementation units and other operational costs. These grants have been used by development partners to facilitate implementation, but they restrict internal capacity-building within the administration (IFAD, 2020b). The implications of these challenges in the current macroeconomic and political context are discussed in the next section.

Figure 3 Public and publicly guaranteed debt



Source: World Bank (2020a)

Borrowing for rural development

Mexico has sustainable debt levels. The country's medium-term public debt outlook was considered sustainable in 2019 (IMF, 2019). The government aimed to keep debt levels stable at around 55 % of GDP through the period 2020–2024 (ibid.; Secretaría de Hacienda, 2020b). As shown in Figure 3, private creditors held 89% of Mexico's public and publicly guaranteed debt in 2018 (World Bank, 2020a). Multilateral non-concessional debt accounted for a further 10%.

Mexico's debt strategy prioritises domestic debt, with long maturity and fixed interest rates, and the main objective of debt management is to finance the public deficit (Secretaría de Hacienda, 2020b). External debt is seen as a complement to internal debt when the market conditions are considered adequate. The government may also engage in debt operations to improve the debt profile (maturity or interest rate).

Mexico's macroeconomic and fiscal environment suggests that external borrowing will remain at the same levels or contract slightly. The government remains committed to fiscal targets, despite the Covid-19 crisis (Presidencia de la República, 2020). As discussed earlier, the macroeconomic outlook for 2020 and 2021 means that the government may have to restrain

spending (Secretaría de Hacienda, 2020a). In addition, the debt strategy prioritises domestic borrowing over external finance (Secretaría de Hacienda, 2020b). In this context, our interviewees felt that the political and fiscal environment is not conducive to greater demand for external borrowing and that it will remain at the same or slightly lower levels.

Cost is the main factor that influences government decisions to borrow external finance. According to our interviewees, external borrowing operations are considered by the government only when they respect the external debt ceiling agreed by the government; and the effective interest rate (considering grace periods, etc.) is below the rate of Mexican debt issued in international markets.

While transaction costs are the same for the government regardless of the size of the loan, the volume of the operations is not considered important. Smaller loans are often better suited to needs and to the implementation capacity of certain government departments and/or can be considered appropriate because of the expected outcomes.

After fulfilling the financial criteria, the government considers the added value of individual projects. Our interviewees recognised that development partners can provide access to technical expertise (including experiences in

other countries), build the capacity of government counterparts and introduce new or better approaches to agriculture and rural development.

From a thematic point of view, the demand for external finance has focused to date on areas where the government feels donors can add value and contribute technical expertise. One of these areas is the economic inclusion of the rural poor through activities related to agriculture value chain development and rural financial services. Our interviews indicate that development partners can help to develop new approaches and solutions to existing challenges.

There is also a demand for external finance to support the introduction of climate-resilient agricultural practices. This includes the transfer of knowledge, capacity-building among government counterparts and exchanging experiences with other countries.

Rural basic infrastructure is another area that the government is willing to support through external finance. Rural basic infrastructure can require large investments, but also has significant potential for revenue, which makes it a good target for external borrowing operations. Large or medium-sized infrastructure projects (e.g. irrigation) are the subject of several borrowing operations with IDB and the World Bank.

Finally, there is a strong preference for regional projects and subnational lending. In this case, demand is not explained by added value, but rather by the challenges of working with different levels of government, as well as the limited replicability and sustainability achieved by existing projects, due to the reduced uptake by authorities at the subnational level (state governments) (IFAD, 2020a).

Mexico's public development finance institutions provide opportunities for development partners' finance operations. As discussed earlier, Mexico has several public development finance institutions that are active in the agriculture and rural development sector. Some institutions such as FND cannot hold deposits or issue bonds and are only allowed to take credit from national and international public finance institutions. These institutions provide opportunities for development partners to develop projects that promote the financial inclusion of smallholder farmers and producers.

A shift in external finance flows for the sector is likely. Priority projects and programmes defined in the previous chapter are likely to attract increasing amounts of external borrowing at the expense of non-priority areas. According to our interviewees, priority projects and programmes have been funded mostly by domestic resources so far. However, they are likely to start attracting more external finance because of the strong message sent by the government in its protection of these actions.

This trend will be accentuated by the negative impact of budget cuts on agriculture and rural development projects that are supported by development partners. The 75% reduction in operational expenses restricts the number of resources available to cover operational costs such as project implementation units, vehicles, etc., and this will affect the implementation of projects funded by development partners. At the same time, there are concerns that the government could reduce budget allocations to non-priority projects and programmes in 2021 as a result of the macroeconomic and fiscal environment. This could also affect the implementation of ongoing projects. In this context, by nesting projects under the government priority projects and programmes, development partners can ensure that the operational budget is protected and that the 'no additionality' rule is less likely to affect project spending and implementation.

Preferences and instruments for rural development

Preferences for development assistance for rural development

In Mexico, the concept of 'partnership' defines the relationship with development partners and preferences for development assistance. According to our interviewees, the role of development partners in Mexico is to support the government in achieving its policy objectives, predominantly by building capacity, sharing expertise and introducing new approaches to tackle existing problems.

This vision of development cooperation explains the strong preferences suggested by our interviewees for alignment with government

priorities, lack of policy conditionality, and the speedy provision of flexible and predictable finance that helps to ensure the sustainability of development projects. However, some of these preferences fail to take into account the challenges imposed by Mexico's budget rules (see above), which explain low disbursement rates e.g. in IFAD projects, among others (IFAD, 2020b).

Demand for other types of instrument

The demand for specific instruments is explained by the role of development partners described above combined with the added value of external finance. Beyond traditional project finance, there is a strong demand for instruments whereby development partners provide support that is aligned with government priorities. Here, there is significant demand for policy-based lending and long-term programme lending (multi-phase lending). There is also a growing demand for reimbursable technical assistance, which allows the government to draw on development partners' expertise to fill existing gaps or meet emerging needs. Our interviewees perceive the presence of development partners in the country as essential to identify opportunities to support government initiatives. In-country presence is considered even more important in the current context, where the opportunities for development partners are likely to shift towards the government's priority projects and programmes.

Conclusions

Our analysis of the experience and perspective of Mexico on financing public investment for inclusive and sustainable rural development, and particularly its demand for external assistance, is summarised as follows.

- The government has re-defined its agriculture and rural development priorities. The PND and sectoral strategies place a strong emphasis on agriculture and rural development to tackle poverty and inequality problems in Mexico. The new framework has a stronger focus on the productive inclusion of rural areas, poor

households and Indigenous communities than previous strategies.

- With the Covid-19 crisis, the government has protected the budget for all priority projects and programmes, but has frozen the operational budget for other activities. This will affect the implementation of agriculture and rural development projects that fall outside the 'umbrella' of the priority projects and programmes defined by the government. This includes ongoing projects supported by development partners (e.g. IFAD and World Bank projects on forestry and rural development with CONAFOR).
- Demand for external borrowing from development partners is likely to coalesce around the government's priority projects and programmes, and the government has sent out a strong signal by protecting their budgets. Given the challenges imposed by budget cuts, donors can ensure continued project implementation by ensuring that projects are 'nested' under government priorities.
- The macroeconomic and fiscal environment suggests that the appetite for external borrowing will remain stable or contract slightly. The government remains committed to fiscal austerity and prioritises domestic over external borrowing. At the same time, the Covid-19 pandemic is expected to increase pressure on government revenues in 2021. The combination of these factors suggests limited space for additional external finance operations.
- Government institutions are interested in working with development partners primarily because they can provide access to technical expertise (including experiences in other countries), build the capacity of government counterparts and introduce new or better approaches to agriculture and rural development. This approach also explains the main preferences for development finance flows (alignment, lack of conditionality, flexible and predictable finance) and instruments (policy-based lending, long-term programme lending and reimbursable technical assistance).

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Annex 1 List of interviewees

Name	Institution
Oscar Alonso Ramírez	Secretaría de Hacienda y Crédito Público (SHCP)
Francisco J. Arrazate García	Comisión Nacional Forestal (CONAFOR)
Sergio Campillo Díaz	Secretaría de Hacienda y Crédito Público (SHCP)
Francisco García	Office of the Resident Coordinator (United Nations)
Luciana Ludlow Paz	Comisión Nacional Forestal (CONAFOR)
Francisco Pichón	International Fund for Agricultural Development (IFAD)
Katharina Siegmann	World Bank
Taryn A. Sánchez Montesinos	Comisión Nacional Forestal (CONAFOR)
Pablo Yanes	Economic Commission for Latin America (ECLAC)

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