USAID/EGAT-ILD COOPERATIVE AGREEMENT

N° EEM-A-00-03-00005-00

PROGRESS REPORT

October 2003 – January 2004

February, 2004

USAID/EGAT-ILD COOPERATIVE AGREEMENT

PROGRESS REPORT

October 2003 – January 2004

TABLE OF CONTENTS

EXECUTIVE SUMMARY i-v

INTRODUCTION 1

I. **NARRATIVE REPORT** 3

ACTIVITIES CARRIED OUT 3

Activity 1 Establishing a Training Centre in Lima 3

Activity 2 Expanding Delivery Capacity 4

Activity 3 Conducting Training Activities for Strategic/Priority Countries 5

Activity 4 Building Awareness 5

Activity 5 Securing On-going and Future Projects 10

Activity 6 Improving and Adapting Products and Services 14

II. **FINANCIAL REPORT** 16

Table 1 Income Statement

Table 2 Disbursement Report by Item Line

Table 3 Disbursement Report by Activity and by Country

ANNEXES

Annex 1	Summary of Local Real Estate Agents and Monthly Rental Rates
Annex 2	Letter of Support from Norwegian Public Institutions
Annex 3	Proposal: "Promoting Economic and Political Empowerment in Latin America"
Annex 4	Letter Received from Head of States
Annex 5	Programme of Conference: "Formalization of Business and Real Estate in Egypt"
Annex 6	Estimated Impact of Formalization Reforms on the Growth of the Egyptian Economy
Annex 7	Estimating the Economic Impact of Institutional Reform
Annex 8	FOMIN's Memorandum to Support the Business Reform Design in Mexico
Annex 9	Executive Summary of the ILD's Proposal to the Government of Tanzania
Annex 10	Copy of President Mkapa's message
Annex 11	Impact of Proform and Busform in the Peruvian Economy Between 1991-2002

PROGRESS REPORT

October 2003 - January 2004

EXECUTIVE SUMMARY

During the last four months (Oct '03 – Jan '04), with the generous support of USAID, the ILD has embarked on an aggressive program to strengthen its resources and deliver services in accordance with its mission:

> *"To support the efforts of governments of developing and former Soviet Union countries, the Institute for Liberty and Democracy (ILD) will design and help implement Property and Business Formalization Programs in these countries which are accessible to all citizens that will empower the poor by allowing them to capitalize the value of their assets (if they so desire) and help create an expanded market economy based on the rule of law."*

To pursue its mission, the ILD has developed a comprehensive, five stage[1] Property and Business Formalization Program that addresses five crucial objectives:

a) To build an architecture of property and business rules
b) To foster national integration
c) To ensure that all assets can be used to create liquidity
d) To develop broad-based support for change
e) To enable overall economic policies and supporting mechanisms

In accordance with Cooperative Agreement **No. EEM-A-00-03-00005-00**, the ILD is pursuing six activities to meet these objectives:

- Establishing a training center in Lima;
- Expanding delivery capacity;
- Conducting training activities for strategic/priority countries;
- Building awareness;
- Securing on-going and future projects; and
- Improving and adapting products and services.

The following highlights the main areas of concentration and achievement while details for each activity can be found in the body of the report.

[1] The stages of the ILD's Property and Business Formalization program are: 1) Awareness, 2) Diagnosis, 3) Reform Design, 4) Implementation and 5) Capital Formation and Good Governance.

Project Activities

ILD's most significant achievement during the reporting period is the success we have had in advancing our projects in both Egypt and Mexico.

Egypt

In Egypt, the ILD has completed the reform design stage for its program and presented concrete proposals for reform. These proposals, for both real estate and business reforms, were approved unanimously by the Council of Ministers, and hence, the Egyptian Prime Minister granted ILD the authority to prepare an action plan to implement this programs immediately. This plan includes the necessary actions to ensure approval of the reforms by Parliament together with a supplier consortium to help implement the reforms and financing package. For this latter stage, ILD hopes to obtain the assistance of the USA and some governments from Europe. We are using funding under this cooperative agreement to maintain a small ILD team who is assisting the Government of Egypt (GOE) advance the project.

On the basis of our own practical experience, along with the work done by others throughout the world during the past half century, we are confident that the implementation of the reforms we have proposed have two important effects. First, it will substantially increase net benefits to the middle classes and the poor by raising the value of their income, their holdings, and total factor productivity, and second, it will increase employment and fiscal revenue. The two effects together will substantially augment the growth potential of the Egyptian economy as a whole. From both macro- and micro-economic analyses, it would seem that over the long run Egypt's per capital GDP growth rate should grow by at least an additional two percentage points per year. This means that the proposed reforms program could almost double Egypt's GDP per capita growth rate five years after commencing implementation of the reforms.

An important result of the acceptance and approval by the GOE is the fact that it can serve as a model for other countries in the Middle East, including Afghanistan (whose legislation, as well as that of other Middle Eastern countries, follows the Egyptian model) and Pakistan. Egypt would be the first country in the Middle East to implement these reforms, and if so, it will set a precedent and serve as an example of economic transformation throughout the entire Arab and Islamic world. Egypt could also eventually become the first regional base in the Middle East. **See the attached press clippings.**

Mexico

The FOMIN grant to the Government of Mexico, which will enable it to contract the ILD for the Businessform Reform Design, is expected to be approved during the Donors Committee Meeting in March 2004. The ILD is ready to start work in Mexico immediately. The fieldwork plan is ready, and the human resources have been identified, together with the contacts necessary to start the recruitment of Mexican professionals. The Mexican government is putting together a team of

professionals to act as the counterpart to the ILD and is in the process of committing the funds necessary to start the project in March.

Other countries

Many countries have contacted the ILD and expressed interest in our program, most recently, South Africa, Madagascar, Mauritius, and Guatemala. While not ignoring expressions of interest from these countries, we have concentrated on improving current projects, maintaining our presence in existing countries that are expected to progress from one stage of ILD's program to the next, thus resulting in further projects. However, before we can initiate projects in additional countries, our first priority is to finish our organization realignment and staffing needs. The following is a synopsis of recent activities:

Project initiatives in equatorial Africa (Tanzania, Ghana and Nigeria) have all reached the firm proposal stage and we are assisting these governments in securing the financing for Diagnosis and Reform Design projects using funds from the Government of Norway. The heads of state of all these countries are actively involved in developing these projects and we have been coordinating closely with the Government of Norway re: funding, although this would take some time before it can materialize.

Similarly, the World Bank and the IMF have asked the ILD to conduct projects in Madagascar and Mauritius as pilot countries to augment its response to items 9 and 10 of the 1991 Washington Consensus: "promote a business friendly environment" and "secure property rights". A firm proposal to commence work will be submitted in the next few weeks. Funding for these projects would come from the World Bank.

Last but not least, the IDB's Multilateral Investment Fund (MIF) has expressed its strong desire for the ILD to become part of its property rights network, serving in an advisory capacity to MIF activities in support of property rights reforms. The MIF cluster "From Property to Prosperity" to be launched in February will contain from 10 - 12 projects that aim to improve the functioning of markets and the environment facing businesses and investors. Projects in the cluster address specific bottlenecks in the web of laws, regulations and institutions that prevent moveable and immoveable property from serving as the foundation of private sector development and wealth. MIF will explore with ILD mechanisms to promote awareness, and the dissemination of knowledge and practical know-how in the area of property rights reforms across the region, and support ILD involvement with SEDESOL in Mexico, and in other possible programs (e.g. Honduras and Guatemala).

The future of the ILD depends upon our ability to secure additional projects and alternative funding sources. We believe our progress to expand funding sources to include FOMIN (IDB) in Mexico, the Government of Norway and The World Bank in Africa, as well as other possibilities being pursued with the governments of Belgium and Canada, represent significant advancement in this

area. The funding that USAID has provided under this agreement has allowed us to achieve the results above and work toward broadening our funding base.

Expanding Delivery Capacity

To expand its delivery capacity, the ILD is in the process of both realigning its organization and recruiting additional key staff. Organizationally, we have more clearly defined key roles/responsibilities for building awareness, leading the delivery of Diagnosis and Reform Design programs and implementing our program in Egypt. We have recruited a senior person to lead our economic area with emphasis not only on project valuations and cost/benefits, but also on developing[2] both macro- and micro-economic models to estimate the impact of our programs.

We have successfully recruited three additional attorneys to assist with our project delivery; many more will follow. We have initiated a full search process, using external search consultants, to hire a Chief Operating Officer (COO) and Chief Financial Officer (CFO). The COO/CFO search has proven more difficult than anticipated both to specify job specifications as well as find qualified individuals —this continues to be a top priority.

We are working on a new operations plan which will respond to the requirement to assist several countries at the same time. We have drawn up a preliminary plan for the formation of diagnostic teams which envisages the simultaneous operation of 15 teams of professionals over the next three to five years, as well as a working plan which will enable us to carry out some 50 diagnoses as quickly as possible. The staffing outlined above supports this plan.

Over the past few months, we have made progress in revising, expanding and updating our fieldwork manuals and preparing checklists to help ILD staff with project delivery. Using these manuals, we are in the process of identifying discrete work packages which will allow us to "outsource" certain parts of the work to host country personnel and other third parties. Once these work packages have been defined, training and QA materials will be developed using external consultants to augment our fieldwork manuals and provide the necessary information to allow non-ILD staff to perform these activities without continuous ILD supervision.

[2] These models are a joint effort of the ILD and recognized experts such as Prof. Gwartney, who heads the "Economic Freedom of the World Index" at Florida State University

Building Awareness and Improving Products

- ILD has been very active in national and international forums[3] at which the President and other ILD staff have participated. At these sessions, our principal task is to introduce and explain ILD's message and work program;

- Our work continues to be referenced by international leaders throughout the world —numerous excerpts of these references are contained in this document;

- We have signed an agreement with the International Republican Institute (IRI) and the Center for International Private Enterprise (CIPE) to provide political capacity to political actors and educate businesmen and other members of the civil society on the need to understand and support economic reform policies consistent with market based principles and property rights;

- We have studied and reviewed a number of alternatives offered by the academic and research worlds to measure the impact of the kind of institutional reforms we propose. We have used two different methodologies, a macroeconomic estimate and a microeconomic analysis, to measure and project the economic impact of our reforms. A brief explanation of the methodology used and the calculations carried out in arriving at this impact are contained in **Annexes 6** and **7** of the Progress Report;

- We continue research in a variety of areas including: the study of "tools" that enabled western societies to evolve from tribal confederations into democratic regimes and market economies and the importance of business in creating national wealth.

Other Activities

Progress has been made with respect to a number of other activities including the following:

- We have identified premises and are in the process of leasing space for our headquarters and our training center in Lima;

- We have hired Gris Hernandez y Asociados, member of Deloitte & Touche, as our external auditors. Audit of our year 2003 operations will start next March.

In summary, thanks to the continued support of USAID, the ILD has made progress on numerous fronts in the Oct '03 – Jan '04 reporting period and is on target to pursue the objectives outlined in the cooperative agreement.

---

[3] See report for a comprehensive list of events where the ILD has participated.

QUICK LINKS: HOME | NEWS | OPINION | RIGHTPAGES | CHAT | WHAT'S NEW

townhall.com

Egypt on the economic cusp

Jack Kemp

January 19, 2004

I just returned from a remarkable conference in Cairo, Egypt, put on jointly by the Egyptian Center for Economic Studies and Instituto Libertad y Democracia. ILD is led by Peruvian economist and Empower America associate Hernando de Soto, whose two books, "The Mystery of Capital" and "The Other Path," are seminal works for understanding and solving world poverty and terrorism in the 21st century.

The conference was the culmination of a joint study by the two organizations in which they developed concrete proposals on how to integrate Egypt's informal sector (what usually is referred to loosely as the "underground economy") into the formal economy. The project was conducted with the support and assistance of Egypt's Finance Ministry and would not have been possible without the personal commitment of Finance Minister H.E. Medhat Hassanein and the Mubarak government.

The particular focus of the ECES/ILD study was on how to bring the extralegal business and real estate sectors above ground and onto the books, thus turning "dead capital" into "live capital." If successful, Egypt will be the first country in the Middle East to make these reforms, and it will set a precedent and serve as an example and template for the whole Arab and Islamic world. At the conclusion of the conference, I invited the leaders to Washington in the spring to help make the case for taking these reforms beyond Egypt into Iraq, Afghanistan and beyond.

In a nutshell, the study concluded that, "Under the coarse mask of extralegal activities lies a mass of talented and hardworking people capable of creating value out of practically nothing who hold the potential for making Egypt a rich and powerful country." Egypt has approximately 1.4 million extralegal entrepreneurs, who comprise 82 percent of Egypt's entire entrepreneurial class.

The extralegal economy employees some 8 million Egyptians, and the value of business and real estate assets in extralegal enterprises totals almost $30 billion. All told, 92 percent of the Egyptian population holds its private real estate assets extralegally, thus preventing people from leveraging property into capital. In round numbers, this "dead capital" adds up to almost $250 billion.

In addition, Egyptian taxes, laws, paperwork and regulations thwart entrepreneurial efforts and discourage work, saving and investment. For example, the study found that it takes more than 500 days and costs the equivalent of 27 minimum monthly salaries to open a mere bakery in Egypt. Registration and licensing of a single-person business take an entrepreneur 189 days and 86 administrative steps to complete. An entrepreneur must suffer through more than 10 years of red tape to convert a sandy piece of land into a commercially useful parcel, and up to six years of judicial and administrative battles are required to avoid demolition of a business initiated in an extralegal manner.

Doing business in Egypt subjects the poor to dealing with 56 different government agencies and complying with 300 separate pieces of legislation, all of which lead to "repetitive, redundant and overlapping government inspections." Meanwhile, there are no enforceable accounting principles to standardize business activity and regularize commercial relationships. In short, the study concludes, "because businesses and real assets cannot be organized productively, using the economies of scale that would result from operating in the broad Egyptian market, and because people cannot secure the interests of all parties and be leveraged to guarantee credit and

investments are 'dead capital' incapable of initiating surplus production and the increasing productivity in any significant manner."

Just before the Super Bowl in Houston, I will be reporting on the Egypt conference and speaking on the topic dear to my heart - a 21st century Marshall Plan for Central Asia and the Middle East - at the Baker Library of the James A. Baker III Institute of Public Policy at Rice University. The institute's director, Ambassador Edward P. Djerejian, a leading expert on the complex political, security, economic, religious and ethnic issues of the Middle East, has written extensively on how to bring democratic capitalism to this region and how to engage in new diplomacy to the Arab world. I will be sharing with the institute the work of the 21st Century Committee, created and led by Ted Forstmann at Empower America in conjunction with ILD, where we are thinking through how best to create a 21st century Marshall Plan based, in large part, on de Soto's ideas.

Egypt stands on the cusp of an economic revolution. If the reforms proposed by the ECES ILD study are implemented, it will ignite the most far-reaching economic and social transformations since the Japanese, Korean and Taiwanese economic wonders were created in the aftermath of World War II. If Egypt implements these reforms, it could ignite an economic transformation not only in the Middle East but throughout the entire Arab and Islamic world.

© 2003 Copley News Service

townhall.com

QUICK LINKS: | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible]

REUTERS
NEWS AND FINANCIAL INTELLIGENCE FROM THE WORLD LEADER

Egypt backs plan bring firms into formal economy

By Jonathan Wright

CAIRO, Jan 19 (Reuters) - Peruvian economist Hernando de Soto said on Monday the Egyptian government had accepted his plan to break down financial and bureaucratic barriers which keep much of the country's businesses out of the formal economy. Under current arrangements, about 80 percent of Egyptian businesses operate without licences because they find it too expensive and time-consuming to seek legal recognition. Prime Minister Atef Obeid and his economic ministers have now asked de Soto's think tank to prepare a plan of action setting out practical steps that need to be taken, de Soto told Reuters in an interview. "The plan was accepted. That was on Saturday. Today they affirmed their commitment and said our next task was now to draw up an action plan, which means the immediate details of how we kick this thing off," he added. De Soto, who is known for his advocacy of property rights for the poor, says the Egyptian government could add several percentage points to annual economic growth if it gives the vast informal sector of the economy incentives to go formal. Without formal status, businesses cannot obtain credit, they cannot expand easily, they tend to keep a low profile and they may have to pay bribes to stay in business. A team from de Soto's Peruvian-based think tank, the Institute for Liberty and Democracy, after four years examining the Egyptian informal sector, concluded that administrative changes could transform the economic landscape. It found that it takes an average 200 days of bureaucratic work to open a business, and 549 days to open a bakery. Registration also brings recurrent costs, such as of meeting the government's sanitation regulations.

Under the institute's recommendations, the costs of setting up a business would fall 75 percent and 300 pieces of legislation would be consolidated into one law. Sixty-six government agencies would merge into what de Soto called the one stop-shop "where anyone who wants to get into enterprise has to go to one window". "The average time will go down to an average time of five days -- radical," he said. Once businesses go formal, they can use assets to guarantee loans, issue shares, integrate their operations without fear and raise their profile in the market. De Soto's theory is that once the institutional structure is right, most businesses prefer to go formal, even if it means they have to pay more taxes. Egyptian Finance Minister Medhat Hassanein told a news conference after Monday's meeting with Obeid that the government was looking at ways to streamline the process of setting up small businesses and to allow their owners to obtain licences from a single place as quickly as possible. "The government is trying to provide a legal umbrella for this (informal) sector and to simplify the procedures," said Hassanein, who has been working with de Soto on the project. A new law would also make finance and land in new areas available to small businesses, he added.

(Reporting by Jonathan Wright, editing by David Stamp; Cairo bureau +20-2-578-3290, Reuters messaging: jonathan. wright. reuters.com@reuters.net))

Forbes.com

Fact and Comment

Steve Forbes, 02.16.04, 12:00 AM ET

Mideast Miracle?

When it comes to the middle east, the eyes of the world focus mainly on Iraq and on the Israeli-Palestinian conflict. Yet in coming months Egypt will be initiating reforms that should dramatically transform its economy into a wealth-creating, wealth-distributing dynamo that will lead millions of Egyptians into a vibrant, increasingly democratic middle class. The country is set to become an economic miracle rivaling Ireland or Hong Kong. In doing so, Egypt will deal a devastating blow to global terrorism.

The catalyst is something that's prosaic yet absolutely essential for a sustained, innovation-oriented economic takeoff: property rights. We in America and the rest of the West take our inclusive, easy-to-access property systems for granted. You own land, for instance, and everyone recognizes it. You can readily mortgage it. Want to start a business? The legal requirements are easy. Want to sell bonds or shares or use other capital-raising instruments? The legal structures to do so are open to anyone who can meet standard requirements. Commercial contracts? They're widespread, and the courts are there to enforce them and to adjudicate disputes.

Incredibly, most of the world has no such property rights or common rule-of-law system. Japan didn't until after World War II, when, under General Douglas MacArthur's occupation, it shucked off its medieval social structure and put in place institutions and laws with principles long familiar to Americans. This dramatic change played a critical, oft-overlooked role in Japan's rapid postwar modernization and economic expansion. After all, in the early 1900s Japan's per capita income was less than that of Peru.

After several years of preparation, Egypt is about to commence a Japanese-like makeover of its society, one that will profoundly and positively impact the rest of the Middle East and the developing world. Reforms will create easy access to private property for all Egyptians, including those in city slums. All enterprises will be able to easily turn themselves into legal entities; previously, obtaining a business license had been a costly process that could take nearly two years. Not surprisingly, most Egyptian businesses are extralegal, part of the country's shadow economy.

Most development experts ignore the elephant in the room--the fact that most people in the world operate outside their country's formal legal systems. In Egypt's case, 88% of all

enterprises are extralegal, as is 92% of the country's housing. Egypt and other developing countries do not lack for entrepreneurs; they lack institutions and legal structures that would enable their entrepreneurs to expand and truly flourish. The Peru-based Institute for Liberty and Democracy, which spurred this project and is headed by economist Hernando de Soto, estimates that Egypt's shadow economy has accumulated $248 billion in assets. But as De Soto notes, "All this activity and all the assets in the extralegal economy are dead capital--assets that cannot be leveraged to obtain credit and investment. To convert all of this dead capital into live capital requires the two cornerstones of a market-based rule of law: legal property rights that cover all of Egypt's assets and good business law for entrepreneurs."

Too often, Western aid programs assume that codifying property rights means documenting existing *formal* properties and businesses; they overlook the fact that most such assets are outside the system--they are *informal*. In the U.S. property laws often *followed* what people did informally. American property law history can be summed up as having turned squatters into pioneers.

The system prevalent in most of the rest of the world is immensely costly. It hampers the ability of businesspeople to expand. There is too little accountability for performance, and this also hobbles growth. When people are brought into the formal economy and legal system, the rule of law takes on real life. People then know who owns what. Losses can be tracked and fraud attacked. Contracts and rules can be enforced. The current informal system effectively excludes most businesspeople from having access to their national economies, not to mention the global economy. In effect, Egypt will be doing what Japan did in the late 1940s--it will be legalizing what's already there.

The massive informal economies in Egypt and elsewhere resoundingly put paid to the hand-wringing conclusion of many Western experts that certain cultures and religions are incompatible with Western-style free enterprise.

The kind of survey Egypt engaged in several years ago to discover what its informal commercial and housing patterns and systems actually were should be replicated in Iraq and other nations. Societies evolve differently, so no one-size-fits-all approach will work. What will work is to legalize, to make transparent the systems that hundreds of millions of businesspeople and homeowners around the world have already created.

PROGRESS REPORT

October - January 2004

INTRODUCTION

The ILD's Property and Business Formalization Program and its objectives

To support the efforts of governments of developing and former Soviet Union countries, the Institute for Liberty and Democracy (ILD) will design and help implement Property and Business Formalization Programs in these countries which are accessible to all citizens that will;

- empower the poor by allowing them to capitalize the value of their assets (if they so desire) and;
- help create an expanded market economy based on the rule of law.

The Property and Business Formalization Program that ILD is proposing comprises five Stages: 1) **Awareness,** 2) **Diagnosis**, 3) **Reform Design**, 4) **Implementation**, and 5) **Capital Formation and Good Governance**. Each of the five stages of the Program is conducted as a discrete project with clearly defined objectives, tasks, and deliverables.

This program goes far beyond land titling or business deregulation programs. What we are proposing is to create a property and business legal system as an entry point to reach five crucial objectives.

a) **To build an architecture of property and business rules** that will bring together, standardize, and modernize the dispersed customary arrangements that currently prevail so as to create one universal property system that incorporates all sectors of society. This would include the institutions required to identify and locate people, real estate and businesses, as well as the institutions needed for associated transactions and the enforcement mechanisms that would allow all citizens to hold property and operate businesses, and exchange goods and services on a national and international scale.

This system will be devised to ensure that the poor and traditional local communities will find it convenient and profitable to abide by its rules because it will integrate their customary practices and offer them access to the expanded markets at both national and global levels, if they and the government so wish. Our research demonstrates that no matter how unintended, the exclusion of poor people from the law —separated from each other by existing local extralegal property conventions— is largely responsible for some of the most fundamental economic and political problems of poor countries, such as:

- little or no investment;
- lack of access to credit;
- an unenforceable tax system and narrow tax base;
- constant fiscal crises, stagnant economic growth;
- class alienation and persistent poverty.

The absence of widespread and inclusive property and business rights limits the awareness of how positive a role the central government can play in the lives of the people. History shows that the inability to resolve the aforementioned problems provides fertile ground for black markets, corruption, organized crime, and, in some cases, divided sovereignty and terrorism.

b) **To foster national integration** by assisting Governments to move beyond their present situation of parcelized sovereignty to a nationally integrated State that can govern the nation's market activities.

All governments in the world are founded, to one degree or another, on territorial or property arrangements. No country has ever created a sustainable market system unless all economic activity takes place within an all-encompassing institutional framework. To have an integrated national economy, there must be a national system that guarantees property rights —while integrating traditional, local ways of doing business— so that it can help pull the whole nation together and secure public order.

c) **To ensure that all assets can be used to create liquidity**. The assets of most citizens are probably held and exchanged outside the existing legal system —and thus cannot be adequately recorded in standardized and universally accepted property records so that they can secure the interests of third parties. Such assets are, therefore, "dead capital" — that is, they are useless because they cannot be used as guarantees for credit and contracts; nor can they be divided and represented in shares that allow owners to raise capital.

d) **To develop broad-based support for change** from both traditional community leaders and the poor for a national property framework that can help realize the potential of a modern market economy. Major changes require a broad constituency. By creating a property and business legal system that is accessible to all parties, that explicitly respects the practices of the currently excluded traditional economy; and that is not seen as privileging particular interests, Governments should be able to form a consensus that supports one system for all parties including the poorest.

e) **To enable overall economic policies and supporting mechanisms,** such as monetary and fiscal stimuli, so that they will actually work once most people are working in a legal market economy. It is not widely understood that most people (economic agents) in the Third World operate in the underground economy (i.e., extralegal sector) and don't pay

taxes. Legal incentives mean nothing in the extralegal economy, and tax cuts are equally useless to people who do not pay taxes.

Leadership

Experience has proven that achieving a viable set of legal reforms will only be possible if the strategy and ongoing support to perform these changes is championed by the head of state. Only the head of state and his office can grasp all the benefits that the capitalization of the poor can bring to the country; calculate the impact of such reforms; command the attention of indifferent elites; and garner the overwhelming political support required to wipe out the willful inertia of the *status quo* and the resistance of those running the existing system should that occur.

Also, it is only the head of state that has the power to prevent the bureaucratic infighting that inevitably paralyzes legal and institutional reforms. Clearly, a decision as far-reaching as creating a market-based system by reforming the legal property system that will give every citizen the opportunity to create wealth and will emancipate the poor is a giant political undertaking that must be put in the hands of the head of state right from the start and continue to be one of his top priorities.

I. NARRATIVE REPORT

ACTIVITIES CARRIED OUT

In support of the dissemination and implementation efforts of the ILD's Reform Program, USAID has recently approved Cooperative Agreement No. EEM-A-00-03-00005-00 that will allow ILD to solidify support for its core services from its central headquarters in Lima, yet decentralize and disburse the knowledge and expertise necessary to carry out projects in all regions of the world.

This report describes the activities carried out under said Cooperative Agreement in the period between October 2003 and January 2004, and the details of our activities are given below:

Activity 1 – Establishing a Training Centre in Lima

- After a couple of months of hard work and after studying various alternatives together with Colliers International, a well-known local real estate broker, we have found premises that we believe are suitable for our new offices in Lima. It was decided to rent 1,500 m2 in a building located in the district of Santiago de Surco. Negotiations with the owners of this building aimed at signing a long-term leasing agreement have already started and the contract should be ready for signing in a few weeks. The proposal is to have the necessary alterations carried as soon as possible and move into the premises in March. For more

information on the real estate brokers consulted, the main premises found and corresponding costs, see **Annex 1.**

Activity 2 - Expanding Delivery Capacity

In accordance with ILD's need to expand its delivery capacity to meet the demand for its services we have undertaken the following tasks:

Organizational Structure:

- The first major task is the setting up of the **new organization** designed for massive delivery of ILD's Property Creation Programs. A preliminary operating and management structure has been designed to cover the two main working areas: Operations (awareness, diagnosis, reform, implementation, economic research/innovation) and support (technical, administrative and financial).

  This organizational scheme, subject to fine-tuning later with the assistance of international consultants, is the basis for initial staff recruitment.

Recruitment and Staffing:

- The other major task is **recruitment and staffing**. We are in an intensive process of recruitment, especially of attorneys, economists and senior managers, which started a couple of months ago with the assistance of executive search consultants.

- To facilitate the task of recruitment, personnel profiles and job descriptions have been prepared to help the search consultants better understand our requirements at, both the management and operational levels within ILD's organization.

  We are currently experiencing some difficulties in the search process finding people with experience in the type of work carried out by ILD. We are finding that the people coming closest to our requirements are those with experience in legal reform of government agencies and those who work or have worked in the institutional reform which took place in Peru in the first half of the 1990s. COFOPRI, the state organization designed by ILD to formalize property in Peru is one of the key sources we have used to identify personnel for the fieldwork.

  We are also negotiating with professionals of other nationalities, identified during our work in other countries, and through our network of international contacts. These professionals will complement our team and provide competence in those tasks at which ILD does not specialize (S/M, IT, quantification and asset valuation, etc.). We will use professionals identified in Egypt, The Philippines, Australia, Norway and Canada.

- We have already engaged three attorneys for the institutional reform department and a *senior* economist who will head our economic research department.

- We are working on a new **operations plan** which will respond to the requirement to assist several countries at the same time. We have drawn up a plan for the formation of diagnostic teams which envisages the simultaneous operation of 15 teams of professionals over the next three to five years, as well as a working plan which will enable us to carry out some 50 diagnoses as quickly as possible.

- **Training and outsourcing** (to professionals located in the client countries or to international consultants) will be the key mechanisms and the basis for expanding our operations. Hence, we are in the process of concluding a co-operation agreement with 5 Norwegian technical and academic organizations (non for profits) which will provide us with qualified technical personnel on an as required basis (see **Annex 2**) specially for African countries.

- We have finished fine-tuning our **fieldwork manuals** for the diagnosis and reform design stages. At present, we are revising the **methodological guides**. These manuals and guides serve three purposes: i) to facilitate the fieldwork, ii) to define the tasks that can be outsourced and iii) to facilitate subsequent production of the training courses and manuals. To design the mechanisms for outsourcing and the protection of intellectual property and to develop the training manuals and courses we will engage the services of international consultants.

Activity 3 – Conducting Training Activities for Strategic/Priority Countries

- Formal training activities have yet to commence for personnel from strategic/priority countries. This will be done upon launching the corresponding contracts with client countries. Meanwhile, ILD's existing manuals, which are being used to train newly recruited Peruvian personnel are being updated and revised to support training of host country personnel.

Activity 4 - Building Awareness

In each national and international forum in which the President or other ILD staff participate, our principal task is to introduce and explain ILD's message and work program. Some of these events are mentioned below:

- On the 1st of October, video conference "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else", as part of the book discussion program organized by The Tanzania Global Learning Center (IFM)

- Symposium "Entrepreneurship, Development, and Philanthropy: Walking the Talk", held in Costa Rica on the 8th and 9th of October, organized by the INCAE Business School.

- "The Future of Globalization, Explorations in Light of Recent Turbulence", a symposium organized by The Yale Center for the Study of Globalization and The World Bank on the 10th and 11th of October.

- A conference on the 15th of October "Mexico: rich in dead capital" and a workshop "The Mystery of Capital in Juarez" organized by the Center for Inter American and Border Studies of the University of Texas, El Paso.

- A video conference from Lima as part of "The Second UNECE/REAG Land for Development Programme (LFDP) Forum", held in Rome.

- Invitation to the Seattle Initiative for Global Development on the 12th of November, Mr. Hernando de Soto was the keynote speaker at a reception at the Columbia Tower Club. The following day, the 13th of November which was the day of the Seattle Initiative Event, he was the principal speaker at the Seattle Initiative Breakfast. During his stay in Seattle, he had meetings with the founders of the Seattle Initiative for Global Development and officials of the Rural Development Institute.

- From the 13th to the 15th of November, Mr. Hernando de Soto discussed the principal ideas contained in the book "The Mystery of Capital" at The Philanthropy Roundtable 2003 Annual Meeting, which took place in San Diego, California.

- The city of Ica, Peru hosted the XLI Annual Conference of Executives (CADE) 2003 from the 20th to the 22nd of November, having as its theme "Institutionality: Clear Rules for Investment". At this event, ILD participated in the "Democracy of the Market" working group.

- 10th of December, Meeting of the United Nations Commission on the Private Sector and Development, held in the city of New York. Mr. Hernando de Soto is a member of the commission and, together with other prominent personalities he participated actively in discussing the content and structure of the report being prepared by the commission.

- From the 21st to the 23rd of January, "World Economic Forum", held in the city of Davos, Switzerland. On the 21st, Mr. de Soto discussed how to integrate the informal sector and shadow economy with Mohammad Hossein Adeli, Deputy Minister of Foreign Affairs of the Islamic Republic of Iran; Shaukat Aziz, Minister for Finance and Economic Affairs of Pakistan; Hans Eichel, Federal Minister of Finance of Germany; among others. On the 22th, Mr. de Soto participated in an interactive session entitled "How Business Boosts Development", session introduced by Paul Martin, Prime Minister of Canada. Finally, on the 23rd, Mr. de Soto attended two sessions: "Reducing Inequity" and "The

Imperative of Partnering against Poverty", and a working dinner "Books that Have Shaped Our Thinking", where the principal ideas contained in his book "The Mystery of Capital" were discussed with Thomas L. Friedman, Columnist, Foreign Affairs of The New York Times; Samuel P. Huntington, Chairman of Harvard Academy for International and Area Studies, and Moisés Naím, Editor in chief of Foreign Policy Magazines.

- Similarly, Mr. Hernando de Soto is a member of the World Commission on the Social Dimension of Globalisation established by the International Labour Organization (ILO) and participated in drafting the final report of that commission.

As a result of our Awareness building efforts, decision makers and policy experts in the field of development are beginning to be aware that if a nation lacks capital, if their productivity is low and their markets are fragmented, that this is not the result of cultural or other fundamental factors, but rather they are due to bad legal structures that need to be reformed. Such reforms give all citizens equal access to the tools required to create property and companies and also secure the interest of third parties and thus generate credit and investment. Following some selected quotes and extracts that demonstrate this fact:

SELECTED QUOTES AND EXTRACTS

"We are a major donor country, but we have also come to realize in recent years that the cheques we write do not, on their own, produce all the change the poorer countries need".

"Local businesses in developing countries... are often held back because there are no strong laws to protect their property ".

—**Co-chair of the Commission on the Private Sector and Development, Paul Martin**
National Post
27 August 2003

"... I should like to pay tribute to the pioneering work carried out by our good friend, Hernando de Soto, and the Institute for Liberty and Democracy (ILD). Our resolve, and the aspirations of all those who are struggling to convert the assets they hold into valuable properties, must not be left in doubt. "

—**President of the United Republic of Tanzania, Benjamin William Mkapa,**
at a property formalization awareness presentation,
Dar es Salaam, 8 September 2003

The disparity in land ownership and, just as importantly, the lack of legal titles, are the root of vast inequities in income, education and health. Peruvian economist Hernando de Soto has urged governments to provide deeds to millions of peasants, arguing that land ownership makes the difference between serf and citizen. "Capitalism doesn't work without property rights," de Soto, a free-market champion, has said.

The lack of legal ownership undermines not only a poor farmer's incentive to invest in his land and apply for credit, it hobbles his participation in democracy: Officials can take away property from "uppity" peasants with little or no repercussions. Effective land policy "empowers poor people to participate in economic opportunities and in society more generally," World Bank Chief Economist Nicholas Stern, told reporters in June.

—**World Bank Chief Economist, Nicholas Stern,**

LatinTrade
1 October 2003

"Productive businesses thrive where government focuses on the definition and protection of property rights."

Regular readers of these columns would be forgiven for assuming that the line above is our own, but the surprise — no, the shock — is that it comes instead from the World Bank.

Hernando de Soto has been saying pretty much the same thing for 20 years, but better late than never. We're delighted that the Peruvian economist's ideas about the importance of property rights in Third World development are finally getting a hearing at the Bank.

The Wall Street Journal,
8 October 2003

HERNANDO DE SOTO has star appeal. He is on the must-call list of many world leaders. He is feted by the press and funded by international development agencies. His think tank in Peru [the Institute for Liberty and Democracy - ILD] has produced some of the most influential work in development economics, while his best-seller The Mystery of Capital was hailed by The Economist as "the most intelligent book yet written about the current challenge of establishing capitalism in the developing world."

—***Finance and Development,*** **IMF publication,**
December 2003

"Small and medium-sized businesses account for 80 percent of the economic activity in Latin America and the Caribbean and generate 60 percent of all jobs. We seek to reduce or remove altogether the obstacles to starting a small business and to increase the availability of capital for business start-ups and expansions.

We will aid small farmers by ensuring they have clear legal title to their land and greater access to credit based on that equity. ... In short, our aim is to make the free-market system work fairly for all of the region's citizens. "

—US Secretary of State, Colin Powell,
The Dallas Morning News
12 January 2004

"We are a major donor country, but we have also come to realize in recent years that the cheques we write do not, on their own, produce all the change the poorer countries need".

"Local businesses in developing countries... are often held back because there are no strong laws to protect their property ".

—Co-chair of the Commission on the Private Sector and Development, Paul Martin
27 August 2003, National Post

"Africans are sitting on a colossal stock of underexploited assets; what Hernando de Soto, a Peruvian economist, calls dead capital. Mr. De Soto estimated that the total value of Africans' informally owned houses and farmland in 1997 was roughly $1 trillion. That is nearly three times sub-Saharan Africa's annual GDP, and more than 70 times the amount of aid the continent receives each year".

—*The Economist*
15 January 2004,

"If the reforms proposed by the ECES/ILD study are implemented, it will ignite the most far-reaching economic and social transformations since the Japanese, Korean and Taiwanese economic wonders were created in the aftermath of World War II. If Egypt implements these reforms, it could ignite an economic transformation not only in the Middle East but throughout the entire Arab and Islamic world".

—Former secretary of Housing and Urban Development, President of Empower America, USA, Jack Kemp
19 January 2004

Clinton enunció entre otras organizaciones merecedoras de un apoyo global el Instituto Libertad y Democracia del peruano Hernando de Soto, al que definió como "el economista vivo más importante".

ABC
22 January 2004

On the other hand, the World Bank's "Doing Business in 2004" provoked the following comments in the specialized press:

"The report -Doing Business in 2004: Understanding Regulation" - is inspired by work that began with Peruvian economist Hernando de Soto, President of ILD. In his 1989 book, The Other Path, Mr. De Soto argued that, as this new report puts it, "the prohibitively high cost of establishing a business in Peru denies economic opportunity to the poor".

Globe and Mail
13 October 2003

"The report quotes the seminal work by Mr. Hernando de Soto of Peru, The Other Path, which shows that the "prohibitively high cost of establishing a business in Peru denies economic opportunity to the poor. In 1983, de Soto's research team followed all the bureaucratic procedures in setting up a one-employee garment factory on the outskirts of Lima".

—*Business Line*
20 October 2003

"The study - which despite its soporific title, Doing Business in 2004, contains some fascinating data - carried out worldwide the experiment that Peruvian economist Hernando de Soto did in his home country two decades ago. At the time, de Soto's team followed all legal bureaucratic steps needed to open up a one-employee garment factory in Lima and discovered that it was almost impossible to do it legally, because it would take 289 days and $ 1.231, the equivalent of three years of wages at the time".

—*The Miami Herald*
19 October 2003

It is also important to note that the ILD has signed an agreement with the International Republican Institute (IRI) and the Center for International Private Enterprise (CIPE) to promote economic and political empowerment in Latin America. The two fundamental objectives of this project are: 1) to promote the adoption of policies that seek to integrate the poor into the market economy and establish legal property rights for their assets; and, 2) to promote the implementation of institutional reforms that assure a level playing field and fair rules of the game for those seeking to integrate into the formal economy and establish legal and potentially capital accruing ownership over property. ILD has joined this project in a consultancy capacity and will provide trainers and technical consultants to participating political parties and civil society groups. The idea is to provide the political capacity to political actors and educate citizens on the need to understand and support economic reform policies consistent with market based principles and property rights.

Given the innovative nature of this project, a one-country pilot program focused on El Salvador has been deemed most suitable for the initial year, with possible expansion toward the end of the twelve-month program. For more details on the program see **Annex 3**.

Last but not least, the IDB's Multilateral Investment Fund (MIF) has expressed its strong desire for the ILD to become part of its property rights network, serving in an advisory capacity to MIF activities in support of property rights reforms. The MIF cluster "From Property to Prosperity will contain from 10 – 12 projects that aim to improve the functioning of markets and the environment facing businesses and investors. Projects in the cluster address specific bottlenecks in the web of laws, regulations and institutions that prevent moveable and immoveable property from serving as the foundation of private sector development and wealth. MIF will explore with ILD mechanisms to promote awareness, and the dissemination of knowledge and practical know-how in the area of property rights reforms across the region, and support ILD involvement with SEDESOL in Mexico, and in other possible programs (e.g. Honduras and Guatemala).

Activity 5 - Securing On-going and Future Projects

Many countries have contacted the ILD and expressed interest in our program, most recently, South Africa, Madagascar, Mauritius and Guatemala (see **Annex 4** for letters received from heads of states). While not ignoring expressions of interest from these countries we have concentrated on improving current projects, maintaining our presence in existing countries that are expected to progress from one stage of ILD's program to the next, thus resulting in further projects. However, before we can initiate projects in additional countries, our first priority is to finish our organization realignment and staffing needs. The following is a synopsis of recent activities:

Egypt

The ILD has completed the reform design stage for Egypt's program and presented concrete proposals for reform. These proposals for both real estate and business reforms were approved unanimously by the Council of Ministers, and hence the Egyptian Prime Minister granted ILD the authority to prepare an action plan to implement this program immediately. This plan includes the necessary actions to ensure approval of the reforms by Parliament together with a supplier consortium to help implement the reforms and financing package. For this latter stage, ILD hopes to obtain the assistance of the governments of the USA and Norway.

The reform program proposed by ILD was presented at three conferences. On Saturday the 17th of January, the proposal was presented to the Egyptian Prime Minister and Council of Ministers. The following day, January 18th, was the date of the central conference at which we explained to senior representatives of Egypt's academic and business sectors (300 people) the characteristics and advantages of the proposed formalization of companies and real estate, as well as the economic dimensions of the formalization. The conference was attended by H.E. Jack Kemp, former secretary of Housing and Urban Development and President of Empower America, USA, and Olav Kjorven, Norwegian Secretary of State (see **Annex 5** for a copy of the program). Finally, on Monday the 19th the Implementation Action Plan was discussed with the Prime Minister.

In addition to an in-depth diagnosis of the institutional obstacles preventing companies from operating in the formal sector and a recipe for making the change to and maintenance of formal status profitable for businesses, ILD proposed reform program includes estimates of the economic impact of our reform on Egypt's per capita GDP growth rate, validated by renowned economists/specialists from the USA (see **Annexes 6** and **7**).

An important result of this project, and its acceptance and approval by the Government of Egypt is the fact that it can serve as a model for other countries in the Middle East, including Afghanistan (whose legislation, as well as that of other Middle Eastern countries, follows the Egyptian model) and Iraq. Egypt would be the first country in the Middle East to make these reforms, and if so, it will set a precedent and serve as an example of economic transformation throughout the entire Arab and Islamic world.

Mexico

The FOMIN grant to the government of Mexico, which will enable it to contract the ILD for the Businessform Reform Design stage, is in the final approval process. The cost involved in the Bussinesform project is US$ 5.0 million (US$ 2.3 million assumed by FOMIN and US$ 2.7 million, by the Mexican government). Approval by FOMIN should be given during the Donors Committee Meeting to be held in March 2004 (see **Annex 8**). We have received this information from the Managing Director of FOMIN, Don Terry and José Fourquet, US

Executive Director of IDB. The budget for the Proform project is US$ 6.465 million and will be entirely assumed by the Mexican government.

The ILD is ready to start work in Mexico. The fieldwork plan is ready (and includes the states and cities to be studied), the human resources have been identified, together with the contacts necessary to start the recruitment of Mexican professionals once the project has been launched. The Mexican government has already contracted a team of professionals to act as the counterpart to the ILD and is in the process of committing the funds necessary to start the project in March, when the GOM - ILD contract has been signed.

We have also made progress with the initial legal aspects of incorporating ILD-Mexico, which is necessary to operate in that country.

Tanzania

We have agreed with the President of Tanzania, Benjamin Mkapa to submit the proposal officially in Dar es Salaam in March 2004. Prior to this official announcement a personal presentation to President Mkapa will take place in February so his comments and input can be incorporated. The Executive Summary of the Proposal to President Mkapa is included in **Annex 9.** This is the same model that will be used for other African countries.

After two previous trips to Tanzania, ILD has now identified potential technical counterparts and the contacts necessary to penetrate the extralegal sector in Tanzania. Furthermore, progress has been made with the financial commitments from the Norwegian government. According to the Norway-Tanzania Bilateral Agreement, the GON will give resources to the GOT to cover the diagnosis and reform design stage, so that the GOT can contract ILD. The total estimated cost for the diagnosis project is US$ 1.5 million (US$ 1.014 ILD costs, US$ 0.486 local costs). The budget for the Reform Design project is estimated to be US$ 5.486 million (US$ 3.203 ILD costs, US$ 2.283 local costs).

This progress is the result of the success of the Awareness Building phase, which included a one-week Workshop (May 2003) for medium/high level public functionaries and a two-day high-level Conference (September 2003), chaired by President Benjamin Mkapa, for ministers, deputy ministers, permanent secretaries, governors and parliamentarians, as well as the heads of key NGOs and Donors' representatives. See **Annex 10** for a copy of President Mkapa's message.

Nigeria

The treatment of this project will be similar to that for Tanzania. In other words, ILD will be contracted to carry out the diagnosis and reform design in Nigeria using financing from Norway, which will be arranged by President Obasanjo. The total estimated cost for the diagnosis project is US$ 1.950 million (US$ 1.368 ILD costs, US$ 0.582 local costs), while

the budget for the reform design project is in the order of US$ 6.060 million (US$ 3.551 ILD costs, US$ 2.509 local costs).

ILD has submitted a draft proposal to Dr Magnus Kpakol, currently Nigeria's National Coordinator on Poverty Reduction, who has been named by President Obasanjo as the responsible person to coordinate the ILD Program. We await his comments and after incorporating them into the proposal, it will be officially handed over to he Norwegian government for their financing consideration.

As with Tanzania, after two trips to Nigeria, ILD has identified a network of professionals who will work in the largest cities and remote rural areas of the country.

Ghana

The Norwegian government has also agreed to support this project. We are coordinating with the President, John A. Kufuor the appointment of our political and technical counterpart in the country before providing a draft proposal. When the proposal is submitted and sanctioned by GOG it will be put forward to the World Bank's representative in Ghana, to arrange financing through the Norwegian trust fund managed by the World Bank. As per Tanzania, the total estimated cost for the diagnosis project is US$ 1.5 million (US$ 1.014 ILD costs, US$ 0.486 local costs), while the reform design budget is in the order of US$ 5.486 million (US$ 3.203 ILD costs, US$ 2.283 local costs).

As we reported earlier, the government sponsored/established Foundation for Building the Capital of the Poor in Ghana is already in place and would be the support entity of the ILD. We have been informed that the Foundation, currently chaired by the Minister of Foreign Affairs, the Hon. Nana Akufo-Addo, will shortly be under the direction of the new Minister of Justice and Attorney General, the Hon. Papa Owusu-Ankomah, who has expressed strong support and the desire to continue with the Diagnosis phase immediately. The funding for the Diagnosis will also allow the Foundation to initiate its official launching and operations.

The importance and priority of this project for the GOG can be seen from President Kufuor's most recent message to the nation made on January 22, 2004.

The Philippines

Despite the desire of the President of the Philippines to begin the reform design stage during 2003, this was not possible in a pre-election year. We believe that the importance of the program for the country, is well understood by political leaders, as well as the recognition already achieved by the project, will enable it to move forward when the new government takes office.

Meanwhile we have updated the legal part of the Assessment of the Informal Urban and Rural Assets in the Philippines, drawn up in May 1999. Similarly, we are continuing with the monitoring and analysis of other initiatives related to land tenure, specifically the Land Administration and Management Project (LAMP).

Activity 6 - Improving and Adapting Products and Services

- We have carried out a systematic compilation of all data showing the results and benefits of our reform efforts in Peru. The magnitude of these benefits is overwhelming. ILD's land tenure and business formalization program has proved highly profitable, the costs involved have been recovered and, in the case of land tenure, a net benefit equivalent to **US$ 3,941.9** millions was obtained and in the case of business a benefit equivalent to **US$ 5,485.3** millions was achieved, which together signify a net benefit of **US$ 9,400 millions**, at current value.

  See **Annex 11** for more information on the results and effects of our reform efforts in Peru.

- In order to complete a professional economic analysis of the benefits represented by the reforms proposed by the ILD, we have used existing macroeconomic growth models to show in more precise quantitative terms the impact that the reform program would have on a specific country with respect to macroeconomic variables such as GDP, employment, and fiscal income. The ILD has carried out 2 economic estimate exercises as discussed below.

  The first is a macroeconomic estimate of the impact that some of the institutional reforms that we propose will have on Egypt's per capita GDP growth rate. With a team led by Prof. Gwartney, who heads the "Economic Freedom of the World Index" at Florida State University, it was possible for us to fit into their cross country regression analysis model four of the twenty reforms contained in this proposal (entry into business, contract enforcement, bankruptcy procedures, and credit coverage). The methodology used and the calculations carried out in this exercise are contained in **Annex 6**. They indicate that if these four reforms were 60 to 80 percent successful, they would enhance Egypt's long run growth rate of per capita GDP between 1 and 2 percentage points.

  The second exercise —contained in **Annex 7**— is a detailed microeconomic analysis on the effects that the proposed reforms would have on business in four possible scenarios. This exercise, which does not include the impact that real property reforms could have, is based on ILD fieldwork where we collected information on 11 types of informal business activities, allowing us to build a model of a "typical" informal enterprise in Egypt. Using this model, we have calculated the impact of the proposed reforms on the process and growth of a typical enterprise. These results have in turn been subjected to a sensitive

analysis to test the soundness of the microeconomic results. We then estimated the aggregate impact of reforms on a national level.

Again, the results improve the Egyptian economy in significant ways. For instance, our calculations show that over a 10-year period, the owners of legalized businesses will increase their net revenues, (expressed in current value), by about US$ 6.9 billion (LE 31.9 billion). The workers employed by legalized businesses will earn surpluses equal to approximately US$ 12.8 billion (LE 58.9 billion). And the Government of Egypt will collect from these legalized businesses additional taxes worth about US$ 12.2 billion (LE 56.1 billion). The total net benefits of the program would be positive and equal to US$ 31.9 billion (LE 146.8 billion) in the first ten years of operation. This means that the proposed reforms (only for business and not including property) would increase Egypt's per capita GDP growth rate by 1.9 percentage points by the 5th year and by 1.4 percentage point in the 10th year.

- In order to make use of the knowledge accumulated and experience acquired by those countries that have achieved economic development, research is being carried out on the importance of businesses in the creation of a market economy and in increasing the productivity of developed countries. The hypothesis of this study is that in poor countries, because they have poorly defined property rights, there is inadequate legislation to enable people to form businesses that enable them to co-operate with others beyond the scope of their own families. Thus, people cannot make use of forms of economic association, which is a fundamental tenet of how Western countries have created wealth and capital.

- We have resumed our research into the study of "tools" that enabled western societies to evolve from tribal confederations into democratic regimes and market economies. In this regard we are now studying ancient forms of association, whether clans, tribes, brotherhoods, or tribal confederations that have arisen among all the peoples of the world prior to the existence of the modern state.

In summary, thanks to the continued support of USAID, the ILD's has made progress on numerous fronts in the Oct '03 – Jan '04 reporting period and are on target to pursue the objectives outline in the cooperative agreement.

----- o -----

II. FINANCIAL REPORT

The current report and tables cover the financial aspects of the Agreement signed with USAID from the beginning of said agreement in May 2003 to the end of December 2003.

Income Statement

The Income Statement (**Table 1**) presents the approved amount (US$ 5,122,000), the amount received (US$ 1,629,370), the amount spent (US$ 1,628,902), cash on hand (US$ 468), and the amount available (US$ 3,493,098).

Expenses

Table 2 presents the expenses incurred by line item as per the periods reported to USAID and **Table 3** present the expenses incurred by activity and for each country.

Financial Statement

At the end of March, the auditing firm Gris Hernandez and Asociados, member of Deloitte & Touche, will be initiating the financial audit of the ILD's financial statement for the year ending in December 31, 2003. As soon as we receive their report, we shall forward a copy to USAID.

Accounting System

Both the accounting system and the accounts plan have been modified in order to issue the expense reports by the source of financing as well as by expenses by activity and by country.

----- o -----

LOCAL REAL ESTATE AGENTS AND MONTHLY RENTAL RATES

SUMMARY

Real Estate Agent 1
V & G Corredores Inmobiliarios
Armando Blondet 159, San Isidro, Lima 27
Pone: 271-9760
E-mail: vgcorrinm@yahoo.com

	LOCATION / ADDRESS	TOTAL SPACE AVAILABLE (M2)	RENT $/M2	MONTHLY RATE (tax included)	REMARKS
Alternative 1	Av. Libertadores 165 San Isidro	1,590	$10.5 + tax (*)	$22,886	Including 30 parking lots
Alternative 2	Los Zorzales 160, San Isidro	2,600	$8.00 / m2 + tax (*)	$24,544	Including 40 parking lots
Alternative 3	Av. Camino Real, San Isidro	1,400	$7.00/m2 + tax (*)	$15,164	Including 30 parking lots
Alternative 4	Av. Canaval y Moreyra 380 San Isidro	1,700 (4 floors)	$13.00 /m2 + tax (*)	$30,574	Including 30 parking lots
Alternative 5	Av. Larco 1301 Miraflores	1,480 (2 floors)	$12 /m2 + tax (*)	$34,515	Including 30 parking lots
Alternative 6	Av. Javier Prado Este Cdra. 23 San Borja	1,875 (3 floors)	$8 /m2 + tax (*)	$17,700	Including 14 parking lots

(*) 18% value added tax

LOCAL REAL ESTATE AGENTS AND MONTHLY RENTAL RATES

Real Estate Agent 2
BINSWANGER PERU
Jorge Chávez 265, Miraflores, Lima 18
Pone: (51-1) 446-6644
Fax: (51-1) 444-3189
E-mail: gmalatesta@millicom.com.pe

	LOCATION / ADDRESS	TOTAL SPACE AVAILABLE (M2)	RENT $/M2	MONTHLY RATE (tax included)	REMARKS
Alternative 7	Tudela y Varela 102 San Isidro	2,326 m2	5/ m2 + tax (*)	$13,718	Including 26 parking lots

Real Estate Agent 3
COLLIERS INTERNATIONAL
Av. San Borja Norte 793, San Borja, Lima 41
Pone: (51-1) 224-0861 / 224-2548 / 476-9326 / 476-7838
Fax: (51-1) 224-0804
E-mail: gerencia@colliers.com.pe
Web Page: www.colliers.com

Alternative 8	Calle San Borja Norte 523 San Borja	1,500 m2		$23,600	Including furniture , equipment and 26 parking lots
Alternative 9	Pasaje El Carmen 180, Urb. El Vivero de Monterrico, Surco	1,511	$8.50 + tax /m2	$15,284	Including 16 parking lots

(*) 18% value added tax

LOCAL REAL ESTATE AGENTS AND MONTHLY RENTAL RATES

Real Estate Agent 4
URBINA Y ASOCIADOS
Calle Hermilio Valdizán 204 , Jesús María, Lima 11
Pone (51.1) 261-0082
Fax: (51-1) 460-3703
Celular (51-1) 9995-5587

Alternative 10	Calle Uno 795, Esq. Calle 41 San Isidro	1,900 m2		$14,844	Including 20 parking lots

(*) 18% value added tax

Draft

LETTER OF SUPPORT

FROM NORWEGIAN PUBLIC INSTITUTIONS

TO

PROPERTY CREATION PROGRAMS IN DEVELOPING COUNTRIES EXECUTED UNDER THE LEADERSHIP OF ILD

Recognising the fast growing understanding of the importance of formal property rights to social and economic development in developing and former Soviet Union countries, and the success of the Peruvian Institute of Liberty and Democracy (ILD) in designing and implementing a comprehensive program for the formalization of the property and business rights of the poor so as to facilitate their development into capital as a means to combat poverty;

Desiring to support the ILD's interest in achieving the expansion of its services to an increasing demand, by focusing in areas where it has a comparative advantage –diagnosing and integrating the informal sector of society into the rule of law so as to allow the poor to develop rapidly and peacefully using principally their own resources— and reaching an agreement with recognized technical organizations and professionals to carry out technical tasks in which they have well tested experience;

Understanding the interest of the ILD to consolidate and strengthen its emerging relationship with Norwegian authorities, professionals, and civil society concerned with combating poverty worldwide;

Noting the expressed interest of the Norwegian government, specifically the Ministry of Foreign Affairs and Norad, to support ILD and related projects in former soviet and developing countries;

Noting the letter of co-operation between ILD and Statens kartverk, committing Statens kartverk, *inter alia*, to:

- Explore the opportunity of establishing a permanent facility in Norway to assist ILD in executing it's programs in a fast growing number of countries seeking the help of ILD

- Assist ILD in recruiting relevant experts from Norway and other Scandinavian and European countries to carry out traditional and technical tasks so as to help ILD focus on its exclusive expertise, initially in respect to supporting the Property Creation Program for Tanzania

a number of Norwegian public and non-profit institutions *agree to support* the initiative highlighted in the two points above.

In addition to the Norwegian Mapping and Cadastre Authority, the following Norwegian public and non-profit institutions (their respective particularly relevant competencies in brackets), underwrite to this letter of support:

- Norwegian Institute of Land Inventory – NIJOS (valuation)
- University of Oslo - Faculty of Law (business law, business register law)
- University of Agriculture - Department of Lands (cadastre and land registration law)
- Norway Land Information – Norsk Eiendomsinformasjon (cadastre and land register IT-operation)
- Bronnoysund Register Centre – Brønnøysundregistrene (business registers)

As a first contribution, the institutions will do their outmost to identify and provide experts from their own institution, or from other institutions having relevant or better knowledge and capacities, to support ILD in the execution of the Diagnosis and Design Reform phases of the Program for Tanzania

In doing the above, the Norwegian institutions fully respect and support the approach and methodology for the creation of property and capital as developed by ILD.

It is understood, and hereby properly communicated to ILD, that costs in relation to provision of experts or to other related services, will have to be financed externally, i.e. from other sources than the regular budget of the respective institution.

Supporting institutions and signatures of representatives

Name of institution	Signature and position	date
Norwegian Institute of Land Inventory – Norsk Institutt for jord- og skogkartlegging -		
University of Oslo, Faculty of Law - Universitetet i Oslo		
University of Agriculture, Department of Lands - Norges Landbrukshøgskole, Institutt for landskapsplanlegging		
Norway Land Information – Norsk Eiendomsinformasjon		
Bronnoysund Register Centre – Brønnøysundregistrene		
Norwegian Mapping and Cadastre Authority – Statens kartverk		

6.1 Staffing

The project teams for both the Diagnosis and the Reform Design will be composed of experienced ILD staff members, who have been involved in the execution of corresponding projects in Peru, and other developing countries and a number of local professionals from a variety of disciplines.

However, ILD will also include experts from other countries, mainly from Norway.

We have currently engaged Mr. Helge Onsrud from the Norwegian Mapping and Cadastre Authority (Statens kartverk-SK) who will also help us engage other experts from a number of Norwegian public non-profit institutions like:

- Norwegian Mapping and Cadastre Authority - SK (cadastre and land registration operation)
- Norwegian Institute of Land Inventory – NIJOS (valuation)
- University of Oslo - Faculty of Law (business law, business register law)
- University of Agriculture - Department of Lands (cadastre and land registration law)
- Norway Land Information – NE (cadastre and land register IT-operation)
- Bronnoysund Register Centre (business registers)

In addition private commercial companies like Norway Register Development (NRD) can be engaged.

All foreign and local experts, who are not familiar with the ILD methodology, will be trained beforehand. A complete list of experts, with CV's will be presented to the Government before starting the project.

The budget for the Diagnosis is based on a total input of x man-months of Peruvian and other foreign experts, and y man months of local Tanzanian experts and assistants.

The budget for the Reform Design is based on a total input of x man-months of Peruvian and other foreign experts, and y man months of local Tanzanian experts and assistants.

INTERNATIONAL REPUBLICAN INSTITUTE

Promoting Economic and Political Empowerment in Latin America

Submitted to the Bureau for Democracy, Human Rights and Labor
U.S. Department of State

I. BACKGROUND

During the early and mid nineteen-nineties, Latin America appeared to be moving toward democracy and economic growth at a much accelerated pace. Optimism abounded as democratically elected governments enacted economic and fiscal reforms designed to put their houses in order, expand trade, rid themselves of bloated bureaucracies, and privatize inefficient nationalized industries. The North American Free Trade Agreement (NAFTA), ratified by Canada, Mexico and the United States in 1992 was to mark the first major step toward a Free Trade Area of the Americas (FTAA). The "Washington Consensus" promoted a vision of a hemisphere bound together through open trade and democratic systems of government.

Today, this vision is little more than nostalgia. In 2001, Latin America as a whole experienced its worst economic performance in two decades. In several countries, the politicians that had promoted free trade and other economic reforms like privatization have been punished by voters at the ballot box or otherwise discredited. The sudden and recent emergence of populist governments in the hemisphere has given new life to outdated arguments demonizing free market policies. Ill-informed -- yet very vocal and well-organized -- groups have expressed their opposition to any market based policies, disseminating often-erroneous information to farmers groups, unions, small and medium sized business owners and private sector organizations. Coupled by the recent financial woes that have rocked economies in South America, the detractors' arguments have attracted significant attention. Meanwhile, pro-free market constituencies have remained disorganized, failing to counter-balance the anti-market rhetoric.

Concurrently, international financial institutions have focused too much effort on implementing austerity measures and fiscally conservative policies. While these measures are important for the financial health of these countries, they are aimed almost exclusively at helping them meet their financial obligations with multilateral organizations and servicing their debts with donor country governments. These multi-million -- and sometimes billion -- dollar aid packages do little to address the needs of the most impoverished, as they are not directly aimed at generating jobs and promoting investment.

The prevailing attitude in many parts of the Americas is now one of deep-seated cynicism toward market-based economic policies. But perhaps more disheartening, people are losing hope that democracy brings economic improvement or social justice to the region's impoverished majorities.

The response to this reversal from optimism to pessimism in the region has brought little new thinking to the table. The emergence of a class of leaders from outside of the traditional political

parties and elites is the direct result of frustration with traditional politicians over their perceived disregard for the poor and the failure of a new economic model to improve the daily lives of citizens. In countries from Venezuela to Ecuador, Bolivia, Peru, and Brazil, leaders either emerging or in power have adopted an anti-free market message and employed the jargon of the past to characterize market based economic reforms as unjust, or at worst, as an imperialist ploy of the United States in collaboration with international lending institutions.

Those seeking a balanced view and the goal of promoting sound economic policy for the region need to conduct a critical assessment of what went wrong. Analyzing issues including mismanaged privatizations, bloated public payrolls and debt loads, failure to diversify economies, inefficient or insufficient government revenue systems, and protectionism might provide insight into the stagnation that has occurred throughout the region. The overall condition of the world economy is another crucial factor in this equation.

Additionally, and perhaps more importantly, the issue of poverty and extreme poverty needs to be examined through the prism of economic reforms. New platforms and strategies need to be developed to ensure that those living in poverty have a stake in the decisions taken by their countries political leaders. A concerted effort must be undertaken to prevent these countries from taking several steps backwards in their economic and political development. Without far-reaching and comprehensive policies aimed at genuinely alleviating poverty and generating jobs in these countries, not only will their economies falter, but so too will their political stability, and in some cases, even their democracies.

The ability of Venezuela's Chavez and Brazil's President Lula da Silva to rally millions of poor and traditionally disenfranchised citizens behind their causes suggests that many of the regions poor are seeking a political outlet for their pent-up frustrations. The fact that this is happening at the ballot box under democratic frameworks ought to be an encouraging signal – however, it should also give us some pause. Populism has proven an effective political instrument to win elections in the hemisphere. But, it has been unsuccessful in delivering on its promises of a better standard of living. Not only have populist leaders failed to improve the standard of living for their constituents, in some cases, they have pushed their countries to the brink of economic, political, and social chaos.

To offer hope to the region's struggling economies and the corresponding political stability the United States and its partners in the hemisphere seek, the question of poverty needs to receive greater attention and a more innovative search for solutions. A new approach must be considered, one that looks towards permanent solutions. Fortunately, there are individuals and organizations promoting new and innovative ideas to address the issue of poverty and provide answers as to why capital has served as an engine of growth and prosperity in some countries, while left untapped in others.

The informal sector, an unaccounted for, yet significant, portion of the economically active population in Latin America could be the answer. According to the International Labor Organization (ILO), these self-employed, unlicensed and unregistered street vendors and service providers account for more than 46 percent of Latin America's job market. In many countries, this figure is well above the 50 percent threshold. Incorporating this considerable segment of the

economically active population into the formal sector would solve numerous challenges for both the governments and for these small business owners. Providing formal land titles and recognized legal property rights to impoverished families would allow these new homeowners to leverage capital to improve their dwelling, purchase electricity, start a small business, or any of a number of enterprising activities currently unimaginable given the fact that their residence is currently "dead capital".

Hernando de Soto's study of "The Mystery of Capital" provides an analysis of five countries where the poor hold billions of dollars of "dead capital" that cannot be used for the expansion of wealth. De Soto explores the factors behind this phenomenon and calls for a series of reforms designed to give citizens greater security over their assets, institutions capable of protecting private property, and means to convert "dead capital" into "live capital" that can be used to secure loans and credit, and other productive tools of financial worth. Once this potential capital is unleashed, the poor can visualize an escape from poverty through incentives to entrepreneurship and the capacity to operate in an integrated, formal economy as opposed to an improvised and informal one. The challenge is clear. According to the International Labor Organization since 1990, eighty-five percent of all new jobs in Latin America have been created in the informal economy. It is also clear that where these reforms have been implemented, the results have been dramatic. In Peru, de Soto's reforms have been only partially implemented under several governments – but already they have allowed 6.3 million of Peru's poor to gain legal title to their homes and property. As a result, their homes have increased in value by $2.2 billion and their income by $3.2 billion. The reforms have allowed newly formalized owners to obtain $300 million in capital loans and saved them $254 million in reduced red tape costs. As a consequence, child labor among newly formalized property owners has been reduced by 28 percent. In El Salvador, the real estate formalization system designed by the Institute for Liberty and Democracy (ILD) is expected to bring one million people under the law by the end of 2003. These reforms clearly need to expand their scope throughout the region. (Source: Institute for Liberty and Democracy)

II. IRI RESPONSE

In a recent study by Richard Roll and John Talbot at UCLA, the effects of several dozen variables on per capita income were tested. The results showed that respect for property rights had the strongest positive correlation with income, while black market activity has the strongest negative correlation. Other consistently positive correlations were found with respect for political rights, civil liberties and other facts associated with democratic societies. IRI will couple the need to provide the political capacity to political actors and educate citizens on the need to understand and support economic reform policies consistent with market based principles and property rights.

The two fundamental objectives of this project are: 1) to promote the adoption of policies that seek to integrate the poor into the market economy and establish legal property rights for their assets; and, 2) promote the implementation of institutional reforms that assure a level playing field and fair rules of the game for those seeking to integrate into the formal economy and establish legal and potentially capital accruing ownership over property.

To advance these objectives, IRI has partnered with program subgrantee, the Center for International Private Enterprise (CIPE). Hernando de Soto's Institute for Liberty and Democracy (ILD) will provide the technical expertise and training in the area of property reform and formal market economy integration outlined in the summary ILD curriculum in the activities portion of the proposal.

Following is an outline of the specific reforms IRI will promote for inclusion in political party platforms, governance plans (*planes de gobierno*) and communication strategies.

Areas for Reform

Legal Property Reform

IRI will work with political parties and civil society stakeholders to promote legal reforms designed to define by law capital assets held by individuals and businesses currently operating outside of the formal economy. This will include identifying existing bureaucratic and structural obstacles to legal property ownership

Rule of Law

IRI and CIPE will develop and implement a training curriculum and methodology promoting legal and institutional reforms designed to help build a constituency for reform among those informal sector groups seeking to integrate into the formal sector.

Additionally, training will promote reforms to guarantee that legal procedures for incorporation and establishing property rights are not prohibitive in terms of cost, time, or other factors that might impede or discourage citizens and business owners. These reforms will be adopted in political party platforms, communications strategies and policy blueprints. Civil Society and grassroots associations will have a clear understanding of these reforms and provide advocacy for their implementation by policymakers and adoption by parties and candidates in their platforms.

Legal Property Ownership and the Accumulation of Wealth

IRI and partners will identify legal and institutional reforms and civic education devices needed to assure that property rights translate into expanded economic growth opportunities for the region's poor. Laws and rights that allow property to serve as a means to secure lines of credit, expand production capacity, and promote entrepreneurship will be promoted and citizens will be educated on how to use these mechanisms to improve their economic well-being.

IRI Role

IRI will administer the program in all respects, coordinating the work of the partner groups and identifying participating political parties and civil society entities.

IRI will provide expert trainers and consultants who will work directly with the political parties to provide a greater technical understanding of the reforms and the means necessary to communicate these concepts in a convincing and understandable fashion to citizens. IRI will support research -- including focus group activities -- to provide policy-makers and parties the information needed to develop political messages that resonate with voters. IRI will also provide the technical assistance necessary to construct sound platforms that reflect a commitment to the institutional reforms needed to enact market-based solutions to wealth creation and economic empowerment.

Center for International Private Enterprise Role

As a consultant to the program, CIPE will undertake its civil society component. CIPE will identify think tanks and business organizations in El Salvador to promote greater understanding and advocacy for the three reform areas. CIPE will also provide expertise in the area of institutional reform, and economic reform targeted at the informal sector El Salvador. CIPE will coordinate with ILD to develop economic reform modules for incorporation in political party programs. CIPE and IRI will develop and distribute educational materials explaining these reforms in a way that is clear and comprehensible to often-times under-educated or marginalized populations. To address questions or concerns from specific audiences, IRI and CIPE will conduct workshops with civil society groups and local community organizations designed to sensitize citizens to the need for reform. These efforts will target some of the more impoverished areas of El Salvador as identified through program assessments. Concurrently, CIPE will help develop and train local advocates that will promote reform in these areas. Finally, CIPE will facilitate communication and exchange between civil society and the political parties and policy-makers promoting reform.

Institute for Liberty and Democracy Role

ILD, headed by Peruvian economist Hernando de Soto, is the most recognized source of technical training and consultation in the area of market based property rights reform in the world. The concepts and methodologies developed by ILD have been synthesized into a training curriculum. ILD provides international trainers and consultants to assess local realities and develop corresponding reforms and strategies for their implementation. ILD has joined the program in a consultancy capacity and will provide trainers and technical consultants to participating political parties and civil society groups.

Scope of Program

Given the innovative nature of this project, a one-country pilot program focused on El Salvador has been deemed most suitable for the initial year, with possible expansion toward the end of the twelve-month program.

El Salvador

A civil war prevented El Salvador from making significant economic and political gains during much of the *1980s*. The peace, brokered by the UN in 1992, positioned El Salvador to begin anew and use its solid industrial base and human capital for much needed economic growth. Unfortunately, the peace was followed by a series of natural disasters including Hurricane Mitch in 1998 and earthquakes in 2001, which left at least 1,200 people dead and more than a million others homeless. Those disasters notwithstanding, during the 1990s growth and stable prices replaced economic decline and inflation. Trade liberalization, financial sector and pension reforms, privatization of state-owned enterprises, and the decision to move to a bi-monetarist regime in 2001 have all contributed to a strengthened economy.

Nowadays, El Salvador has a more deregulated and diversified economy than in the past, is less dependent on agriculture and is developing strong service and manufacturing sectors. As a consequence, standards of living improved and poverty declined markedly during the last decade. Net enrollment in primary education increased by close to 10 percentage points, infant mortality declined by 40 percent, population without access to safe water was halved and extreme poverty was reduced by half." (World Bank, July 2002)

Democratic consolidation has advanced with six peaceful, broadly based elections since 1989. The *Alianza Republicana Nacionalista* (ARENA) won both presidential elections during the 1990s (1994 and 1999), but lost its legislative majority to the *Frente Farabundo Marti para la Liberación Nacional* (FMLN) in 2000. Although reaching consensus has been difficult since peace was signed, El Salvador's ability to agree on a National Development Plan (*Plan de la Nación*) which was endorsed by the authorities in the Four Pillars Government Plan (*Alianzas*) and by civil society in 2000, and to function under a divided Congress are signs of a healthy democracy.

Following the 1999 Presidential elections, El Salvador was well positioned to make strides toward growth under a reform-minded president. Francisco Guillermo Flores, of the conservative ARENA party, is US-educated and a strong advocate of privatization. Furthermore, negotiations for CAFTA, the Central American Free Trade Agreement, which will boost long-term growth, create jobs and reduce poverty, as the U.S. is the major trading partner to all the countries concerned, are well underway.

However, these positive strides may be in jeopardy with presidential elections approaching in March 2004. A common perception in El Salvador is that economic reforms have not generated prosperity, and some reforms such as privatizations have actually led to a higher cost of living. El Salvador's political environment is showing hints of volatility with the lead opposition to the ARENA Government, the FMLN, continuing to make strides under the leadership of presidential candidate Schafik Jorge Handal Handal. Handal has been critical of U.S. efforts in the War on Terror, U.S. economic and trade policies, and has referred to himself as a "1930's-style Stalinist." More moderate elements from the FMLN, including former San Salvador Mayor Héctor Silva, have left the party. Silva, and members of center and center-left parties, have formed a more moderate coalition to contest the presidency.

III. ACTIVITIES

Without an all-encompassing effort aimed at addressing the needs and concerns of both the supply side (policy makers and political actors) and the demand side (intended beneficiaries of reforms) genuine economic reforms will be difficult to achieve. To successfully meet the challenges outlined above, IRI proposes to undertake a four-pronged effort, modeled after its successful political party training programs in the region. These components consist of: 1 – series of assessment missions to El Salvador and analysis of existing data/research 2 – training initiatives to target political parties and civil society organizations using IRI, CIPE, and ILD experts; 3 – regional and local workshops at the grassroots level; and 4 – publications based on focus group findings.

Country Assessments

In an effort to further evaluate the political and economic situation in El Salvador, as well as local buy in and political party participants, IRI, CIPE and ILD will undertake a series of assessments.

A small scale, preliminary assessment mission to El Salvador will be necessary to gauge local buy in, identify political party and civil society collaborators, as well as research firms with whom IRI would work in the future. IRI will make use of its existing relationships with political parties to identify economic policy experts. To address the supply and demand side of the programmatic equation, this initial assessment will also serve to identify representatives from at least two civil society organizations interested in promoting economic reforms in El Salvador. For this initial assessment, IRI will work closely with CIPE and ILD, who already have an existing network of economics-focused civil society organizations. Ultimately, the organizations identified by IRI and CIPE, in coordination with U.S. Embassy and USAID Mission, representing five political parties and two civil society organizations will form the backbone of IRI's economic and political empowerment program. On this mission, IRI will also coordinate with local NGO's, and economics departments of national universities to build relationships for follow-on activities, and to share knowledge and techniques. This initial mission will also allow for IRI to gauge local perceptions of economic models, performance of leaders, and policy preferences.

Along with this small-scale preliminary assessment mission, a research compilation phase will be conducted. This phase of the program will be conducted by IRI D.C. staff, in conjunction with ILD and CIPE, drawing on their extensive experience in the region, and analyzing existing data on the public perception of these issues. Initial research of studies by the Justice Study Center of the Americas, the World Bank, and the IDB have shown El Salvador to be a productive partner in the sort economic and legal reform training that is part of the proposed program. The World Bank's "Competitiveness Enhancement Project," which began in 1995, has helped the Government of El Salvador increase productivity and accelerate outward-oriented private sector development by completing a series of legal and regulatory reforms. These reforms include investment and accounting laws and creating the National Investment Office which has reduced the time needed to start a new investment from seven weeks to seven days. The Government of El Salvador took out a $70 million loan from the World Bank to develop a national cadastre and draft legislation relating to the regulation of land titles. El Salvador and its government

institutions have had significant experience in the area of property rights, but permanent legislation has yet to be passed.

During the closing stages of this program, a joint IRI, CIPE, ILD evaluation mission will be conducted to gauge internal political party conditions, such as dialogue and platform developments. IRI will also assess the work of the civil society organizations in their efforts to promote reforms and follow up with program participants.

Focus Group Activities

Gauging public opinion regarding private enterprise and the degree of opposition to free market policies, and the reason for this opposition, is an important first step in empowering political parties to effectively address and implement reforms. In order to address the political and economic climate of El Salvador, focus groups will determine which areas of reform are most immediately sought by the Salvadorian people and which would have the most support amongst them. Furthermore, the information garnered from the focus groups will be used to prepare publications that will be disseminated to better inform the public. They will also be instrumental in conducting the local workshops and in training local reform advocates.

Economic Reform Training Activities

This component of the program consists of a two-faceted training initiative aimed at providing economic experts from the participating political parties with the tools necessary to develop and incorporate market based policies into their respective parties' platforms, communicate and market these policies to their constituents, and develop strategies to use these policies as campaign tools. This portion of the program will be particularly relevant to participating political parties as they analyze the results of presidential elections in March 2004

Representatives of the civil society organizations will learn what policies bring benefits to various sectors of society. In addition, they will analyze methods to effectively educate citizens and promote these policies. (Please see Regional and Local Workshops section) Based on the findings from the focus groups, the participating political party and civil society representatives will be provided with current and country-specific data related to the economic policies and the market behavioral trends of citizens.

The first phase of the training initiative consists of in-country training seminars on various economic reform issues. Based on IRI's first round of assessment missions, and in coordination with the U.S. Embassy and USAID mission, political party representatives from each of the five major parties will have been identified as participants. Representatives of two civil society organizations will have been identified as well. These seven organizations will be invited to attend the training activities, which will be conducted by experts from IRI, CIPE and ILD.

Representatives from CIPE and ILD will travel to El Salvador and will conduct training activities focusing on general economic principles and economic trends. As mentioned above, these sessions will also serve to closely analyze focus group findings. Concurrently, an IRI expert

would be present to train participants on communications strategies to promote reforms, incorporate these reforms into party platforms and provide the tools necessary to communicate the benefits of the reform policies to constituents.

After phase one is completed, fifteen participants will participate in a four pronged training program conducted by IRI, CIPE and ILD, that is focused on crafting a strategy to raise the issue of the informal sector of the economy, and creating a basis for reform. The participants will be selected from the seven participating organizations in El Salvador – between two and three representatives from each political party and two representatives from each civil society organization.

The program will begin with a two day orientation, in which IRI and CIPE will brief participants on political and economic reform strategies in order to develop a framework for promoting policies to be discussed in the ensuing ILD workshop. Participants will then attend a three to four day workshop at ILD in Lima, Peru for a 'Tour of Informality,' where they will be exposed to an in-depth look at the informal sector of the economy and its effects. Following the ILD workshop, IRI will conduct a three to four day 'political boot camp,' addressing how to target the issues from a political perspective, and providing the necessary tools to promote political and economic reforms. The program will be concluded with a one day debriefing, in which some of the participants will be selected to attend the CIPE informal sector workshop at the World Movement for Democracy in Sao Paulo.

Regional and Local Workshops

In an effort to recognize and address the concerns of the demand side of this programmatic equation, IRI and CIPE will reach out to citizen groups. To that end, IRI proposes to organize a series of in-country workshops aimed at bringing together members of civil society to analyze and conduct an advanced level of dialogue on market based policies, property reform and the three reform areas identified above.

Based on the initial in-country evaluations, country, states, cities, and/or towns will be identified and workshops will subsequently be held with local members of civil society. In addition, publications (Please see Publications section) will be distributed at these forums.

Publications

IRI and CIPE will develop materials for distribution to intended audiences explaining and promoting the proposed reforms. The Economic Reform Modules will detail the methodology, and will serve as the major point of reference for political parties and civil society groups on these economic reforms. These reform modules will be constructed in a manner that will be suitable for use in different countries.

In addition to the Economic Reform Modules, materials will be developed highlighting the importance of informal members of the economy integrating into the formal sector. These materials will be published detailing the benefits of market-based reforms and property rights reform in a fashion understandable to the general population.

IV. EVALUATION PLAN

Quantitatively measuring the success of this program will be somewhat challenging. However, qualitative results will be easier to gauge. The country assessments will serve to establish the baseline for the evaluation of the subsequent impact of this effort. By assessing party platforms, consistency of dialogue on the issue, and civil society activity promoting economic reforms, we will have provided a basis for evaluation of whether these groups have increased or improved on their activity in support of: 1. Policies that seek to integrate the poor into the market economy and establish legal property rights for their assets; and 2. Institutional reforms that assure a level playing field for those seeking to integrate into the formal sector of the economy. The focus group activities conducted at the outset of the project, besides laying the groundwork for the training activities of this proposal, will also serve as reference points for later evaluation.

Toward the end of the twelve month program, a final evaluation mission, as mentioned above, will be conducted by representatives from IRI, CIPE and ILD in which issues and key data points observed during initial assessment and research compilation phases will be revisited. IRI, CIPE and ILD will then consider the results to determine what worked and what was less effective – which is essential given the innovative blend of economic and political training and the new approach to collaboration among these organizations.

The overall success of the program will be measured by political advances, which will be determined by analyzing the content of market based policies in political party platform planks (the next elections are for the Legislative Assembly in 2006), governance plans (*planes de gobierno*), proposed legislation dealing with reform areas identified in this proposal, civil society engagement, favorable media coverage, and then comparing it to the findings of the preliminary assessment and research compilation. Additionally, the emergence of these reforms in political and public discourse will be an indication of progress.

V. PROGRAM EXPANSION

Toward the end of the twelve month pilot program, IRI, CIPE and ILD will initiate a program expansion phase by conducting initial assessments in other suitable countries, which will be determined based on feasibility and demonstrated need. The structure of expansion country program activity will be planned in similar fashion to this program in El Salvador.

Promoting Economic and Political Empowerment In Latin America

Initial year Work plan, El Salvador

12 Month Program

	2003	2004										
	Dec	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**
Assessments												
Research Compilation												
Preliminary assessment												
Evaluation assessment												
Expansion country assessment												
Focus Group												
Trainings												
In Country Trainings												
ILD course												
IRI/CIPE political boot camp												
Publications												
Reform Module development												
Focus Group Publications												

INTERNATIONAL REPUBLICAN INSTITUTE

Promoting Economic and Political Empowerment in Latin America

Submitted to the Bureau for Democracy, Human Rights and Labor
U.S. Department of State

Work Plan Notes

I. Assessments:

Research Compilation IRI D.C. staff will coordinate with CIPE and ILD staff to analyze existing data on the public perception of this issue, as well as previous work that has been done promoting such reforms. Estimated time frame: December, 2003 through April, 2004.

Initial In-Country Assessment to gauge local buy-in and identify potential collaborators. Estimated Date of initial in-country assessment: January, 2004

Evaluation Assessment which will be conducted near the end of the initial year to evaluate internal political party conditions, platform developments, and efforts to promote proposed reforms. Estimated Date of evaluation assessment: September October, 2004.

Expansion country initial assessment is structured similar to the initial assessment in El Salvador. The amount budgeted for Expansion country initial assessment is based on refundable airfare to La Paz, Bolivia, a likely expansion country. Estimated date of expansion assessment:

II. Focus Group Activities

Focus groups will be conducted to determine which reforms would be supported by the public of El Salvador. The results will be published and disseminated to better inform the public on the issues. Estimated date of focus group activities: December, 2003 Februaru, 2004.

III. Trainings

In-Country Training activities focusing on economic trends, focus group findings and communications strategies to promote reforms. Participants of these in-country trainings workshops will be identified in initial in-country assessment. Estimated dates of In Country Training activities: March, 2004 & August-September, 2004.

ILD Course: a "Tour of Informality" in which 15 participants from San Salvador, El Salvador will travel to Lima, Peru to be exposed to an in-depth look at the informal sector of the economy and its effects. Estimated date of ILD course: May June, 2004.

Political Boot camp IRI staff and expert trainers will address how to target the issues covered in the "Tour of Informality" from a political perspective, providing the technical tools necessary to promote political and economic reforms. Estimated date of political boot camp: May June, 2004.

IV. Publications

Reform Module Development: CIPE ILD will begin developing economic reform modules for program participants following preliminary assessment mission and focus group results. Estimated date of Reform Module: March April, 2004

Focus Group Publications: IRI CIPE will publish the results of the focus group soon after it is completed. Estimated date of focus group publications: March April, 2004.

Prime Minister
Republic of Mauritius

January 27, 2004

Dr Hernando de Soto
Avenue Del Parque Norte – Lima 37
PERU

Dear Dr de Soto,

Integration of Informal Sector in Formal Economy

Our Economic Agenda for the New Millennium seeks to achieve consistently high rates of growth and transform the country into a high-income, high-tech knowledge and services economy. We have set out to do this by investing massively in education and training, infrastructure and environment protection and by undertaking policy reforms to enhance competitiveness and improve economic management.

The slowdown in the world economy, recession in our main markets and fierce competition in the wake of globalisation and the liberalisation of world trade have led to job losses and affected the overall level of employment. A direct outcome has been the rapid expansion of the informal sector, a phenomenon which needs to be managed carefully to preserve social cohesion.

You are known for your deep understanding of the emergence of the informal sector, the forces underpinning it, and the way it could best be integrated in the mainstream without affecting economic activity. We therefore wish to benefit from your experience, and invite you to visit Mauritius during your forthcoming trip to the region to share with us your views on the issues outlined.

We look forward to your visit.

Yours sincerely,

REPOBLIKAN' i MADAGASIKARA
Tanindrazana - Fahafahana - Fandrosoana

PRESIDENCE DE LA REPUBLIQUE

LE PRESIDENT

Antananarivo le 08 décembre 2003

Objet : *Invitation pour Discussion Relative aux Droits de Propriété Foncière*

Cher Docteur de Soto,

La Stratégie de Réduction de la Pauvreté à Madagascar met en exergue le besoin de sécuriser les droits de propriété foncière pour favoriser une croissance économique tirée par le secteur privé. Afin de traduire cette Stratégie en pratique, mon Gouvernement s'est engagé dans un programme intégré de réformes juridique, politique et administrative.

Un tel programme est un enjeu politique majeur pour le Pays et doit être bien conçu mon. Mon Gouvernement souhaite ainsi pouvoir tirer parti d'expériences réussies en la matière.

Compte tenu de votre expertise et de votre renommée en la matière, je pense que vous pourriez utilement apporter votre appui analytique à la préparation d'un tel programme. Je souhaite par la présente lettre vous inviter formellement à travailler avec moi et mon Gouvernement sur le sujet.

Dans l'attente d'une réponse positive, je vous prie, Cher Docteur de Soto, de croire en l'assurance de ma très haute considération.

Marc RAVALOMANANA

Dr Hernando de Soto
Av. Del Parque Norte - Lima 27
PERU

Cc : Hafez Ghanem
Directeur des Opérations pour Madagascar
Banque Mondiale, Antananarivo
MADAGASCAR

Date: Tue, 03 Feb 2004 10:13:50 -0500
To: mmayorga@ild.org.pe
From: Hernando de Soto <hds@ild.org.pe>
Subject: Fwd: solicitud de información

Subject: solicitud de información
Date: Mon, 2 Feb 2004 10:25:10 -0600
From: "Thelma Gomez Taracena" <tgomezt@segeplan.gob.gt>
To: <postmaster@ild.org.pe>

Señora Miriam Gago:
Tengo el agrado de dirigirme a usted en seguimiento a la conversación telefónica del Ing. Harris Whithbeck, Comisionado Presidencial para la Modernización del Estado (República de Guatemala) y, en ese sentido, como es de su conocimiento, reiterar el interés del Presidente Berger de contar con los servicios profesionales del Doctor De Soto para brindar asesoria y capacitación a un grupo de funcionarios de gobierno alto nivel, sobre temas relacionados con el logro del desarrollo económico y lucha contra la pobreza, considerando en ello el otorgamiento de derechos de propiedad a los pobres, tanto del área rural como del sector informal de la economia.
A través del portal del Instituto Libertad y Democracia (ILD), puede obtener información del mismo y sobre logros obtenidos, como también sobre la hoja de vida del Doctor de Soto. En esta ocasión, mucho le agradeceré me brinde información sobre contenidos, tiempos y costos de la presentación (puede considrarse cómo un seminario de inducción al tema?), diagnóstico de país y diseño de reformas. La anterior solicitud es para trasladarle la información al Doctor Hugo Eduardo Beteta Méndez-Ruiz, Secreario de la Secretaría de Planficación y Programación de la Presidencia, del cual soy asistente técnico, y así poder iniciar los trámites de consecución de fondos.
Cualquier otra información necesaria al respecto, por favor comunicarse conmigo a esta dirección o bien a los teléfonos (502) 251-4549 ó 238-0268
Al reiterarle mi agradecimiento por la atención que le de a la presente, aprovecho la oportunidad para manifestarle las seguridades de mi consideración y estima.
Thelma Gómez.

FORMALIZATION OF BUSINESS AND REAL ESTATE IN EGYPT
An ECES/ILD Conference
Conrad International Hotel, Cairo
January 18, 2004

8:30–9:00 am **Coffee & Registration**

9:00—10:30 **OPENING SESSION**
Chairperson: *Taher Helmy (Helmy & Hamza Law Firm & ECES)*
Introductory Remarks: *Ahmed Galal (The Egyptian Center for Economic Studies)*
Keynote Speakers: *Hernando De Soto (Instituto Libertad y Democracia, Peru)*
H.E. Medhat Hassanein (Minister of Finance, Egypt)

10:30–12:00 **SESSION 1: THE ECONOMICS AND LEGAL DIMENSIONS OF FORMALIZATION**
Chairperson: *Galal El Zorba (Nile Clothing Co. & ECES)*
Speakers: *Ahmed Galal (The Egyptian Center for Economic Studies)*
Ziad Bahaa El-Din (Bahaa El-Din Law Office)
Discussants: *Heba Handoussa (Economic Research Forum)*
Bahaa Ali El Dien (Menoufia University)

12:00–12:30 **Coffee**

12:30–2:00 **SESSION 2: FORMALIZATION OF BUSINESS**
Chairperson: *Mohamed Taymour (EFG-Hermes & ECES)*
Speakers: *Enrique Diaz (Instituto Libertad y Democracia, Peru)*
Discussants: *Alia El Mahdi (Cairo University)*
Hani Seif El Nasr (Social Fund for Development, Egypt)

2:00-3:30 **LUNCHEON SPEAKER:** *H.E. Olav Kjorven (State Secretary for International Development, Norway)*

3:30–5:00 **SESSION 3: FORMALIZATION OF REAL ESTATE**
Chairperson: *Hatem El Karanshawy (The American University in Cairo)*
Speaker: *Maria del Carmen Delgado (Instituto Libertad y Democracia, Peru)*
Discussants: *Mustafa Kamal Madbouli (Research Center for Construction and Housing)*
Abdel Hamid Ibrahim (Capital Market Authority)

5:00-5:30 **Coffee**

5:30–7:00 **CLOSING SESSION: THE WAY FORWARD**
Chairperson: *H.E. Medhat Hassanein (Minister of Finance, Egypt)*
Panelists: *Ahmed Galal (The Egyptian Center for Economic Studies)*
Hernando De Soto (Instituto Libertad y Democracia, Peru)
Mounir Abdel Nour (Vitrac, Egyptian Parliament & ECES)
Taher Helmy (Helmy & Hamza Law Firm & ECES)

7:30 **DINNER SPEAKER:** *H.E. Jack Kemp (Former Secretary of Housing and Urban Development & President, Empower America, USA)*

المركز المصري للدراسات الاقتصادية
E C E S
The Egyptian Center for Economic Studies

إدماج القطاع غير الرسمي في الاقتصاد المصري"

مؤتمر ينظمه المركز المصري للدراسات الاقتصادية بالتعاون مع معهد الحرية والديمقراطية (بيرو)
فندق كونراد القاهرة، مصر
١٨ يناير ٢٠٠٤

٨:٣٠ – ٩:٠٠ صباحا	تسجيل
٩:٠٠ – ١٠:٣٠ صباحا	**الجلسة الافتتاحية** رئيس الجلسة: الدكتور/ طاهر حلمي (مكتب حلمي وحمزة للمحاماة، والمركز المصري للدراسات الاقتصادية) كلمة استهلالية: الدكتور/ أحمد جلال (المركز المصري للدراسات الاقتصادية) المتحدثان الرئيسيان: الدكتور/ ايرناندو دي سوتو (معهد الحرية والديمقراطية، بيرو) معالي وزير المالية الدكتور/ مدحت حسانين (وزارة المالية)
١٠:٣٠ – ١٢:٠٠ ظهرا	**الجلسة الأولى: الأبعاد الاقتصادية والقانونية لإدماج القطاع غير الرسمي في الاقتصاد المصري** رئيس الجلسة: السيد/ جلال الزربة (شركة النيل للملابس، والمركز المصري للدراسات الاقتصادية) المتحدثان: الدكتور/ أحمد جلال (المركز المصري للدراسات الاقتصادية) الدكتور/ زياد بهاء الدين (مكتب بهاء الدين للمحاماة) المعقبان: الدكتورة/ هبة حنتوسة (منتدى البحوث الاقتصادية) الدكتور/ بهاء على الدين (جامعة المنوفية)
١٢:٠٠ – ١٢:٣٠ ظهرا	استراحة
١٢:٣٠ – ٢:٠٠ ظهرا	**الجلسة الثانية: تقنين أوضاع قطاع الأعمال غير الرسمى** رئيس الجلسة: الدكتور/ محمد تيمور (المجموعة المالية المصرية، والمركز المصري للدراسات الاقتصادية) المتحدث: الدكتور/ إتريكا دياز (معهد الحرية والديمقراطية، بيرو) المعقبان: الدكتورة/ عالية المهدي (جامعة القاهرة) السيد/ هاني سيف النصر (الصندوق الاجتماعي للتنمية)
٢:٠٠ – ٣:٣٠ ظهرا	الغداء ويتحدث خلاله: معالي الدكتور/ أولاف كجورفين (وزير الدولة للتنمية الدولية، النرويج)
٣:٣٠ – ٥:٠٠ عصرا	**الجلسة الثالثة: تقنين أوضاع القطاع العقاري غير الرسمي** رئيس الجلسة: الدكتور/ حاتم القرنشاوي (أستاذ الاقتصاد والتمويل بالجامعة الأمريكية بالقاهرة) المتحدث: الدكتورة/ ماريا ديل كارمن ديلجادو (معهد الحرية والديمقراطية، بيرو) المعقبان: الدكتور/ مصطفى كمال منبولي (مركز أبحاث التشييد والإسكان) السيد/ عبد الحميد ابراهيم (هيئة سوق المال)
٥:٠٠ – ٥:٣٠ مساء	استراحة
٥:٣٠ – ٧:٠٠ مساء	**الجلسة الختامية: الخطوات المستقبلية** رئيس الجلسة: معالي وزير المالية الدكتور/ مدحت حسانين (وزارة المالية) المتحدثون: الدكتور/ أحمد جلال (المركز المصري للدراسات الاقتصادية) الدكتور/ ايرناندو دي سوتو (معهد الحرية والديمقراطية، بيرو) السيد/ منير عبد النور (شركة فيترك، والمركز المصري للدراسات الاقتصادية) الدكتور/ طاهر حلمي (مكتب حلمي وحمزة للمحاماة، والمركز المصري للدراسات الاقتصادية)
٧:٣٠ مساء	عشاء ويتحدث خلاله: معالي الوزير/ جاك كمب (وزير الدولة الأسبق للإسكان والتنمية الحضرية ورئيس شركة Empower America، الولايات المتحدة الأمريكية)

Estimated Impact of Formalization Reforms on the Growth of the Egyptian Economy

by

James Gwartney
Florida State University
E-mail: jgwartne@coss.fsu.edu

Robert Lawson
Capital University
E-mail: rlawson@capital.edu

Bruce L. Benson
Florida State University
E-mail: bbenson@garnet.acns.fsu.edu

(This study was undertaken for the Institute of Liberty and Democracy of Lima, Peru.)

Dr. Gwartney is a Professor of Economics and holder of the Gus A Stavros Eminent Scholar Chair at Florida State University. He is also the Director of the Gus A Stavros Center for the Advancement of Free Enterprise and Economic Education.

Dr. Lawson is a Professor of Economics and the holder of the George H. Moore Chair at Capital University in Columbus, Ohio.

Dr. Benson is the DeVoe Moore Distinguished Research Professor of Economics at Florida State University.

Estimated Impact of Formalization Reforms on the Growth of the Egyptian Economy

The Institute for Liberty and Democracy (ILD) has proposed a number of changes in Egypt's institutions and laws in order to strengthen property rights, contract enforcement in the country, and rule of law. The primary objective of this study is to provide statistical estimates of the likely impact on Egypt's economic growth of implementing the ILD proposals. Section 1 of the paper analyzes the key characteristics of a sound legal system and explains why they are important for the achievement of economic progress. Section 2 considers the potential contribution of the ILD proposals with regard to the development of a sound Egyptian legal system. Section 3 uses data on the quality of legal systems in other countries and the importance of this factor as a source of economic growth to derive the empirical estimates for how the ILD proposals, if adopted, will influence the long-term growth rate of the Egyptian economy.

Section 1: Why is a sound legal system essential for economic progress?

The Economic Freedom of the World (EFW) Project uses 38 different variables to rate the consistency of the institutions and policies of 123 countries with economic freedom (Gwartney and Lawson 2003). The summary rating of each country reflects its policies and institutions in five major areas: (1) size of government, (2) legal system and security of property rights, (3) access to sound money, (4) freedom to trade with foreigners, and (5) regulation of credit, labor, and business. In analysis of the impact of these five areas on the income levels and economic growth rates of countries, however, the importance of a sound legal structure stood out. There were 24 countries with an average legal structure rating of 7.0 or more on a ten-point scale during 1980-2000. All of these countries achieved solid growth of per capita Gross Domestic Product (GDP) during these two decades, and the lowest per capita income among the 24 was approximately $12,000. At the other end of the spectrum, there were 21 countries with an average legal structure rating of 4.0 or less during 1980-2000. The highest per capita income among this group with poor legal structures was $7,010. None of the countries with a poor legal structure was able to achieve both a per capita GDP of more than $3500 and an annual growth rate of more than one percent during the two decades. Clearly, countries with a quality legal structure grew and achieved high levels of income, while those with a poor legal structure stagnated and their income levels were low.

What constitutes a sound legal system? For a strong and growing economy, it is crucially important for a legal system to provide citizens with:

- clearly defined and secure property rights,
- low-cost, effective enforcement of contracts, and
- evenhanded application of clear rules ("the rule of law").

These factors are important because they provide people with assurance that they will get to keep what they invest in, improve, produce, and purchase, and because they facilitate exchange over a large and expanding market.

1.1 The Benefits of Secure Property Rights

The institution of property (the network of rules regarding ownership and transfer procedures) determines how the resources of a society will be brought into use. Resources will be used no matter what the property rights system is, however. Even the lack of formal property rules and enforcement is a property rights system: it implies a right of free access for everyone (or to the strongest, in the absence of enforceable rules against the use of violence) to all resources. But importantly, the nature of the rights influences the use and the potential for enhancing well being or wealth.

Relatively *secure and well defined private property rights create an environment conducive to wealth production* by creating incentives for individuals to use resources in ways that will make the owner as well off as possible over the long term. A private owner has *a long decision horizon* because he knows that he or his heirs can count on using the resource and consuming benefits from its use over a long period of time. This creates *incentives to invest* in maintenance of the resource, and in improvements that will increase the stream of earnings that flow from it. Entrepreneurial individuals also have incentives to *look for opportunities*, such as new ways to use their resources, that will expand their wealth even more. As all individuals in a society react to the incentives created by secure property rights, investments and innovations lead to an expanding economy.

On the other hand, individuals who may claim a resource, whether with a formal title, or through informal means (e.g., squatters who protect their claims through threats of violence), but who feel their claims are insecure, have short decision horizons. If an individual knows that someone else can steal his resources or his products easily, or that the government can easily take the resources or products without compensating him for their value, he has incentives to consume any benefits of resources quickly before they are taken from him rather than producing something that someone else may want. His incentives to expand wealth through innovations and investments are weak because property rights to that wealth are insecure. When many individuals confront an incentive structure of this type and adjust their behavior accordingly, resources will be wasted and income levels will fall well below their potential.

It is important to recognize that voluntary exchange takes place because *both parties expect to be better off* (i.e., wealthier) as a consequence. With voluntary exchange people trade something they value less for something they value more, thus assets are *allocated to higher valued uses*. Furthermore, competitive bidding can lead to exchanges that result in assets being allocated to their highest valued use (unless something prevents exchange and/or competition - issues addressed below). Finally, note that the difference between the value the seller and the buyer place on an asset is the *cooperative surplus* or the potential *gains from exchange*, and the actual distribution of this surplus depends on the price at which the exchange takes place. Therefore, *voluntary exchange increases wealth,* and both parties generally share in that

increase. Exchange is never costless, however, and *transaction costs* can be high enough to prevent a potentially wealth enhancing trade. This brings us to another benefit of private property rights: *clear and secure private property rights encourage and facilitate bargaining by reducing transaction costs*. If there is no institution that records the title to land, for instance, a potential buyer will be unsure about the seller's claim of ownership. In order to avoid buying a parcel of land that is not actually owned by the seller, the buyer will have to engage in a costly effort to verify ownership. The cost can, and often is, so high that the potential mutually advantageous exchange never takes place. If ownership can be easily verified, however, the costs of transactions are lower and exchange is more likely.

One very important exchange that can have dramatic impacts on economic growth is the transaction between a borrower and a lender. In order to expand a business enterprise or improve a piece of property, an individual may need to obtain additional financial capital. *If that individual has clear title to an asset, he can use that asset as collateral to obtain a loan* in order to make the desired investment. Lack of a clear title means that the potential lender cannot verify ownership, and he will either refuse to make the loan, or demand such high interest payments to offset the risk of the loan that the investment and resulting economic growth may never occur.

1.2. Contract enforcement and wealth expansion through voluntary exchange.

Clear title to secure property rights reduces uncertainty (increases knowledge) but even so, transaction costs never fall to zero. *Depersonalized* exchange (trade among strangers) of simple goods may occur if the good's characteristics are easily observed and quality can be determined before a purchase (e.g., as in an informal urban market for fruits and vegetables). But for more complex difficult-to-measure goods, the seller often knows more about the product and its quality than the buyer. Under these circumstances, the cost of the exchange for the buyer will be relatively high if he cannot believe the claims or promises of the seller. If the seller's assurances are not credible, the buyer will either have to invest in obtaining more information, bear the risk of making an undesirable purchase, or forgo what might be an advantageous exchange. Under such conditions, people may make small risky purchases in hopes of getting something that improves their lives. But for large exchanges and/or exchanges that involve complicated products where quality can only be determined with use, *trust or recourse* generally must be available in order to make promises credible so that voluntary transactions can occur (Benson 2001).

Repetitious dealings within small close-knit communities encourage the development of trust (a willingness to make oneself vulnerable to another even in the absence of external constraints), because incentives to live up to promises and make valid claims arise in such personalized exchange. The scope of trust-based trade tends to be limited to small groups, however, and this limits the potential benefits of specialization and trade. In fact, living standards in the countries of Western Europe, North America and other parts of the "developed" world are the result of depersonalized exchange, that is, trade between parties that do not know each other and will probably never meet. These exchanges require the "extension of the market" from the trust-based arrangements in a local town or village to the region, nation, and indeed to the far

corners of the world. In order for large scale depersonalized exchange to occur in extensive markets, however, individuals generally require recourse to some third party enforcement mechanism before they will accept the claims and promises made by unknown trading partners.

One way for extension of the market to occur is for traders to develop *reputations* for trustworthiness, given that information about such reputations spread. After all, people have strong incentives to avoid dealing with someone they believe may be untrustworthy. So if the spread of information about fraud or contractual breaches is sufficiently effective, a spontaneous boycott of anyone who cannot be trusted can be anticipated (recourse is available as the spread of information will produce punishment for misbehavior: the third party is the trading community as a whole). Depersonalized trade networks based on reputation can be geographically extensive, although they tend to be functionally focused (e.g., within communities of traders in the same industries, or vertically related industries), because they require that individuals within the network have strong incentives to spread information. Time is also required to invest in and build reputations, so emerging markets may not have many participants who can offer valuable reputation bonds to contractual partners. Indeed, since the payoff to such investments are delayed and very uncertain, incentives to make them tend to be relatively weak. Such incentives are strengthened, however, if individuals with mutual interests in long-term interactions can form "contractual" groups or organizations rather than waiting for reputations to slowly develop.

Potential contractual arrangements are numerous, including the implicit contracts of ethnic or religious networks, indirect equity ties through pyramidal ownership structures, direct equity ties, interlocking directorates, and various informal and formal commercial organizations and trade associations. Such arrangements can provide formal mechanisms to overcome frictions in communication of information about trustworthiness, and establish their own unbiased dispute resolution arrangements. After all, if a contract does not clearly address some unanticipated occurrence, a dispute between two trustworthy parties can arise over how to treat the new situation. In order to maintain the potential for ongoing trade and protect reputations, *mediation or arbitration services* can be produced within the group, or external mediation and/or arbitration specialists (individuals with extensive knowledge of trade practices and usage within the disputants' area of commerce) can be employed (e.g., from the International Chamber of Commerce, the Arbitration Association, or any number of other private dispute resolution providers). Mediation and arbitration selection mechanisms actually vary widely, but in general, they guarantee knowledgeable and unbiased specialists by allowing for pre-screening, and possibly more than one level of screening (Benson 1999).

The laws of a nation may significantly undermine the potential for reputation-based depersonalized trade. Laws limiting the options for the formation of firms and associations will raise the cost of such trade, for instance. In addition, some states explicitly prohibit the use of alternative dispute resolution mechanisms, preferring to provide recourse through national courts. Other states refuse to respect the decisions made by arbitrators by allowing the national courts to overturn such judgements, or by preventing boycotts against traders who practice deception or breach contracts. The legal systems of developed countries with strong economies engaged in international trade generally allow and even *support organizational flexibility and the use of alternative dispute resolution.*

1.3 The "Rule of Law" and economic growth.

Given the limited scope of trust-based personalized trade, as well as reputation-based trading associations as sources of recourse, organizations with greater scope to provide recourse may expand the potential for depersonalized exchange. In particular, nation-states with coercive power certainly can provide strong sanctions against fraud, breach of contract, and other forms of non-cooperative behavior, creating incentives for people to live up to their promises and make valid claims. Furthermore, a state's legal system can provide recourse for trades between people who are not members of informal or formal trading communities. Despite such potential benefits, however, there are a number of reasons for traders to resist the substitution of the state's legal system for trust and privately produced recourse.

One reason that traders resist the involvement of the state in their transactions and disputes is simply that governments of the nations where markets are attempting to emerge may not be capable of doing the things that they should do to encourage trade and economic growth. After all, legislators, bureaucrats, and judges in emerging economies are even less likely to understand the important underpinnings of a successful market system well enough to provide effective support for them than the Western European and North American judges, bureaucrats, and politicians, who frequently seem to make decisions that undermine rather than support market processes (Pejovich 1997). One way to alleviate this potential problem is to create *specialized courts with knowledgeable judges who can deal exclusively with commercial issues* (i.e., judges who are like commercial arbitrators).

A second potential problem arises because rule creation and enforcement for a larger community than the trust or reputation-based communities that spontaneously evolve through individual interaction will require some concentration of coercive power. While such power might be used to simply extend the scope of trade by offering recourse (contract enforcement) to individuals engaged in depersonalized trade, this need not be the case. Coercively imposed and enforced rules can facilitate voluntary interaction, but they also determine the distribution of wealth, and the use of law to transfer wealth actually reduces wealth creation for several reasons. First, such transfers are often achieved by preventing or raising the costs of voluntary exchange, including limitations on entry and competition, thereby limiting the wealth that could be created through these activities. Second, the resources consumed in the political competition for wealth transfers (lobbyists, political organizers, etc.) could be employed to produce new wealth rather than to seek transfers of existing wealth. Third, potential victims of the transfer process have incentives to resist, so transfer-avoidance costs also arise. These costs can take the form of diverting some of their productive resources in order to compete in the political process.

Exit is another option, however, whether by moving to an alternative political jurisdiction or by hiding economic activity and wealth (e.g., moving transactions "underground" into the informal sector). Therefore, in order to induce compliance with discriminatory transfer rules, the rule makers will generally have to rely on a large enforcement bureaucracy, both to limit exit and to execute the rules. The resources devoted to such enforcement also are diverted from productive activities. Enforcement bureaucracies can develop their own agendas and extract

wealth transfers (e.g., excessive budgets, bribes) for their own benefit, raising the cost of enforcement even further. These high enforcement costs are a fourth source of costs that accompany a wealth transfer process. The fifth consequence is likely to be even more significant than the other four, however. Faced with the probability of involuntary transfers, individuals' property rights to their resources, products, and income flow are perceived to be relatively insecure, so their incentives to invest in maintenance of and improvements to their assets and to produce and innovate in order to earn more income are undermined. If transfers are expected to be large, frequent, and arbitrary, production will be low and wealth expansion (economic growth) will be very slow if it occurs at all.

In order to avoid the wealth reducing costs that arise when the state's legal system is used to transfer wealth, the state must commit to the "rule of law". That is, the state must offer *unbiased rules that do not favor* (i.e., transfer wealth to) *some individuals or groups over other individuals or groups*. The *state also must constrain itself*. That is, the individuals who wield the coercive power of the state must subject themselves to the same rules that apply to others, by recognizing and respecting the property rights of citizens, and by living up to the obligations and promises that they make.

Adoption of the proposals recommended by the Institute for Liberty and Democracy will move the Egyptian government toward a rule of law while establishing more secure property rights and enforceable contracts in order to encourage more voluntary exchange, investment, innovation, and economic growth.

Section 2: The ILD Proposals and Development of a Sound Legal System for Egypt.

This section will explain why the ILD proposals will improve the security of property rights, the operation of the legal system, and strengthen rule of law principles.

2.1 Security of Property Rights

One of the primary focuses of the ILD proposals involves recognition by the state of the private property rights that have been established by the informal sector in Egypt. In particular, proposals **15** (formalization of real estate ownership and creation of a unified, system for its registration) and **16** (simplification of the registration procedures for drawing up mortgages) will promote more secure property rights for real estate, especially for assets owned in the informal sector.

In addition, several of the other proposals will strengthen property rights by improving the quality and accessibility of information. Proposal **7** will improve the flow of credible information to decision-makers by strengthening and standardizing the accounting rules for all businesses. Proposal **8** will create an interconnected information system regarding business assets, as well as transactions involving these assets. Proposal **9** will create an integrated system of pledges for the poor and a registry in which to record them. Proposal **10** will establish a system for the certification of signatures and the protest of documents and Proposal **11**

establishes a mechanism for the enforcement of guarantees. Proposal **20** creates a specialized body responsible for the capitalization of the poor. Implementation of these proposals increase the potential use of assets for collateral, but they also will make contractual promises more credible, and reduce the costs of contract dispute resolution and enforcement.

2.2 Contract Enforcement And Voluntary Exchange

A second focus of the ILD proposals for Egypt is on providing low-cost and unbiased contract enforcement (recourse under the rule of law) for Egyptians and the international traders with whom they deal, thereby making contractual promises more credible and expanding the potential scope of impersonal trade. A number of proposals will have beneficial impacts in this area, including some listed above (e.g., **7, 9, 10, 11, 20**). In addition, Proposal **13** (creation of a Conciliation and Arbitration Centre, and improvement of existing alternative conflict resolution) is intended to encourage choice in dispute resolution by providing state backing for arbitration and mediation. This can complement and therefore encourage the use of non-state sources of recourse in impersonal trading relations that are otherwise available only for parties engaged in trade within small close-knit communities that can employ ostracism sanctions. In addition, proposal **17** (establishment of out-of-court mechanisms for the enforcement of guarantees) complements **11** by creating a low cost (non-litigious) method of enforcing contractual guarantees, which clearly increases the opportunities for impersonal exchange. Similarly, proposal **12** (establish a special judicial system for resolving administrative and registration problems and disputes arising from guarantee contracts) is intended to provide a specialized state-backed source of dispute resolution to resolve disputes between private economic agents and the state, and between those private agents that have entered into collateral contracts registered with the specialized body proposed in **20**.[1] These changes will facilitate voluntary exchange and the resulting increases in wealth arising as resources are moved to higher valued uses and traders share the resulting cooperative surplus.

2.3 Rule of Law

Both the security of property rights and the availability of effective contract enforcement are important characteristics of the rule of law, so the proposals discussed above also apply to this third focus of the ILD proposals. However, the strength of the rule of law principles is also influenced by other factors. For example, detailed regulations create tremendous discretion for regulatory bureaucracies and raise the cost of doing business. Such regulations and the accompanying discretion that they give to public officials often can limit or prevent entry and exit in the formal economy.

Easy entry and exit are key determinants of efficient market economies because only efficient firms providing products desired by consumers will be able to survive in a competitive environment. Furthermore, while many people may believe that regulations are required in order to protect consumers from the opportunistic behavior of firms, the fact is that the most effective regulator of all is market competition. One firm cannot over price its product or sell a low quality product if consumers can choose among many producers of substitute products who have incentives to set lower prices and/or provide better quality than their competitors in order to

capture more revenues. Indeed, limits on entry and exit actually protect inefficient firms and force domestic consumers to purchase products that are more expensive and of lesser quality than they would be in a competitive setting. Entry restraints also reduce the opportunities for foreign trade and its accompanying economic growth, as foreign consumers will opt for the cheaper and higher quality products produced in more competitive economies.

Restrictions on entry and exit also mean that property rights are not recognized and secure, because such limits mean that owners of property who want to use that property to produce for a particular market are not able to do so. They may not be able to enter the market, or they may not be able to disinvest in a market (exit) in order to move their resources to more profitable ventures. Regulations and their discretionary application also increase the compliance costs of operation in the formal sector, thus forcing prices to be higher and reducing the potential for voluntary exchange in that sector. Many businesses will shift to the informal sector in order to avoid the compliance costs. Therefore, the ILD proposals include several that are intended to reduce entry, exit, and compliance cost in the market sector. Proposals **1, 2, 3, 4, 5, 6, 14, 18** and **19** fall into this category.

Section 3: How Will the Reforms Affect the Performance of the Egyptian Economy?

In order to answer this question, we will make use of data from the Economic Freedom of the World Annual Report and a recently released study by the World Bank, *Doing Business in 2004*. The World Bank recently assembled four key variables that reflect the quality and effectiveness of a country's legal structure. The four variables are:

1. The number of days required to acquire permits, licenses, and other provisions necessary to legally start a standardized generic business.
2. The number of days required for the settlement of a clear-cut contractual violation involving a failure to repay debt.
3. The cost and effectiveness of laws regulating the exit from business and insolvency.
4. The presence and comprehensiveness of a credit bureau registry.

These variables are available for approximately 130 countries in the World Bank's *Doing Business* report and are described in more detail in Annex 2. They are of particular interest here because of their close relationship to several of the proposals recommended in this document. After all, direct measures of the degree to which legal systems are characterized by implementation of individual proposals **7, 8, 9, 10, 11, 15, 16, and 20** simply do not exist. Furthermore, measures of the resulting impacts of such legal characteristics on property rights recognition and security, and the ease with which property can be turned into capital (serve as collateral for loans), also are not available for a large set of countries. However, the World Bank data on public and private credit bureau coverage should capture at least part of the impacts of these proposals. If a relatively large portion of a country's population is listed in such databases, the implication is that they hold property that can be used to secure loans (which in turn implies that the recognized property is alienable so it can be voluntarily transferred through exchange).

That is, property rights to the resources controlled by a relatively large portion of the population are likely to be recognized, relatively secure, and transferable.

Direct measures of the degree to which legal systems are characterized by implementation of individual proposals **7, 9, 10, 11, 12, 17, and 20** are also not available. Similarly, the impacts of such a legal environment on the credibility of contractual promises do not exist across countries either, but the World Bank data on the number of days from the filing of a breach-of-contract claim until the debt was paid serves as a proxy. While this is clearly not a direct measure, particularly of the availability of arbitration, mediation, or non-litigious alternatives to public courts, or the availability of specialized public courts, these data should capture some of the impacts of such options. After all, public courts tend to respond to the competitive pressures from alternative dispute resolution options (Benson 1999), improving their procedures and rulings when their potential "customers" (litigants) can turn to faster, less biased, and/or lower cost options. In addition, the World Bank measure of the cost and effectiveness of laws regulating the exit from business and insolvency is intended to represent the ability of lenders with secured claims to obtain repayment when a business is liquidated and/or reorganized. Therefore, this index is included in the statistical analysis as a proxy for the availability of recourse and the resulting credibility of contractual promises, along with the days-to-settle-a-contract-dispute variable discussed above.

The proxy for the aspects of rule of law that are targeted by proposals **1, 2, 3, 4, 5, 6, 14, 18, 19** and **20** is the World Bank data on the number of days that are necessary to start a legal business in each country. Note that the World Bank data on exit from business discussed above also has implications for the cost of exit as it is intended to measure the likelihood of maximizing the value of bankrupt businesses, rescuing viable business assets and facilitating the system of claims against bankrupt firms.

It is important to recognize both the limitations and the implications of the data used in the following analysis. Since direct measures of the degree to which the twenty individual ILD proposals are not available, proxies must be employed in an effort to capture the impact of three identifiable but often overlapping categories of proposals discussed above. Again, the proposal groups are directed at improving (1) the security of property rights, (2) the availability and cost of contract enforcement, and (3) other aspects of the "rule of law" associated with the ease of entry and exit in markets. The proxies are imperfect, but they can be expected to capture a substantial portion of the impact of improvements in Egypt's legal environment that will result if **all of the ILD proposals** are instituted. Obviously, Egypt could not be expected to achieve the improvements in growth projected below merely by changing these four variables directly. These variables are chosen because they are expected to **correlate** with the non-measurable characteristics of legal systems dealt with in the entire set of ILD proposals. Therefore, the coefficients on the four variables are intended to capture a substantial portion, although probably not all, of the impact of the unmeasured but correlated factors accompanying the entire set of proposals. The coefficients on these variables in the regression analysis will reflect both the direct impact of the variables themselves and the unmeasured impact of other factors that cannot be directly accounted for but that are correlated with these observed variables. Clearly, if the

unmeasured elements of the package are not changed the results predicted below cannot be anticipated.

When analyzing economic growth, it is important to focus on a lengthy period of time. Short-term fluctuations in growth rates will be influenced by a number of factors such as business cycle conditions and changes in the world price of important import or export items. In the short run, these largely random factors may dominate and conceal the strength of the relationship between policy variables and growth. Moreover, credibility of the government will influence the response to a policy change. Before decision-makers will be willing to make major behavioral changes, they must be convinced that the change in policy direction is permanent rather than temporary. Furthermore, it will take time for information to be transmitted and markets to adjust fully to a new economic environment. Thus, the primary response to a policy change will often be delayed and the full response will almost always be greater in the long run than in the short run.

The *Doing Business* data of the World Bank are not available for years prior to 2001. Thus, these data cannot be directly used to analyze cross-country variations in long-term growth. However there is reason to believe that both the ILD recommended proposals and the four factors of the World Bank study will be closely related to the EFW legal structure/property rights measure. The components of the EFW legal index are designed to identify the effectiveness and evenhandedness of contract enforcement, the security of property rights, and the adherence to rule of law principles. Thus, institutional changes like the implementation of the ELD proposals that reduce the cost and improve the effectiveness of contract enforcement, provide for more evenhanded settlement of disputes, and encourage the legal operation of economic activity by recognizing property rights can be expected to increase a country's EFW rating. Fortunately, the EFW data are available for a large number of countries throughout the 1980-2000 period, as well as 2001. Because the EFW data are both comprehensive and available over a lengthy time period, they are particularly suitable for the systematic analysis of cross-country differences in income levels and the long-run growth process.

We have already conducted extensive research analyzing the impact of the EFW factors, including the legal structure/property rights area, on the long run growth rate of countries. If we can derive the relationship between the World Bank *Doing Business* components and the EFW legal area rating, this relationship can then be used to estimate the impact of the recommended proposals on Egypt's long-term growth rate.

Step 1: Estimation of the Relationship between the World Bank *Doing Business* variables and the EFW legal structure/property rights area rating. Both the *Doing Business* variables and the EFW legal area ratings were available in 2001. Each of the four variables available from the World Bank was standardized and regression analysis was utilized to investigate their linkage with the EFW legal structure/property rights rating. Like the other components and areas of the EFW index, the legal structure area ratings are on a zero to 10 scale, with higher ratings indicating arrangements that are more consistent with the effective and evenhanded enforcement of contracts, protection of property rights, and rule of law. Annex 1, Table 1 presents the ratings

in 2001 for both EFW legal system area and the standardized composite of the four World Bank *Doing Business* variables for the 106 countries for which these data were available.

Table 1A shows the relationship between the World Bank *Doing Business* standardized components and the EFW legal rating in 2001 for all countries for which both variables were available. For both indexes, higher values are indicative of less regulation and a better legal and property rights environment. As Equations 1through 4 illustrate, there was a positive and significant (95 percent level and above) relationship between each of the four variables and EFW legal structure/property rights area rating. As Equation 5 shows, when all four of the World Bank variables were included in the regression, each of the four was positive and three of the four were highly significant (99 percent level and above). The R^2 for this equation indicates that the four variables explained more than half of the cross-country variation in the EFW legal structure/property rights area rating.

Next, we took the average of the standardized values for the four variables for each country and combined them into a single composite standardized variable.[2] (Note: this combination variable will be referred to as the World Bank *Doing Business* Index or WBI.) As Equation 6 of Table 1A shows, the WBI is closely related with the EFW legal structure/property rights rating. Among the 106 countries, 43.1 percent of the cross-country variation in the legal structure area rating is explained by this single composite variable. The coefficient for the *Doing Business* Index indicates that a one-unit change in this variable is associated with a 2.25 unit change in the EFW legal structure rating. The t-ratio for the WBI is 8.97, indicating significance at more than the 99 percent level of confidence.

Table 1B is identical with Table 1A except that only less-developed countries (LDCs) are included in the former. The pattern of the results is similar, but the explanatory power of the model is generally lower when only LDCs are included in the analysis. Equation 6 of Table 1B indicates that a one unit increase in the WBI is associated with a 1.55 unit increase in the EFW legal structure/property rights area rating. While the size of this coefficient is lower than when all countries are included in the analysis, it is nonetheless sizable and highly significant (99 percent level of confidence).

Step 2: Estimation of the Impact of EFW Legal Structure on the Long-term Growth of an Economy. In this section, we will use the EFW data along with other control variables to estimate the independent impact of cross-country differences in the legal structure/property rights area on the long-term growth of a country's per capita GDP. Annex 1, Table 2 contains the average EFW legal rating during 1980-2000 for the 85 countries with EFW data and the other control variables used in this section.[3] In order to isolate the impact of the legal structure/property rights variable, one must also control for the impact of other factors that may also influence growth. The results presented in Table 2 reflect this methodology.

In addition to the EFW legal rating, the model presented in Table 2 also includes the following independent variables: (1) initial (1980) per capita GDP, (2) the average EFW sound money area rating, 1980-2000, (3) change in the sound money rating between 1980 and 2000, (4) private investment as a share GDP, 1980-2000, (5) public investment as a share of GDP, 1980-

2000, (6) change in human capital[4] (primarily years of schooling) of persons in the labor force between 1980 and 2000, (7) percentage of the population living in the tropics, and (8) percentage of the population residing within 100 kilometers of an ocean coastline.[5] These eight variables along with the EFW legal structure/property rights rating were available for 85 countries. As Equation 1 of Table 2 shows, these variables explained 63.4 percent of the cross-country variation in the growth of per capita GDP during 1980-2000. All of the independent variables have the expected sign and, except for the coastal population variable, all are significant at the 90 percent confidence level or higher.

For our purposes, we are most interested in the legal structure variable. The coefficient for this variable was positive 0.69, and it was significant at more than the 99 percent level of confidence. This indicates that a one unit difference in the average 1980-2000 legal structure rating was associated with a 0.69 difference in growth over the two decade period. Thus, a country with the legal area rating of 7.0 could expect to grow about 0.69 of a percentage point more rapidly **each year** than a country with a 6.0 legal area rating. Correspondingly, a country with the 7.0 legal area rating could expect that its annual growth rate of per capita GDP would exceed that of countries with EFW ratings of 5.0 by almost 1.4 percentage points. Moreover, these differential annual growth rates are after the impact of the other eight variables in this comprehensive model have been taken into account.

Equation 2 of Table 2 presents the results when only LDCs are included in the model. The pattern is virtually identical with that of Equation 1 and the explanatory power of the model increases to 66.2 percent. This suggests that two-thirds of the cross-country variation in growth during 1980-2000 is the result of cross-country differences in the independent variables of the model. When only LDCs are included, the coefficient for the legal area variable is 0.74 compared to 0.69 for the all-country model. This indicates that a one unit change in the legal area rating for LDCs is associated with a 0.74 percentage point increase in long-term growth. Thus, the impact of the legal structure area rating is virtually the same regardless of whether all countries or only LDCs are included in the model.

The explanatory power of the growth model presented in Table 2 is exceedingly high, higher than most cross-country growth models that have appeared in the scholarly literature. Even more important for our purposes, the EFW legal variable is quite stable. When a variable or two was either added to or omitted from the model, the coefficient for the EFW legal variable persistently remained in the range between 0.5 and 0.8.[6] Thus, we can have a high degree of confidence in the estimated impact of the EFW legal rating on growth. See Annex 3 for additional information about alternative specifications and robustness of the model.

Step 3: Estimation of how adoption of the proposals will affect Egypt's long-term growth of per capita GDP. We are now ready to estimate how the twenty ILD-proposed reforms, represented by the four World Bank *Doing Business* variables, once they are implemented and fully effective, will impact Egypt's long-term growth rate. We will derive estimates under two different assumptions: (1) a 60 percent improvement in Egypt's performance for each of the four *Doing Business* variables and (2) an 80 percent improvement in Egypt's performance for each of

the four variables. We will also derive estimates based on the regression analysis for both all countries and LDCs only.

What would constitute a 60 percent (or 80 percent) improvement in the four components of the *Doing Business* Index? Consider the number of days required for a legal start-up of the World Bank's generic business. According to the World Bank, in 2001 it took 43 days for a legal startup of this business. If there was a 60 percent improvement, the number of days required for the startup would decline to 17.2. In the case of an 80 percent improvement, the number of days for the startup would fall to 8.6. Similar procedures were followed to derive the values for a 60 percent and 80 percent improvement for the other three *Doing Business* variables.[7] The figures for the four components that reflected a 60 and 80 percent improvement were then used to calculate how Egypt's standardized WBI score would be affected. A 60 percent improvement would increase Egypt's WBI rating by 0.84 units. An 80 percent improvement would increase Egypt's Index rating 1.12 units.

These figures can be used along with those derived in Step 1 and Step 2 above, to estimate the impact of the ILD-proposed reforms on Egypt's long-term growth rate, once the reforms are instituted and become fully effective. As Summary Exhibit 1 (and Table 1, Equation 6) shows, a one-unit increase in the World Bank's *Doing Business* Index is associated with a 2.25 unit increase (on a ten-point scale) in the EFW legal structure/property rights variable. As the second equation of Summary Exhibit 1 (and Table 2, Equation 1) shows, a one unit increase in the EFW legal structure rating enhances a country's long-term growth by an estimated 0.69 percentage points. Thus, each unit increase in the World Bank's *Doing Business* Index is associated with a 1.55 (2.25 multiplied by 0.69) percentage point annual increase in long-term growth.

The 1.55 figure can then be used to estimate the impact on long-term growth accompanying both a 60 percent and 80 percent increase in the four components of WBI. A 60 percent improvement in the four factors of the *Doing Business* Index would increase Egypt's WBI by 0.84. This improvement implies an increase in the long-term annual growth rate of per capita GDP of 1.30 percentage points (1.55 multiplied by 0.84). An 80 percent improvement would increase Egypt's WBI rating by 1.12 units and enhance its long-term annual per capita growth of GDP by an estimated 1.74 percentage points (1.55 multiplied by 1.12).

Because these estimates make use of all of the information available, we believe that they provide the best estimate of how the ILD proposals would impact Egypt's long-term annual growth rate of per capita GDP. However, some might argue that these estimates may be upward biased because they are based on a combination of data for both developed and less developed countries. Because Egypt is a less developed country, its experience might be different than that of developed countries. In order to consider the potential importance of this alternative view, we also derived estimates based on only data for LDCs. These estimates are presented In Summary Exhibit 2. In the case of a 60 percent improvement in the four factors of the *Doing Business* Index, this methodology estimates an increase in the long-term growth of per capita GDP of 0.96 percentage points (1.55 x 0.74 x 0.84). The parallel projected increase in long-term growth for an 80 percent improvement is 1.28 (1.55 x 0.74 x 1.12).

Summarizing, we estimate that the ILD-proposed reforms, when fully instituted, will increase Egypt's annual long-term growth rate by between 0.96 percentage points and 1.74 percentage points. The 0.96 percentage point increase is based on the assumption of a 60 percent improvement in the four factors of the World Bank's *Doing Business* Index and the use of data for only LDCs. The 1.74 percentage point increase is based on the assumption that the factors in the *Doing Business* Index will improve by 80 percent and the projections are based on data for all countries rather than LDCs only. Given the importance of legal structure/property rights as a source of economic growth, we believe that these estimates are both realistic and attainable if the ILD proposals are instituted.

During the last several decades, LDCs such as Hong Kong, Taiwan, Mauritius, Botswana, Malaysia, and Chile have achieved highly impressive growth rates, and the EFW legal structure/property rights ratings of these countries are one to two points higher than those for Egypt. (For evidence on this point, see Annex 1, Tables 1 and 2.) If Egypt is going to join the "high-growth" club, it must improve the quality of its legal system and the security of property rights. The ILD-proposed reforms would constitute a major step in that direction.

Section 4: Summary and Concluding Thoughts

Most of the ILD proposals will either directly or indirectly affect the legal system. They will provide for more recognizable ownership rights, lower-cost methods of verifying and enforcing contracts, and for removal of obstacles that are often invitations for political favoritism. Both the ILD proposals and the WBI components are primarily about the operation and effectiveness of the legal system. This explains why we focused our analysis on how the legal system would be affected and how these changes would influence the performance of the Egyptian economy.

There is strong evidence that a sounder legal system leads to higher growth and, there is also strong evidence, that the ILD proposals will improve the quality of Egypt's legal system and thereby enhance its long-term growth. Even though the World Bank *Doing Business* components only represent a proxy for the legal structure benefits that can be expected from the ILD proposals, the strength of their relation to the EFW legal system area rating indicates that these proposals would reduce transaction costs, improve the security of property rights, and strengthen the overall quality of Egypt's legal/regulatory system. Given the size of the coefficient and extremely high t-ratio (almost 9.0), we can be virtually certain the elements encompassed and related to the four WBI components enhance the efficiency of legal systems. Correspondingly, the high t-ratio (indicating significance at 99 percent plus level) for the EFW legal area variable in the comprehensive model of Table 2 illustrates that the legal security of property rights area is an extremely important ingredient in the growth process. The robustness and insensitivity of the legal area coefficient to alternative specifications re-enforces our position on this issue.

Based on the relationship between the WBI components and the EFW legal area and, in turn, improvements in the EFW legal area's impact on growth, we estimate that institution of the

ILD proposals will increase Egypt's long term annual growth rate of per capita GDP by between 1.30 and 1.74. These estimates are derived from the use of data for all countries. If only data from LDCs are used, the estimated increase in annual growth rate would be between 0.96 and 1.28 percent.

How important is a 0.96 to a 1.74 percentage point increase in a country's annual growth rate? After 20 years, an increase in annual growth rate in this range implies an increase in income per person of between 20 and 40 percent. Over a 40-year period, a 1.74 percent increase in annual growth would produce twice the income level than would have otherwise been achieved. Improvements in annual growth rates of the magnitude that can be expected from the proposals analyzed here will exert a huge impact on income levels when sustained over a lengthy time frame.

It will take time to institute the ILD-proposed program and for it to become fully operational. As we previously discussed, it will also take time for programs of this type to achieve credibility and for individuals and businesses to take full advantage of the improved economic environment. Thus, the higher estimated growth rates may not immediately be achieved. But there are good reasons to believe that substantial benefits will be derived in a relatively short time frame, four to six years for example, and that the bulk of the improvement in long-term annual rate of growth will be achieved within a decade.

The ILD proposals should be perceived of as a package. Many of the proposals will reinforce and increase the effectiveness of other proposals in the package. For example, the proposals on real estate titling (15) and standardization of business accounting rules (7) will reinforce and increase the effectiveness of the public credit bureau information proposal. The estimates provided above are based on the supposition that the entire package will be instituted.

Of course, some of the ILD proposals may be more important than others. Unfortunately, specific data for most of these proposals are unavailable at this time. We hope that cross-country data for many of these proposals will be developed in the future. Such data would enhance our knowledge of how various dimensions of this program influence economic performance and improve the accuracy of future research regarding their impact.

The titling of real estate and other physical assets is one of the most important elements of the ILD proposals. Titling will promote development, better maintenance, and movement of capital to higher valued uses. The usefulness of the World Bank data as a measure of quality of the legal system would be substantially enhanced if they provided country information on the comprehensiveness of real estate titling. It would certainly improve our ability to measure more directly the impact of both the ILD proposals and, more generally, the impact of more secure legal rights of ownership on economic performance. Unfortunately, at this time, data on titling are not available and therefore they cannot be directly incorporated into our analysis.

Nonetheless, to a degree, our analysis will reflect the impact of this factor because it will tend to be correlated with the four WBI components for which data were available. For example, the comprehensiveness of the credit bureau coverage will almost certainly be positively

correlated with recognition of the legal right to property, including ownership of real estate, businesses, and debt instruments. After all, credit worthiness is about the party's ownership of assets and responsibility for debts. This information would be of little value if property rights in these areas are not recognized. Clearly, a direct measure of the portion of property actually titled would be a superior indicator that would improve our ability to isolate the impact of property titling and recognition of ownership rights. Hopefully, such data will become available in the future.

References

Benson, B. L. (1999) "To Arbitrate or to Litigate: That is the Question." *European Journal of Law and Economics*, 8: 91-151.

Benson. B. L. (2001) "Knowledge, Trust, and Recourse: Imperfect Substitutes as Sources of Assurance in Emerging Economies." *Economic Affairs*, 21: 12-17.

Gallup, John L.; Sachs, Jeffrey D. and Mellinger, Andrew D. *Geography and Economic Development.* Washington, D.C.: World Bank. Annual World Bank Conference on Development Economics, 1998, pp. 127-70.

Gwartney, James and Lawson, Robert. *Economic Freedom of the World: 2003 Annual Report.* Vancouver: The Fraser Institute, 2003.

Pejovich, S. (1997) "Law, Tradition, and the Transition in Eastern Europe." *The Independent Review: A Journal of Political Economy*, 2: 243-254.

Sachs, Jeffrey. "Institutions Don't Rule: Direct Effects of Geography on Per Capita Income." Cambridge: NBER Working Paper No. 9490.

World Bank. *World Development Indicators,* CD-Rom, 2003.

Annex 2

Description of the Four Components Used to Construct the World Bank *Doing Business* Index

Component 1: Entry into Business

Doing Business compiled a comprehensive list of entry regulations, by recording all the procedures that are officially required for an entrepreneur to obtain all necessary permits, and to notify and file with all requisite authorities, in order to legally operate a business in each country. The survey divided the process of starting up a company into distinct procedures, and then calculated the costs and time necessary for the accomplishment of each procedure under normal circumstances. This variable is measured in number of days.

Component 2: Enforcing Contracts

The data on enforcing a contract are derived from questionnaires answered by attorneys at private law firms. The questionnaire covers the step-by-step evolution of a standardized debt recovery case before local courts in the country's most populous city. The respondent firms were provided with significant detail, including the amount of the claim, the location and main characteristics of the litigants, the presence of city regulations, the nature of the remedy requested by the plaintiff, the merit of the plaintiff's and the defendant's claims, and the social implications of the judicial outcomes. They estimated the number of days that would be required to settle the matter under normal circumstances.

Component 3: Bankruptcy: The Goals-of-Insolvency Index (zero to 100 scale)

This measure documents the success in reaching the three goals of insolvency: maximizing the value of the bankrupt business, rescuing a viable business, and keeping the order of claims stable. It is calculated as the simple average of the cost of insolvency (re-scaled from 0 to 100, where higher scores indicate less cost), the observance of absolute priority of claims, and the achievement of more efficient outcomes. The total Goals-of-Insolvency Index ranges from 0 to 100: a score of 100 on the index means perfect efficiency (Finland, Norway, and Singapore have 99), a 0 means that the insolvency system does not function at all.

Component 4: Credit Bureau Coverage (entries per 1000 population)

A public credit registry is defined as a database managed by the public sector, usually by the Central Bank or Superintendent of Banks, that collects information on the standing of borrowers (persons and/or businesses) in the financial system and makes it available to financial institutions. A private credit bureau is defined as a private firm or a non-profit organization that maintains a database on the standing of borrowers (persons or businesses) in the financial system, and its primary role is to facilitate exchange of credit information amongst banks and financial institutions. A coverage indicator for both the public registry and private credit bureau indicated the number of individuals and/or firms listed, and this coverage variable was scaled to

the population of each country. The figure is reported per 1000 population. The higher the coverage, the more comprehensive the registry. We used the figure from the public registry or the private credit bureau depending on which reported the most extensive coverage per 1000 population.

Source: World Bank, *Doing Business in 2004: Understanding Regulation*, (Washington, D.C.: World Bank and Oxford University Press), 2004. (http://rru.worldbank.org/DoingBusiness/default.aspx)

Annex 3

Specification and Robustness

We ran several variations of the growth model presented in Table 2. We ran a model that included all of the independent variables of Table 2, plus the EFW trade area rating and alternative measures of size of government (government consumption as a share of total consumption and transfers and subsidies as a share of GDP). None of these additional variables were significant. Neither did they exert any significant influence on either the size or the significance of the EFW legal rating variable.

We also dropped some of the independent variables, one at a time. With one exception, the size and significance of the EFW legal variable was largely insensitive to these alternative specifications. The exception was the omission of investment (private and public) as a share of GDP. When the investment variables were omitted, the size of the EFW legal variable rose to 0.94. This is not particularly surprising, because the quality of a nation's legal structure will influence the level of investment, particularly private investment. Thus, when private investment as a share of GDP is included in the model, the indirect effect of the legal system variable acting through private investment will be eliminated. This implies that our estimates *understate* the impact of improvements in the legal system on growth because our methodology fails to register the impact of this indirect effect.

We also tested for robustness in several ways. As the equations of Table 2 indicate, there was little difference between the size and significance of the EFW legal variable when the equation was run for LDCs rather than for all countries. Nine countries had to the omitted from our basic analysis because their human capital data were unavailable. Thus, if the human capital variable was omitted from Equation 1 of Table 2, the equation could be run for 94 countries. This was done, and the size and significance of the EFW legal variable were largely unaffected. Finally, we also eliminated the outlier observations from the equations of Table 2 and re-ran the equations. Once again, the results were quite similar to those presented in Table 2.

In summary, the EFW legal variable exerted both a positive and significant impact on long-term (1980-2000) economic growth for every specification and sample of countries considered. Further, the size and significance of the EFW legal coefficient were largely insensitive to both the countries included and alternative specifications of the basic model.

ENDNOTES

[1] By creating a court specializing in such contractual issues, judges with the requisite knowledge might be appointed, thus reducing the potential for judicial error (and reducing litigation costs by lowering the amount of information that has to be provided to non-specialized judges). Note that such a specialized court might be more likely to understand the benefits of contract enforcement rather than the application of state-made legal complexities.

[2] Perhaps an example will help clarify how each country's WBI were derived. Consider New Zealand. New Zealand's data indicate that a business can be established in 3 days and a contract dispute settled in 50 days. It has a 90 rating on the bankruptcy index (out of 100) and 818 people out of 1000 are registered in a credit bureau of some kind. These figures are all well above the average and therefore each of their standardized values is positive. For New Zealand, the average of the standardized values for the four variables was 1.47. This indicates that, on average, New Zealand's raw data were 1.47 standard deviations *above* the world average. In contrast in India, it is estimated that it takes 88 days to start a business and 365 days to settle a contract dispute; India's bankruptcy rating was only 21, and there are no functioning credit bureaus. These figures are all well below the world's average and result in an index number of minus 0.74, indicating that, on average, India's ratings for the four components were 0.74 standard deviations *below* the world average.

[3] Egypt's EFW rating in 2001 placed it 64th and its WBI rating ranked it 60th among the 106 countries with both EFW and WBI ratings in 2001. As Annex 1, Table 2 shows, Egypt's average EFW rating during 1980-2000 was 4.48, which placed it 58th among the 85 countries for which the data were available during that period.

[4] The human capital data are from Baier, Dwyer, and Tamura (2003).

[5] Jeffrey Sachs of Harvard University has popularized the importance of these latter two factors. For additional information on these factors as potential sources of cross-country differences in income and growth, see Sachs (2003) and Gallup, Sachs, and Mellinger (1998).

[6] There was one exception. When the private and public investment variables were omitted from the model, the size of the legal area coefficient rose to 0.94, more than a 30 percent increase. This is not surprising because the rate of investment, particularly private investment, is positively influenced by the quality of the legal environment. When the investment variables are in the model, this indirect effect of the legal system operating through investment will not be registered by the legal area coefficient. But when the investment variables are omitted, this indirect impact of a more attractive legal system on growth will flow into the legal area variable. Thus, the estimates presented in this paper may understate the effects of the legal system on growth because they omit the positive impact on growth that results from the higher rate of investment generated by higher quality legal systems.

[7] The *Doing Business* study indicated that the number of days required for the settlement of a clear-cut contract violation in Egypt was 202. A 60 percent improvement would reduce that

figure to 80.8 and 80 percent improvement would reduce it to 40.4. In the case of the World Bank's insolvency index and public credit bureau registry, we assumed that Egypt moved 60 percent and 80 percent of the way from its current position toward the country with the highest value for each of these variables. For example, Egypt's value for the insolvency index was 39 compared to 99 for the country with the highest rating for this variable. Thus, a 60 percent improvement would increase Egypt's rating for the insolvency variable to 75 (60 percent of 99 minus 39) and an 80 percent improvement would increase Egypt's rating to 85 (80 percent of 99 minus 39). For the public credit registry variable, the highest rating was 496 (per 1000) compared to zero for Egypt. Thus, if Egypt moved 60 percent of the way toward the highest rated country, its value for the credit registry variable would be 297.6. An 80 percent improvement, would generate a rating of 396.8 (per 1000) for this variable. Note, while the highest public credit bureau rating was 496, there were countries with higher private credit bureau ratings. However, we used the highest rating for a country with a public credit bureau to calculate the magnitude of the 60 and 80 percent improvements because it is a public bureau that is currently being proposed. It is recommended that Egypt eventually shift to a private credit registry and, when this happens, more comprehensive coverage can be expected. The estimates presented in the text of this paper do not take this factor into account and as a result they will tend to underestimate the eventual increase in the long-term growth rate accompanying the ILD proposals.

Table 1A: The relationship between the EFW Legal Rating and the World Bank *Doing Business* data

	Dependent Variable: EFW Legal Rating, 2001 (t-statistics in parentheses)					
Independent Variables*	(1)	(2)	(3)	(4)	(5)	(6)
Number of days to enter marketplace	1.30 (5.45)				0.78 (3.83)	
Number of days to settle a contract dispute		0.56 (2.14)			0.29 (1.50)	
Goals-of-insolvency index (Bankruptcy)			2.74 (7.93)		1.30 (3.28)	
Credit bureau coverage (private or public) (borrowers per 1000)				0.76 (6.96)	3.72 (3.72)	
World Bank *Doing Business* Index						2.25 (8.97)
Intercept	5.81	5.61	3.93	5.82	5.24	5.73
Adjusted R^2	21.4	3.4	37.5	31.2	50.7	43.1
Number of Observations	106	104	104	106	102	106

*All independent variables are standardized

Table 1B: The relationship between the EFW Legal Rating and the World Bank *Doing Business* data, LDCs Only

	Dependent Variable: EFW Legal Rating, 2001 (t-statistics in parentheses)					
Independent Variables	(1)	(2)	(3)	(4)	(5)	(6)
Number of days to enter marketplace	0.65 (2.98)				0.61 (3.04)	
Number of days to settle a contract dispute		0.32 (1.50)			0.30 (1.57)	
Goals-of-insolvency index (Bankruptcy)			1.52 (3.84)		0.75 (1.79)	
Credit bureau coverage (private or public) (borrowers per 1000)				0.45 (2.78)	0.35 (2.25)	
World Bank *Doing Business* Index						1.55 (4.28)
Intercept	5.08	4.92	4.13	5.23	5.14	5.27
Adjusted R^2	8.3	1.5	13.9	7.2	23.2	16.6
Number of Observations	88	86	86	88	84	88

*All independent variables are standardized

Table 2: Legal Institutions and Economic Growth

Independent Variables	Dependent Variable: GDP Per Capita Growth, 1980-2000 (All Countries)	(LDCs)
Per Capita GDP, 1980 ($1000s)	-0.45 (5.62)	-0.51 (4.52)
EFW Legal Rating, 1980-2000	0.69 (4.41)	0.74 (4.04)
EFW Sound Money Rating, 1980-2000	0.25 (2.42)	0.20 (1.72)
Change in Sound Money, 1980-2000	0.14 (1.94)	0.14 (1.79)
Private Investmtent/GDP, 1980-2000	0.21 (5.04)	0.21 (4.33)
Public Investment/GDP, 1980-2000	0.08 (1.65)	0.10 (1.67)
Change in Human Capital, 1980-1999	0.37 (1.68)	0.45 (1.85)
Tropical Location	-1.30 (3.71)	-1.44 (3.67)
Coastal Population	0.05 (0.10)	0.58 (0.97)
Intercept	-5.77	-5.63
Adjusted R^2	63.4	66.2
Number of Observations	85	66

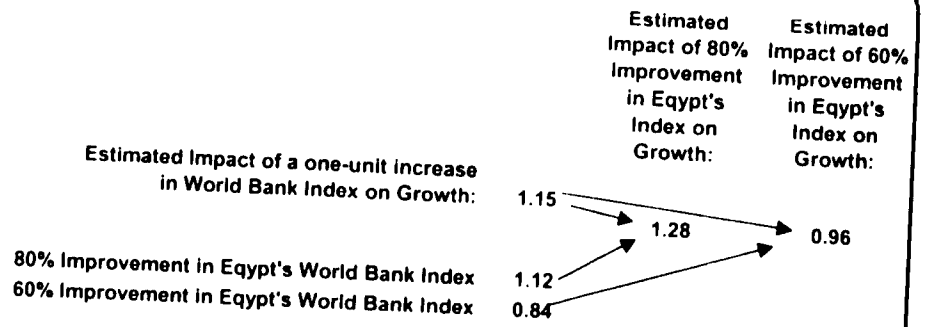
Summary Exhibit 1: Legal Institutions and Economic Growth

Independent Variables:	Dependent Variable: EFW Legal Rating, 2001	Dependent Variable: GDP Per Capita Growth, 1980-2000
Doing Business In Index	2.25 (8.97)	
Per Capita GDP, 1980 ($1000s)		-0.45 (5.62)
EFW Legal Rating, 1980-2000		0.69 (4.41)
Sound Money, 1980-2000		0.25 (2.42)
Change in Sound Money, 1980-2000		0.14 (1.94)
Private Investment/GDP, 1980-2000		0.21 (5.04)
Public Investment/GDP, 1980-2000		0.08 (1.65)
Change in Human Capital, 1980-1999		0.37 (1.68)
Tropical Location		-1.30 (3.71)
Coastal Population		0.05 (0.10)
Intercept	5.73	5.77
Adjusted R^2	43.1	63.4
Number of Observations	106	85

		Estimated Impact of 80% Improvement in Eqypt's Index on Growth:	Estimated Impact of 60% Improvement in Eqypt's Index on Growth:
Estimated Impact of a one-unit increase in World Bank Index on Growth:	1.55		
80% Improvement in Eqypt's World Bank Index	1.12	1.74	
60% Improvement in Eqypt's World Bank Index	0.84		1.30

Summary Exhibit 2: Legal Institutions and Economic Growth (LDCs)

Independent Variables:	Dependent Variable: EFW Legal Rating, 2001	Dependent Variable: GDP Per Capita Growth, 1980-2000
Doing Business In Index	1.55	
	(4.28)	
Per Capita GDP, 1980 ($1000s)		-0.51
		(4.52)
EFW Legal Rating, 1980-2000		0.74
		(4.04)
Sound Money, 1980-2000		0.20
		(1.72)
Change in Sound Money, 1980-2000		0.14
		(1.79)
Private Investment/GDP, 1980-2000		0.21
		(4.33)
Public Investment/GDP, 1980-2000		0.10
		(1.67)
Change in Human Capital, 1980-1999		0.45
		(1.85)
Tropical Location		-1.44
		(3.67)
Coastal Population		0.58
		(0.97)
Intercept	5.27	-5.63
Adjusted R^2	16.6	66.2
Number of Observations	88	66



Annex 1, Table 1: EFW Legal Rating, 2001 and World Bank *Doing Business* Index

Country	Legal Structure Rating, 2001	World Bank *Doing Business* Index (WBI)	Country	Legal Structure Rating, 2001	World Bank *Doing Business* Index (WBI)	Country	Legal Structure Rating, 2001	World Bank *Doing Business* Index (WBI)
Albania	4.58	-0.32	Guatemala	2.64	-1.30	Papua New Guinea	4.36	-0.75
Algeria	2.87	-0.37	Haiti	1.95	-0.93	Paraguay	2.82	-0.04
Argentina	3.64	0.22	Honduras	2.57	-0.54	Peru	4.23	-0.37
Australia	9.25	1.05	Hong Kong, China	7.02	0.28	Philippines	3.94	-0.32
Austria	8.93	0.17	Hungary	6.74	-0.53	Poland	5.78	0.02
Bangladesh	2.96	-0.37	India	5.71	-0.74	Portugal	7.62	0.13
Belgium	7.78	-0.15	Indonesia	2.89	-0.93	Romania	4.63	-0.25
Benin	4.33	-0.47	Iran, Islamic Rep	5.91	-0.07	Russian Federation	3.84	-0.11
Bolivia	2.95	-0.38	Ireland	8.42	1.17	Rwanda	1.98	-0.62
Botswana	7.05	0.31	Israel	7.37	-0.15	Senegal	4.43	-0.32
Brazil	4.94	-0.39	Italy	7.36	0.06	Sierra Leone	3.52	-0.24
Bulgaria	4.85	-0.37	Jamaica	5.60	-0.13	Singapore	8.50	1.03
Burundi	3.26	-0.47	Japan	7.16	1.28	Slovak Republic	5.62	-0.59
Cameroon	4.45	-0.55	Jordan	6.07	-0.50	Slovenia	7.02	-1.04
Canada	8.96	1.14	Kenya	3.97	0.06	South Africa	6.64	0.48
Chad	4.20	-0.92	Kuwait	6.95	0.18	South Korea	6.35	0.88
Chile	6.16	0.01	Latvia	5.70	0.11	Spain	6.27	-0.01
China	5.14	-0.24	Lithuania	5.06	-0.03	Sri Lanka	5.18	-0.58
Colombia	3.44	-0.20	Madagascar	4.59	-0.45	Sweden	8.61	0.77
Congo, Dem. Rep.	2.41	-1.44	Malawi	5.33	-0.23	Switzerland	8.60	0.14
Congo, Rep.	2.39	-0.66	Malaysia	6.15	0.44	Syrian Arab Republic	5.06	-0.65
Costa Rica	6.51	-0.52	Mali	5.00	-0.38	Taiwan, China	5.90	-0.16
Cote d'Ivoire	3.65	-0.39	Mexico	3.64	0.22	Tanzania	6.15	-0.08
Croatia	5.16	-0.39	Morocco	5.87	-0.28	Thailand	6.17	-0.05
Czech Republic	6.55	-0.46	Namibia	7.88	-1.17	Togo	3.73	-0.80
Denmark	9.22	0.26	Nepal	4.76	-0.37	Tunisia	6.95	-0.09
Dominican Republic	3.84	-0.10	Netherlands	9.13	1.04	Turkey	4.14	0.16
Ecuador	2.50	-0.59	New Zealand	8.92	1.47	Uganda	4.60	-0.11
Egypt, Arab Rep.	**4.61**	**-0.30**	Nicaragua	3.18	-0.21	Ukraine	4.20	-0.29
El Salvador	4.38	-0.47	Niger	4.38	-0.38	United Arab Emirates	6.56	-0.60
Finland	9.25	0.00	Nigeria	3.14	-0.73	United Kingdom	9.23	1.09
France	7.12	-0.20	Norway	8.34	1.57	United States	8.66	1.17
Germany	8.72	0.86	Oman	6.93	-0.35	Uruguay	5.76	0.42
Ghana	4.25	-0.51	Pakistan	3.37	-0.23	Venezuela	1.88	-0.52
Greece	5.60	-0.27	Panama	4.67	0.24	Zambia	5.85	-0.20
						Zimbabwe	2.59	-0.61

Annex 1, Table 2: EFW Legal Rating, 1980-2000

Country	Rating	Country	Rating	Country	Rating
Argentina	5.13	Guatemala	3.02	Pakistan	3.66
Australia	8.29	Honduras	3.62	Panama	4.26
Austria	8.49	Hong Kong	7.16	Peru	3.52
Bangladesh	3.19	Hungary	7.16	Philippines	3.49
Belgium	7.97	India	5.39	Portugal	7.50
Bolivia	3.20	Indonesia	3.90	Senegal	3.84
Botswana	6.43	Iran	3.55	Sierra Leone	4.18
Brazil	5.77	Ireland	7.91	Singapore	7.89
Burundi	4.21	Israel	6.04	South Africa	5.24
Cameroon	5.33	Italy	6.87	South Korea	5.54
Canada	8.32	Jamaica	4.27	Spain	6.99
Chile	6.18	Japan	7.84	Sri Lanka	3.67
China	5.75	Jordan	4.60	Sweden	8.05
Colombia	3.43	Kenya	4.50	Switzerland	8.65
Congo, Rep. Of	3.27	Luxembourg	8.45	Syria	3.56
Costa Rica	5.72	Madagascar	4.20	Taiwan	7.03
Cyprus	5.96	Malawi	4.60	Tanzania	5.75
Denmark	8.41	Malaysia	6.33	Thailand	6.04
Dominican Rep.	5.23	Malta	5.69	Togo	4.10
Ecuador	4.80	Mauritius	6.62	Trinidad & Tob	5.55
Egypt	**4.48**	Mexico	5.59	Tunisia	4.81
El Salvador	3.27	Morocco	4.73	Turkey	5.23
Finland	8.36	Netherlands	8.58	Uganda	3.42
France	7.48	New Zealand	8.51	United Kingdom	7.91
Gabon	4.55	Nicaragua	3.54	United States	8.61
Germany	8.36	Niger	4.43	Uruguay	5.80
Ghana	4.26	Nigeria	3.34	Venezuela	4.95
Greece	6.07	Norway	8.31	Zambia	5.11
				Zimbabwe	4.11

ANNEX 7

ESTIMATING THE ECONOMIC IMPACT OF INSTITUTIONAL REFORM

The following sections describe the methods and criteria developed.

I. METHODOLOGY TO ESTABLISH SCENARIO 1: CHARACTERISTICS OF A TYPICAL SMALL EXTRALEGAL BUSINESS OPERATING *OUTSIDE* THE CURRENT INSTITUTIONAL FRAMEWORK

Scenario 1 describes the *current* characteristics of a typical small *extralegal* business, in terms of its *gross* revenue accounts, cost accounts and *net* revenue accounts. The analysis to build *Scenario 1* comprises three stages:

1) *Stage 1* identifies and selects a number of typical small businesses operating extralegally. These typical small businesses have organizational and operational characteristics considered to be typical of the economic activities in which extralegal activities are concentrated.

2) In *Stage 2* the owners of the small extralegal businesses are interviewed. The aim of this task is to obtain first hand economic and financial information to fill in the tables that contain the different categories of revenue and costs on which the expected revenue of the small businesses under study depends.

   Special attention should be given to "extralegal payments" the extralegal entrepreneurs have to make to public employees in order to avoid penalties established by law. These payments are considered as extralegal taxes or extralegal rates, depending on its origin.

3) In *Stage 3* the information obtained is crossed with information derived from secondary sources in order to:

   a) Evaluate the coherence of revenue and cost estimates;
   b) Estimate the relative importance of various categories of revenue and cost;
   c) Analyze the impact of *time*, a variable related to the inter-temporal flow of revenue and cost; and
   d) Estimate the *net expected extralegal revenue.*

Using information obtained in the interviews, Profit and Loss statements for each one of the economic extralegal activities included in the Manufacturing, Trade and Service sectors may be built. Then, weighted averages are applied to establish the Profit and Loss statement of a *typical extralegal* business. Based on that information, the next stage may

be focused on estimating the *net present value* of expected profits and the business expected *internal rate of return*. For this, additional information extracted through the interviews to small entrepreneurs should be used.

A. Classification of Small Extralegal Businesses

Two alternative classifications may be considered:

a) A weighted average of the three economic sectors statements could be obtained, where weights measure the ratio "number of extralegal businesses performing an economic activity/ total number of extralegal businesses". These weights may be extracted from official statistics and should also be applied to build the sample.

b) The Profit and Loss statements of the economic activities may be classified according to business *size* where annual sales may be used as a proxy to size.

   Three groups may be defined:

   i) Businesses with *less* than **$ X** of annual sales.
   ii) Businesses with annual sales *between* **$ X** and **$ Y.**
   iii) Businesses with *more* than **$ Y** of annual sales.

Both classifications should generate the **same** weighted average. However, they are complementary in the sense that each one provides useful information to understand the typical characteristics of *small extralegal* businesses, in terms of *size* and *economic activity.*

However, in order to avoid unnecessary complications, the building of *Scenario 1* may be based on the classification of extralegal small businesses according to the *economic activity* they perform. Additional information regarding *size* may then be introduced when required.

B. Expected Results

The analysis described above should be used to establish the characteristics of a typical small extralegal business in terms of revenues and costs *per year*, consolidated in the Annual Profit and Loss Statement. Each one of the revenue and cost items should be the weighted average of the corresponding items in the three most frequently chosen *extralegal* economic activities: Manufacturing, Trade and Services.

The following information should be obtained:

a) Annual sales of the typical small extralegal business.
b) Annual production costs.
c) Annual administrative costs.
d) Net operation profits.
e) Income tax payments.
f) Extralegal payments.
g) Disposable income.
h) Net present value of expected profits.
i) Expected internal rate of return.

II. METHODOLOGY TO ESTABLISH SCENARIO 2: EXPECTED CHANGES IN A SMALL BUSINESS PROFITABILITY IF ITS ECONOMIC OPERATION IS *LEGALIZED* WITHIN THE *CURRENT* INSTITUTIONAL FRAMEWORK

Scenario 2 describes the characteristics of a typical small business, in terms of its gross revenue accounts, cost accounts and net revenue accounts, including changes *exclusively* produced by the *legalization* of the small business within the *current* legal framework.

The analysis to build *Scenario 2* comprises four stages:

1) In *Stage 1* each of the legal frameworks and legal procedures regulating business activity should be *related* to the different categories of revenue and/or costs of the Annual Profit and Loss Statement estimated in Scenario 1. The aim is to identify the categories of revenues and/or costs through which the legal procedures would affect the expected profitability of the small business *if its operations were legalized within the current legal framework.*

   The most important legal procedures for a small business should be identified: these are procedures that affect the most important areas of revenues and/or costs.

Also should be identified in this stage those legal procedures whose impact (cost) alone could transform cost items that originally were of *little importance* into cost items of *great importance.*

Legal procedures classified as being of *little importance* may be analyzed together and their impact included as a *single* category of costs.

2) Work in *Stage 2* should be divided into two consecutive tasks, to clearly illustrate the *differences* in the impact expected:

   a) *Task A* evaluates the procedures whose impact is only on categories of *costs*. This includes *obligatory* procedures that *only generate costs,* such as administrative, taxation, labor, and social security costs.

   b) *Task B* evaluates the procedures whose impact is expected both on categories of *revenue* and of *costs*. These are current procedures regulating the access to institutional mechanisms which are supposed to improve the way of doing business.

3) *Stage 3* estimates the impact that the *hypothetical* legalization of the economic activity of a small extralegal business *within the current legal framework* would have on its *expected net revenue.* This Stage should evaluate separately the impact on the categories of *gross revenue, costs* and *net revenue* of the small business.

   Based on this analysis, the following effects should be identified:

   a) The *negative* effects that would be advisable to eliminate.
   b) The *positive* effects whose magnitude is deemed *insufficient* and should be increased.
   c) The *positive* effects which are *inexistent* and whose creation would be convenient to encourage.

4) In *Stage 4* the economic and legal information obtained will be analyzed in order to identify the legal and administrative adjustments and/or modifications that would be convenient to carry out in order to bring about the desired effects. This analysis will be the basis to design the proposals for institutional reform and to measure its expected economic impact.

A. Expected Results

The analysis described above should be used to establish how legalization within the current legal framework will affect the profits of the typical small extralegal business. For this, the Annual Profit and Loss Statement and Cash Flow Analysis should be used.

The following expected changes should be obtained:

j) Change in annual sales of the typical small extralegal business.
k) Change in annual production costs.
l) Change in annual administrative costs.
m) Change in net operation profits.
n) Change in Income tax payments.
o) Change in extralegal payments.
p) Change in disposable income.
q) Change in net present value of expected profits.
r) Change in expected internal rate of return.

III. COMPARING SCENARIOS 1 AND 2

The comparison of Scenarios 1 and 2 should allow us to identify some of the most important reasons explaining why the majority of small businesses prefer to operate *outside* the current legal framework.

In summary, the results should show that legalizing the operation of small businesses within the *current legal framework* might produce a *large negative impact* in business profitability.

There should be, at least, two reasons:

1) Legalization is too *cumbersome and costly*.

2) The current legal framework does not offer the small entrepreneur *advantages* like *having access to bank loans* (instead of having to use extralegal restricted loans) *using secure and enforceable contracts* to expand markets and take advantage of better prices and qualities (instead of being forced to do business within the reduced sphere of already known clients, friends and relatives) or *using more predictable and less costly ways to resolve business disputes*. This absence of *legalization benefits* is usually an important reason for staying outside the legal system.

IV. METHODOLOGY TO ESTABLISH SCENARIO 3: IMPACT OF THE ILD PROPOSAL TO IMPROVE THE INSTITUTIONAL FRAMEWORK REGULATING BUSINESS ACTIVITY

A. COMPONENTS OF THE ILD REFORM PROPOSAL

The ILD Reform Proposal is formed by a set of components aimed at obtaining *three* main economic results:

a. *To reduce* administrative (bureaucratic) *costs* of operating *legally*.

b. *To increase gross revenues* (sales revenues) of operating *legally*.

c. To promote that *net revenues* of operating *legally* be *positive* and *higher* than *net revenues* of operating *outside* the legal framework.

The positive effects that the ILD Reform components might produce if implemented, should be classified into "*cost reduction items*" and "*revenue increase items*" and introduced into the revenues and cost structure representing the typical small business, in order to build *Scenario 3*.

The analysis should be based on the basic structure of revenues and costs representing the typical small business. This structure will be built in order to establish *Scenario 1*.

B. SCENARIO 3

Scenario 3 describes the characteristics of a typical small business in Egypt, in terms of its gross revenue accounts, cost accounts and net revenue accounts, including changes *exclusively* produced by the legalization of the small business within the *improved legal framework* designed by ILD. This Scenario allows us to estimate *what would happen* to the small business profits if the entrepreneur decides to legalize operations.

In order to build the Profit and Loss statement of the typical small business, a weighted average of the three economic sectors (manufacturing, trade and services) statements should be obtained, where weights measure the ratio "number of extralegal businesses performing an economic activity/total number of extralegal businesses". These weights should be extracted from official statistics and should be also applied to build the sample.

In order to emphasize the importance of implementing in a *decisive and complete* manner the *whole set* of legal reforms proposed by ILD, at least three *alternative* configurations should be used to build *Scenario 3*.

One configuration may be defined as "*full*" since it assumes that the Government will take *pertinent legal and administrative measures* in order to apply, *decisively and completely*, the *whole set* of Legal Reform components. As a result, "revenue increase effects" and "cost reduction effects" will be "*full*" and legalized businesses will benefit the most.

The intermediate configuration may be defined as *"partial"* since it assumes Legal Reform will produce *relatively small* "revenue increase effects" and "cost reduction effects". This would be the result of *not* applying, *decisively and/or completely*, the *whole set* of Legal Reform components.

The third configuration may be defined as *"minimal"* in the sense that some of the reform components are implemented but other important ones are not. As a result, "revenue increase effects" and "cost reduction effects" will *not* work with full power or they will not work at all.

Three important assumptions should be applied:

i) All configurations assume that legalized small businesses will *fully comply with current* Sales and Income tax regulations. In other words, the results estimated for the three configurations *should not include* tax exemptions eventually granted by the Government.

   However, recognizing that tax obligations are one of the most important costs of operating legally, the study should estimate the way profits would react if the ILD legal proposal to put into effect a *simple tax structure* that replaces *income* and *sales* taxes by a single tax equivalent to a small percentage of *sales* revenues, is implemented. *This simple tax system forms part of the ILD legal reform proposal.*

ii) All configurations assume that legalized small businesses will *fully comply with current* Labor and Social Security regulations. In other words, the results estimated for the three configurations *do not include* any expected *reduction* in the cost of these business obligations.

iii) Finally, all configurations assume that the *cost of finance* for a *legalized* small business under the *improved* legal framework would be the same as the one for an *extralegal* small business. The reason is that interviews to small extralegal entrepreneurs usually suggest that the *main* problem in terms of small business financing *is not* the *cost* of it *but* the *amount* of credit at the disposal of small businesses.

Even though it is not clear if institutional reform would induce *reductions* in relevant *interest rates,* we *do believe,* however, that as a result of institutional reform *credit quantity restrictions* would be *eliminated* and small businesses would be able to get the *larger* amounts required. The proposed reforms are, precisely, aimed at creating a *better* (and *greater*) access to finance.

V. COMPARISON BETWEEN SCENARIO 3 AND SCENARIO 1

If legal reform is implemented according to *Scenario 3* in its different configurations, this would offer small businesses an ample range of *new profitable* economic conditions. This expected result should be obtained when comparing Scenarios 3 with Scenario 1, as the additional net benefits generated by *legal* operation

VI. SCENARIO 4

Scenario 4 assumes that the institutional reform proposed by ILD has already been implemented and then studies the case of a small business that decides to *keep operating extralegally* in spite of the improved legal framework.

This is a pertinent analysis since *operating extralegally outside the* ***improved*** *legal framework* would be the *relevant alternative* for a small business which is trying to decide *if legalizing operations would be a profitable decision.*

VII. COMPARISON BETWEEN SCENARIO 3 AND SCENARIO 4

The ILD Reform Proposal is aimed at promoting that *net revenues* of operating *legally* be *positive* and *higher* than *net revenues* of operating *outside* the legal framework.

This section of the study should estimate the expected *positive change* on the small business *net revenue*, as a result of *legalizing* its operation within a legal framework *improved* by the institutional reform designed by ILD. To this effect, Scenario 3 should be compared with Scenario 4.

Scenario 3 estimates the *net revenue* a small business could obtain by operating *legally* within a legal framework *improved* by the institutional reform designed by ILD.

On the other hand, Scenario 4 estimates the *net revenue* a small business could obtain by remaining operating *extralegally* in spite of the ILD reform that improved the legal framework.

VIII. COMPARISON BETWEEN SCENARIO 1 AND SCENARIO 4

What would be the expected *change* on the small business *net revenue*, as a result of preferring to *keep* operating *extralegally* and *not legalizing* its operation within the *improved* legal framework designed by ILD?

To estimate this expected impact, we should compare Scenario 1 with Scenario 4.

IX. COMPARISON BETWEEN SCENARIO 2 AND SCENARIO 3

How much profitable would it be for a small business to operate *legally* within the legal framework *improved* by institutional reform when we compare it to the option of operating *legally* within the *current* legal framework?

In order to estimate the expected *positive* impact of *improving* the legal framework through the *institutional reform designed by ILD*, we should compare Scenario 2 with Scenario 3.

See attached the economic impact of the ILD proposed institutional reform in Egypt.

*****

ECONOMIC IMPACT OF INSTITUTIONAL REFORM IN EGYPT

SUMMARY

The economic impact of the ILD proposed institutional reform will depend on the *depth* and *scope* of reform implementation.

The preliminary estimates described below assume that the Egyptian Government *decides to implement the whole set of components* that constitute the ILD institutional reform proposal. In terms of the microeconomic analysis described in the following chapters of this Annex, this decision *to implement the whole set of components* is described as "*full* configuration".

I. THE FINAL REPORT RESULTS: ADVANTAGES OF LEGALIZING WITHIN THE *IMPROVED* LEGAL FRAMEWORK

I.1 At Small Business Level

1) If legal reform is implemented *but* the extralegal small business prefers *to stay outside the improved legal framework,* then the small business would obtain **LE 8,341 (US$ 1,813)** as net present value of expected profits in a **5**-year period. This profit would be equivalent to just **14%** of the amount originally invested in equipment and tools (**LE 22,810** or **US$ 4,959**). The internal rate of return would be **25%,** not an impressive figure when compared to the discount rate used in the analysis (**12%**).

2) However, if the small business *enters* the improved legal framework and operates legally, then it would obtain **LE 124,497 (US$ 27,064)** as net profits in a **5**-year period. This profit would be equivalent to **5.4 times** the amount originally invested in equipment and tools (**LE 22,810** or **US$ 4,959**). The internal rate of return would be **119%**. This is a very good result when compared to the discount rate used in the analysis (**12%**).

3) Therefore, the small *extralegal* business could get **LE 116,156 (US$ 25,251)** in *additional* net profits just by *entering* the improved legal framework and *operating legally throughout a 5-year period.* This seems a *very good incentive* for *legalizing* operations if the legal framework is *improved.*

4) It must be noted that *legal* operation within the *improved* legal frameworh would be also *more* profitable than *current* extralegal operation. In fact, a typical extralegal business *now* obtains **LE 94,556 (US$ 20,555)** as net profits in a **5**-year period. Then, just by operating *legally*, the small entrepreneur would get **LE 29,941 (US$ 6,509)** of *additional* net profits in a **5**-year period.

5) This result assumes that the legalized small business will *fully comply with current* Sales and Income tax regulations. In other words, it *does not include* tax exemptions eventually granted by the Government. However, legal operation would be even *more attractive* if legal reform includes a *simple tax structure* that replaces *income* and *sales* taxes by a single tax of **1%** of *sales* revenues, as suggested in ILD legal reform proposal.

6) In this case, the small business would obtain **LE 179,018 (US$ 38,920)** of net profits. This means an *increase* of **89%** when compared to the **LE 94,556 (US$ 20,555)** *currently* obtained by the typical small extralegal business and would be **21 times** *greater* than the **LE 8,341 (US$ 1,813)** of net profit the small business would obtain *once legal reform is in place.*

I.2 At National Level

1) The *net benefits* of the program (in present value) would be *positive* and equal to **US$ 31.9 billion (LE 146.8 billion)** in the first **10** years of operation, assuming a discount rate of **12%** as an estimate of the opportunity cost of capital at national level. In other words, the program will *cover* operation costs, *recover* the investment in the program and *generate a surplus* equivalent to **US$ 1,223** per each **US$ 1.0** invested in said program.

   Main *direct* beneficiaries are:

   a) *The owners of legalized businesses*: In the **10-year** period after legalization of their enterprises, their *net* revenue (in present value) will be **US$ 6.9 billion (LE 31.9 billion)**.

   b) *Workers employed by legalized businesses*: They will obtain *surpluses* equal to **US$ 12.8 billion (LE 58.9 billion)**.

   c) *The Government*: In 10 years legalized businesses will pay *additional* taxes equivalent to **US$ 12.2 billion (LE 56.1 billion)**.

The impact of the legal reform on Egypt's GDP was defined as consisting of two effects:

1) Additional returns to capital and additional salaries generated by *better* economic performance achieved by legalized small businesses, as a result of legal reform (*energizing* effect); and

2) Capital returns and salaries on previously extralegal businesses whose outputs had *not* been registered for National Accounting purposes (*formalizing* effect).

These effects were distributed between two contribution: a) the contribution of *Capital*; and b) the contribution of *Labor*. When both effects were estimated jointly, the results were the following:

1) "Official GDP", i.e. GDP registered in official statistics would be **9.2%** *higher* after **5** years of implementing the legal reform. In year **10**, the contribution of legal reform to "official GDP" would be *even higher*: **15.5%.**

2) Also, "official GDP *per capita*" would be **9.2%** *higher* in year **5** and **15.5%** *higher* in year **10**.

3) By year **5**, legal reform would add **1.9** percentage points on top of the GDP growth rate exhibited in the **1991-2001** period **(4.7%);** in year **10** the addition would be **1.7** percentage points. In other words, "adjusted GDP", i.e. "official GDP" plus the amount contributed by legal reform, would be growing at a pace of **6.6%** in year **5** and of **6.2%** in year **10**. Therefore, the contribution of legal reform to the rate of growth of "official GDP" would be **40.4%** in year **5** and **31.9%** in year **10**.

4) If we assume that population will keep growing at the same growth rate as in the near past (**1.9%** per year), then "adjusted GDP *per capita*" would be growing at a pace of **4.6%** in year **5** and of **4.2%** in year **10**. This means an increase of **1.9** percentage points in year **5** and of **1.4** percentage points in year **10**, if compared with the expected rates of growth of GDP per capita *in absence* of institutional reform.

The impact that legal reform could *exclusively* generate in the economic performance of legalized small businesses, i.e. the *energizing* effect, was also calculated *separately*.

In this case:

1) "Official GDP" would be **3.4%** *higher* in year 5 as a result of implementing the legal reform. In year **10**, the contribution of legal reform to "official GDP" would be *even higher*: **10.8%.**

2) Also, "official GDP *per capita*" would be **3.4%** *higher* in year **5** and **10.8%** *higher* in year **10.**

3) If we assume that, *without* legal reform, "official GDP" would keep growing at the same growth rate exhibited in the **1991-2001** period **(4.7%)**, then *with* legal reform, "official GDP" would grow faster: By year 5, legal reform would add 0.8 percentage points on top of the **4.7%** and **1.1** percentage points, in year **10**.

4) In other words, "adjusted GDP", i.e. "official GDP" plus the amount contributed by legal reform, would be growing at a pace of **5.5%** in year **5** and of **5.8%** in year **10**. Therefore, the contribution of legal reform to the rate of growth of "official GDP" would be **17%** in year **5** and **23.4%** in year **10**.

5) If we assume that population will keep growing at the same growth rate as in the near past (1.9% per year), then "adjusted GDP *per capita*" would be growing at a pace of 3.5% in year 5 and of 3.8% in year 10.

****

DOCUMENTO DEL BANCO INTERAMERICANO DE DESARROLLO
FONDO MULTILATERAL DE INVERSIONES
NO AUTORIZADO PARA USO PUBLICO

MÉXICO

APOYO AL PROGRAMA DE INCORPORACIÓN DE LOS ACTIVOS EMPRESARIALES A LA FORMALIDAD

(ME-M1002)

MEMORANDO DE DONANTES

Este documento fue preparado por el equipo de proyecto integrado por: Javier Jiménez (LEG); William Armstrong (RE2/FI2); Alberto Bucardo (COF/CME); Steven Wilson (MIF); y Nobuyuki Otsuka (MIF), Jefe de Equipo.

INDICE

RESUMEN EJECUTIVO

I. ANTECEDENTES Y JUSTIFICACIÓN

A. Informalidad de la economía 1
B. La informalidad de la economía mexicana y la estrategia del gobierno 1
C. El Instituto Libertad y Democracia (ILD) 2

II. DESCRIPCIÓN DEL PROYECTO 3

A. Objetivos 3
1. Componente 1: Diagnóstico detallado del sistema legal de constitución y operación de negocios (FOMIN US$444,200; LOCAL US$1,034,000) 3
2. Componente 2: Desarrollo del paquete de propuestas de reforma (FOMIN US$ 1,263,400; LOCAL US$ 990,400) 4
3. Componente 3. Implementación de las propuestas de reforma (FOMIN: US$ 405,000; LOCAL US$ 396,000) 5

III. COSTO Y FINANCIAMIENTO DEL PROGRAMA 6

IV. ORGANISMO EJECUTOR Y MECANISMO DE EJECUCIÓN 6

V. SEGUIMIENTO Y EVALUACIÓN 7

VI. BENEFICIOS Y RIESGOS 8

A. Beneficio 8
B. Riesgos 9

VII. VIABILIDAD AMBIENTAL Y SOCIAL 9

VIII. EXCEPCIÓN A LAS POLÍTICAS DEL BANCO 10

IX. CONDICIONES CONTRACTUALES ESPECIALES 11

ANEXOS

ANEXO I	Marco Lógico
ANEXO II	Presupuesto Detallado

APÉNDICES

Proyecto de Resolución

INFORMACIÓN DISPONIBLE EN LOS ARCHIVOS DE FOMIN

Términos de referencia de los especialistas técnicos.

Project Performance Monitoring Report (MPPMR)

SIGLAS Y ABREVIATURAS

CONAFOVI	Comisión Nacional de Fomento a la Vivienda
FOMIN	Fondo Multilateral de Inversiones
ILD	Instituto Libertad y Democracia
PIB	Producto Interno Bruto
SEDESOL	Secretaría de Desarrollo Social
SHCP	Secretaría de Hacienda y Crédito Público

RESUMEN EJECUTIVO

Agencia ejecutora: La Secretaría de Desarrollo Social (SEDESOL)

Beneficiarios: El beneficiario directo será el gobierno mexicano quien se habrá provisto del diseño y las herramientas necesarias para llevar a cabo una reforma integral del marco legal vinculado a las actividades empresariales. Los beneficiarios indirectos serán los propietarios de negocios, cuyos activos aumentarán de valor al legalizarse, y al actuar dentro de un marco legal mejorado, con bajos costos administrativos y mejores accesos a opciones comerciales y financieras.

Financiamiento:

FOMIN (Ventanilla I) No reembolsable	US$	2,600,000 (46%)
Aporte Local	US$	3,000,000 (54%)
Total:	US$	5,600,000

Objetivos y Componentes: El objetivo general es mejorar la capacidad de generación de ingreso de la población en pobreza moderada a través de la creación de incentivos para la entrada y permanencia de los negocios informales en la formalidad. El objetivo específico consiste en diseñar e implantar un paquete de reformas dirigidas a mejorar las condiciones que incentiven la incorporación de los negocios informales a la formalidad, con una estrategia de ámbito nacional para su implementación inmediata. El proyecto comprende: i) diagnóstico del sistema del entorno empresarial; ii) el desarrollo del paquete de propuestas de reforma; y iii) la implementación de las propuestas de reforma.

Plazos de ejecución:

Período de ejecución:	30	meses
Período de desembolso:	33	meses

Condiciones contractuales especiales: El primer desembolso del financiamiento estará condicionado a que SEDESOL presente evidencia de la conformación de la Unidad Coordinadora. Previo al desembolso para el componente 3, SEDESOL deberá firmar un convenio con cada una de las cuatro localidades diagnosticadas para la implementación de las reformas necesarias, con el compromiso de la localidad de realizar las acciones que sean pertinentes.

Excepciones a las políticas del Banco: Se solicita una excepción a la licitación pública internacional sobre contratación de consultores para la contratación directa del Instituto Libertad y Democracia (ILD) para la ejecución de los componentes 1 (diagnóstico) y 2 (propuestas de reforma) del Proyecto (párrafos 8.1, 8.2 y 8.3).

Impacto social y ambiental: El Proyecto fue revisado y aprobado por el CESI el 7 de noviembre de 2003. El proyecto no espera tener impactos negativos de tipo ambiental y social.

I. ANTECEDENTES Y JUSTIFICACIÓN

A. Informalidad de la economía

1.1 Las reformas económicas llevadas a cabo en los países latinoamericanos aún no han podido traducirse en beneficios concretos para una gran parte de la población. Uno de los problemas es que en la actividad económica informal extendida impide a gran cantidad de personas acumular capital, y por tanto, la capacidad de crecimiento de la economía en su conjunto está limitada. Particularmente para micro y pequeñas empresas, el marco normativo y los mecanismos administrativos para integrarse al ámbito formal no existen o resultan demasiado costosos y complicados. Sin certidumbre jurídica, especialmente en lo referente a derechos de propiedad, no es posible establecer los precios relativos que permiten el uso e intercambio eficiente de recursos, como tampoco es posible aprovechar las ventajas comerciales de escala y de integración. La formalización de los activos empresariales es condición necesaria para el óptimo funcionamiento de la economía de mercado, y facilita el acceso a financiamiento e inversión, así como el aumento de productividad e innovación.[1]

1.2 El marco legal institucional de los derechos de propiedad inmobiliaria y empresarial va más allá de los títulos de propiedad. Representa una arquitectura oculta que transforma la propiedad en bienes comerciables por medio de su representación en forma escrita como un título, una acción o un contrato. En las economías desarrolladas, un activo como una casa tiene el potencial de incrementar su valor mucho más allá de sus características físicas, dado que representa la posibilidad de conseguir préstamos a través de hipotecas. Así, una casa se transforma de un simple refugio- "capital muerto", a un vehículo de crear riqueza- "capital vivo". Si los títulos de propiedad y demás certificaciones son reconocidos y aceptados por los empresarios, los inversionistas y las instituciones financieras, los mercados se pondrán en funcionamiento de forma eficiente. Por otro lado, los costos de transacción asociados con los registros empresariales, licencias y otros requisitos son elementos importantes en la transformación de capital muerto a capital vivo. Aún cuando los empresarios tengan un título legal sobre sus activos, la regulación excesiva y obstáculos institucionales desincentivarán su operación formal al encarecer el proceso más allá de lo económicamente razonable, y sólo servirán para perpetuar la descapitalización de los negocios.

B. La informalidad de la economía mexicana y la estrategia del gobierno

1.3 El Banco Mundial presentó recientemente su estudio "Haciendo Negocios", en que ubica a México como un país en donde la economía informal representa el 30.1% del Producto

---

[1] Varios estudios indican que las naciones que definen y garantizan los derechos de propiedad alcanzan mayores tasas de crecimiento económico e ingreso *per capita* que las que los mantienen en incertidumbre.

Interno Bruto (PIB), contrario a los EEUU con tan sólo el 8.8% de su PIB. Esta informalidad, que si bien ha permitido el sostenimiento de muchos trabajadores que no han podido ser absorbidos por el mercado laboral formal, genera efectos perversos en la producción y el comercio, los cuales son perniciosos y ostensiblemente dañosos para el crecimiento económico, dado el alto costo de hacer negocios. Además, de acuerdo con el mismo estudio, la racionalización de trámites, requisitos, formatos y verificaciones es necesaria para fomentar la inversión y la creación de empleo y, al mismo tiempo, reducir la discrecionalidad y las oportunidades a la corrupción.

1.4 En México, se han realizado diversas reformas económicas y políticas para adoptar un sistema de economía de mercado. El gobierno actual ha realizado reformas importantes para brindar una mayor certeza jurídica a las operaciones financieras, plasmadas en parte en el grupo de leyes conocidas como la "Miscelánea de Garantías" aprobada en 2003, cuyo objetivo es aumentar la oferta de crédito, propiciando condiciones que aminoren riesgos y otorguen certeza y seguridad jurídica tanto a deudores como a acreedores, estimulando el uso de fideicomisos de garantías y prenda sin transmisión de posesión.

1.5 La población en pobreza moderada suma alrededor de 6 millones de hogares o 25 millones de personas que representan la cuarta parte de la población total; 70 por ciento de dichos 6 millones de hogares tiene vivienda y negocios propios, los cuales suman más de 4 millones de micro negocios. Reconociendo que la problemática es diferente a la que enfrenta la población en pobreza extrema, el actual gobierno trabaja en un conjunto articulado de políticas públicas especiales que pretende dotar de herramientas a la población para que puedan salir de su condición mediante la acumulación de capital y acceso a mercados, y pone un gran énfasis sobre el reconocimiento formal de los derechos de propiedad inmobiliaria y empresarial con la finalidad de facilitar créditos para inversión.

C. El Instituto Libertad y Democracia (ILD)

1.6 En el 2001, el Instituto Libertad y Democracia (ILD) entregó un estudio preliminar al gobierno mexicano con los siguientes resultados: se estima que los mexicanos en condiciones de pobreza han acumulado US$ 245 mil millones en bienes inmuebles. Asimismo, 6.6 millones de empresas que no están registradas en la Secretaría de Hacienda y Crédito Público (SHCP) tienen activos por un valor aproximado de US$ 70 mil millones. Ambas cantidades suman US$ 315 mil millones que significa alrededor de 30 veces el monto de la inversión extranjera que recibe el país en un año. No obstante, se trata de un capital que no puede usarse como garantía para préstamos o como contraparte de inversión debido a que no se encuentra dentro del marco de la formalidad, por no contar con títulos inscritos en los registros públicos. Entre los hallazgos se destaca que los 6 millones de micro-negocios emplean al 47% de la población económicamente activa y su producción puede llegar a representar hasta el 13 % del PIB. Además, se hizo un cálculo aproximado de los procedimientos necesarios para empezar a operar formalmente una empresa en México, los cuales pueden demorar hasta 17 meses, incluyendo todos los trámites municipales, estatales y federales. Los elevados costos relacionados a trámites superan hasta por 40 veces la remuneración del mexicano promedio. El gobierno reconoce que la pobreza moderada subsiste por no poder beneficiarse de la formalidad, y

las posesiones de activos no sirven para generar inversión, consolidar contratos o cumplir funciones que generen plusvalía.

1.7 El gobierno mexicano no pretende generar medidas coercitivas para que los informales se vean obligados a ingresar a la formalidad, sino generar las condiciones y los incentivos correctos para que los informales ingresen y permanezcan en la formalidad. Para ello, se necesita cuantificar los costos tanto de la formalidad como de la informalidad. Resultará muy importante conocer las normas que regulan los acuerdos informales particulares y dispersos que gobiernan los mercados de las calles o que la población informal ha creado voluntariamente para organizarse, de manera que estas puedan aprovecharse para generar los incentivos antes mencionados. Algunas de dichas normas ocultas pueden ser usadas y convertidas en normas aceptadas dentro de la legalidad junto con otras normas formales dentro del sistema empresarial reformado. Por tanto, las prácticas informales sobre las transacciones comerciales deberían ser cuidadosamente codificadas antes de realizar modificaciones al marco legal para reducir los costos de la formalidad.

II. DESCRIPCIÓN DEL PROYECTO

A. Objetivos

2.1 El objetivo general de la operación propuesta es mejorar la capacidad de generación de ingreso de la población en pobreza moderada a través de la creación de incentivos para la entrada y permanencia de los negocios informales a la formalidad. El objetivo específico consiste en diseñar e implantar un paquete de reformas dirigidas a mejorar las condiciones que incentiven la incorporación de los negocios informales a la formalidad, con una estrategia de ámbito nacional para su implementación inmediata.

B. Componentes

1. Componente 1: Diagnóstico detallado del sistema legal de constitución y operación de negocios (FOMIN US$444,200; LOCAL US$1,034,000)

2.2 Durante los primeros 9 meses de la ejecución, se realizará un diagnóstico exhaustivo y comprehensivo de las dimensiones y la naturaleza del sector informal. Se recolectará información concreta sobre las fallas en el sistema legal vigente y específicamente la razón por la cual los pequeños y microempresarios prefieren permanecer fuera de él. El diagnóstico permitirá, a partir de datos empíricos, determinar las causas, características y costos de permanencia en la informalidad, así como los costos de acceso y permanencia en la formalidad. El diagnóstico comprende los pasos siguientes: i) análisis de las normas y entidades públicas que regulan el acceso, operación y salida de las empresas de la formalidad; ii) identificación de los costos monetarios y no monetarios para los negocios de permanecer en la informalidad; iii) determinación de los costos de ingresar y operar en la formalidad para las empresas informales; y iv) identificación de los problemas y determinación de los costos que enfrentan en la formalidad los negocios para su

expansión y su salida.[2] Para el diagnóstico, se elegirán cuatro localidades representativas de los problemas existentes en México, incluyendo el Distrito Federal y tres municipios correspondientes a la parte norte, centro y sur del país por sus características diferenciadas y diversos tipos de informalidad.

2. Componente 2: Desarrollo del paquete de propuestas de reforma (FOMIN US$ 1,263,400; LOCAL US$ 990,400)

2.3 **Sub-componente a. Reingeniería del sistema legal.** Este sub-componente financiará la generalización y sistematización de los resultados del diagnóstico para proyectarlos a nivel país, elaborándose lineamientos para la reingeniería del sistema legal vigente para el acceso y operación de las empresas en la formalidad. Una vez que se haya terminado la tarea de diagnóstico (a los 9 meses) se desarrollarán alternativas concretas de impacto nacional para resolver los problemas identificados. La importancia de este sub-componente radica en que se podrá contar con una lista de alternativas para analizar su viabilidad política y su compatibilidad con el marco legal existente, de manera que se diseñen anteproyectos de regulación que sean factibles. Además, como un resultado adicional se podrá integrar un registro oficial de las empresas formalizadas y una base de datos que les permita nuevas oportunidades financieras y de inversión informando al mercado ampliado sobre su existencia. Con ello, el país podrá hacer acopio de todas las descripciones económicamente útiles acerca de activos formalizados en una sola base de datos.

2.4 **Sub-componente b. Diseño del paquete integral de reformas legales para la entrada y permanencia de los negocios a la formalidad.** A partir del ejercicio de la generalización de los resultados de 4 localidades (a los 12 meses), donde se habrán generado los elementos para la elaboración de reformas y mecanismos legales de carácter general y de la discusión en el gobierno mexicano de las alternativas propuestas en el sub componente a, este sub-componente tiene como finalidad el diseño y redacción de un conjunto de anteproyectos específicos que reformarán el marco jurídico que regula el entorno empresarial. La propuesta de reforma se enfoca en el acceso e incorporación rápida y a bajo costo de las empresas a la formalidad, así como su permanencia en ella. El paquete deberá contener una cuantificación estimada del impacto económico de las reformas propuestas, y asegurar que toda nueva legislación o reglamento planteado armonice con el nuevo sistema legal.

2.5 **Sub-componente c. Estrategia de implementación.** Este sub-componente financiará el desarrollo de una estrategia de implementación de ámbito nacional para ejecutar las reformas, la cual incluye: priorización de las áreas y/o sectores a formalizar, secuencia de implementación con cronograma tentativo y presupuesto preliminar, el plan de operación de entidades formalizadoras, plan de comunicación, plan de operaciones de campo y plan de reclutamiento y capacitación a funcionarios mexicanos. La estrategia

---

[2] Como parte de la determinación de los costos para la expansión de los negocios, se analizará los mecanismos existentes para realizar transacciones seguras, obtener créditos, usar responsabilidad limitada, presentar información financiera, expandir el mercado más allá del contacto personal, obtener participación de acciones, y de cumplimiento de principales procedimientos tributarios, entre otros.

debe hacer explícitos los beneficios de la formalización con la finalidad de crear un consenso para la aprobación de las reformas y ayudar en el proceso mismo de formalización. La estrategia propondrá recomendaciones para campañas de difusión dirigidas a los dueños de activos formalizados- a fin de difundir las ventajas de su status- y a convocar la participación de los propietarios de activos informales con el fin de convocar la participación. Dicha estrategia incluirá propuestas para el establecimiento de mecanismos de retroalimentación por consulta ciudadana, mediante los cuales se demuestren a diversos grupos sociales las ventajas de la formalización, sea del sector informal, la comunidad empresarial, la autoridad o cualquier grupo propenso a apoyar el status quo.

3. Componente 3. Implementación de las propuestas de reforma (FOMIN: US$ 405,000; LOCAL US$ 396,000)

2.6 Este componente consiste en poner en marcha un paquete de reformas en las cuatro localidades diagnosticadas (el Distrito Federal y tres municipios). Ajustando la estrategia de implementación a fin de llevar a cabo las actividades que constituyan una primera etapa de la implementación nacional, el componente financiará el inicio del mejoramiento de condiciones en términos de reducción de costos para los empresarios. Se enfocará a la reforma de la normatividad estatal y municipal para completar las reformas que ya se hubieran llevado a cabo en la normatividad federal con el fin de que el proyecto en su conjunto tenga el impacto y los beneficios esperados. Paralelamente, se realizarán cambios que no requieran aprobación del congreso estatal como acopio de información empresarial, simplificación administrativa, entre otros. Esta iniciación de la implementación servirá como modelo que podrá reproducirse a nivel nacional de manera acelerada. La estrategia de implementación, cuya base será desarrollada con el componente 2, incluirá herramientas para propiciar el consenso, procedimientos para reclutar y capacitar personal, y manuales y lineamientos que permitan a la autoridad incorporar de manera progresiva las empresas informales al nuevo orden legal.

2.7 De acuerdo con los estudios preliminares y las experiencias en otros países dentro y fuera de la Región, las actividades a ser financiadas esperan incluir, entre otras: la simplificación o desregulación de los procedimientos de constitución y obtención de licencias y autorizaciones; un registro oficial integrado para empresas con ventanillas únicas; procesamiento de datos y archivos basados en formularios simplificados y fáciles de actualizar; reorganización de competencias y controles posteriores al otorgamiento de las licencias; sistema de manejo integrado de información empresarial y mecanismos que permitan un fácil acceso a un sistema de responsabilidad limitada. Adicionalmente, podría incluir el diseño de la organización responsable de la formalización de los negocios, misma que estará encargada de vigilar que los costos legales y administrativos de realizar transacciones sobre activos empresariales y la operación de las empresas dentro de la formalidad se mantengan en niveles razonables, así como la elaboración de los reglamentos de organización, de formalización, de registro y de solución de controversias.

III. COSTO Y FINANCIAMIENTO DEL PROGRAMA

3.1 El costo total del Proyecto es de US$ 5,600,000 y sería financiado con recursos no reembolsables de FOMIN por un monto de US$ 2,600,000 así como con recursos de contrapartida local por un valor de US$ 3,000,000 proporcionado por SEDESOL, de lo cual US$400,500 se contribuirá en especie. Del compromiso de contrapartida de SEDESOL se espera que una parte ($396,000) provendrá de los gobiernos locales. El Proyecto será ejecutado en un plazo de 30 meses y el desembolso se hará en un período de 33 meses, ambos plazos contados a partir de la fecha de entrada en vigencia del convenio de cooperación técnica. El Proyecto tendrá un efecto multiplicador, pues se capacitará a funcionarios públicos quienes darán seguimiento al proceso de reforma y contribuirán al desarrollo de mejores prácticas y entrenamiento, lo cual respaldaría la sustentabilidad de los efectos a ser generados por el Proyecto.

ACTIVIDADES (US$)	FOMIN	LOCAL	TOTAL	%
Componente 1: Diagnósticos	444,200	1,034,000	1,478,200	26.4
Componente 2: Desarrollo de Propuestas de Reformas	1,263,400	990,400	2,226,800	40.8
Re-ingeniería	253,100	150,900	404,000	
Diseño de propuestas	758,200	640,100	1,398,300	
Estrategia de Implementación	252,100	199,400	451,500	
Componente 3: Implementación de reformas	405,000	396,000	801,000	14.3
Administración	355,100	547,500	902,600	16.1
Evaluaciones	45,000	0	45,000	0.8
Auditoría	40,000	0	40,000	0.7
Imprevistos	47,300	32,100	79,400	1.4
Total	2,600,000	3,000,000	5,600,000	100

IV. ORGANISMO EJECUTOR Y MECANISMO DE EJECUCIÓN

4.1 La Secretaría de Desarrollo Social (SEDESOL) será responsable de la ejecución del Proyecto.[3] SEDESOL se creó de acuerdo con el Decreto por el que se reforman, adicionan y derogan diversas disposiciones de la Ley Orgánica de la Administración Pública Federal el 25 de mayo de 1992. Las acciones de SEDESOL se centran en la ordenación territorial, el desarrollo urbano y de vivienda, así como en generar igualdad

[3] Nacional Financiera, S.N.C. actuará como agente financiero. El uso de un agente financiero es procedimiento normal en las operaciones de cooperación técnica y programas de donantes en México, cuando una institución gubernamental actúa como ejecutora o beneficiaria.

de oportunidades para los grupos vulnerables, fomentando el desarrollo comunitario para lograr una mayor cohesión entre los diferentes grupos de la sociedad.

4.2 **Mecanismo de ejecución.** Bajo el liderazgo del Director General de Derechos de Propiedad de SEDESOL, quien actuará como el Coordinador del Proyecto, SEDESOL conformará un grupo de trabajo para la realización técnica y operativa del Proyecto. Dicho equipo se compone de abogados, economistas, ingenieros y personal administrativo. Los oficiales principales del equipo se encuentran en funcionamiento dentro de SEDESOL, y ya han recibido capacitación del personal del ILD y seguirán recibiendo capacitación intensiva durante el proceso de elaboración del propio proyecto. Cabe señalar que el equipo de trabajo de SEDESOL, se encuentra ya en operaciones y se inserta dentro de la estrategia global de combate a la pobreza moderada que la Presidencia de la República está impulsando.

4.3 **Contabilidad y auditoría.** SEDESOL procesará las solicitudes de desembolso y sus respetivas justificaciones de gastos, de acuerdo con las normas del Banco. Los desembolsos se harán mediante la constitución de un fondo rotatorio por el equivalente del 5% del monto total de la contribución del FOMIN. SEDESOL será responsable de la presentación de informes semestrales sobre el estado del fondo a los 60 días del cierre de cada semestre. SEDESOL establecerá y será responsable de mantener sistemas contables para el manejo de los recursos y de mantener en archivo toda la documentación comprobatoria de los gastos. El sistema de contabilidad se organizará de tal forma que proporcione los documentos necesarios, facilite la verificación de transacciones y permita la preparación de los informes. SEDESOL también será responsable de abrir cuentas separadas y específicas para la administración de la contribución del FOMIN y de contrapartida. Por último, SEDESOL deberá presentar ante el Banco estados financieros auditados anualmente. En los 90 días posteriores al desembolso final, SEDESOL presentará al Banco los estados financieros definitivos relacionados con el aporte del Banco y los fondos de contrapartida local, los cuales deben ser certificados por una firma de auditores independientes que sea aceptable para el Banco. La auditoría se realizará de conformidad con los requisitos establecidos por el Banco basados en los términos de referencias aprobados por el mismo.

4.4 **Grado de preparación.** El Proyecto se encuentra en un alto grado de avance, dado que SEDESOL, con el apoyo del Banco, ha elaborado términos de referencia para los consultores principales, lo cual agilizará el ritmo de ejecución. Asimismo, el plan de ejecución de los primeros 24 meses, desglosado por componentes, está desarrollado.

V. SEGUIMIENTO Y EVALUACIÓN

5.1 SEDESOL preparará y presentará ante COF/CME informes del progreso en los 60 días posteriores al término de cada semestre, y un informe final a los 30 días del desembolso final. Estos informes seguirán un formato previamente acordado con COF/CME y abordará las actividades y finanzas del Proyecto, así como los resultados medidos en términos de los indicadores de ejecución identificados en el marco lógico de referencia del Proyecto. COF/CME utilizará estos informes para supervisar los progresos en la implementación del proyecto y preparar un informe final del proyecto en los tres meses

posteriores al último desembolso. Por otra parte, el Banco contratará a consultores individuales para llevar a cabo dos evaluaciones del Proyecto. Se realizará una evaluación intermedia una vez desembolsado el 50% de los recursos. Se efectuará una evaluación final durante los tres meses posteriores al término de ejecución. Con base a la evaluación intermedia, COF/CME, junto con el equipo de proyecto determinará si el proyecto debería proseguir o cancelarse. COF/CME y SEDESOL emplearán los indicadores de supervisión y evaluación, presentados en el Marco Lógico (ver Anexo I) para monitorear el impacto del Proyecto. Los indicadores, medios de verificación, y supuestos, serán revisados conjuntamente con la Oficina del FOMIN una vez se tenga el paquete de reformas, para reflejar con más precisión el desempeño deseable con respecto a su implementación.

VI. BENEFICIOS Y RIESGOS

A. Beneficio

6.1 Dado que la operación contribuiría a la mejora del marco legal e institucional que constituye una condición necesaria para el correcto funcionamiento de la economía de mercado, el Proyecto generaría una amplia gama de beneficios derivados de la formalización de las transacciones, y sus efectos serán conducentes a elevar la productividad y dinamizar la inversión privada. El efecto se vería en la profundización del mercado financiero en términos del volumen y variedad de préstamos comerciales e hipotecarios, así como en los tipos de interés, ya que la demanda por servicios financieros y la competencia entre los intermediarios se robustecerá con el acceso de nuevos sujetos de crédito. En el largo plazo, la certeza jurídica de los contratos y transacciones dará mayor confianza entre los agentes económicos, disminuyendo el riesgo institucional y contribuyendo a alcanzar la estabilidad económica. A su vez, la capitalización generará oportunidades de acceso a mercados de mayor capacidad financiera, laboral y de bienes y servicios.

6.2 **Otros proyectos similares del FOMIN en el país**. Cabe destacar que en México el FOMIN financió un proyecto para la Comisión Nacional de Fomento a la Vivienda (CONAFOVI) para mejorar el acceso al crédito a través del fortalecimiento de los derechos de propiedad (ATN/MT-8245-ME), el cual comprende la ejecución de reformas al registro público de la propiedad inmueble en tres estados participantes, principalmente reformulando los procesos de registro de predios para hacerlos más simples y menos costosos, perfeccionando los sistemas de información gerencial y fortaleciendo el régimen normativo registral. La modernización del registro público de la propiedad inmueble será una parte importante que contribuirá a la formalización de la economía. Se trata de un proyecto complementario a la presente operación, la cual se encargará de construir una infraestructura legal que mejore y amplíe las condiciones para hacer negocios y permita integrar económicamente a los mexicanos que pertenecen al segmento específico de pobreza moderada. La presente operación definirá propuestas que otorguen incentivos no sólo para ingresar, sino también para permanecer o retornar a la formalidad, y por eliminar las restricciones al comercio derivadas de la informalidad, espera lograr una mayor eficiencia en la asignación de los recursos productivos.

6.3 El beneficiario directo será el gobierno mexicano quien se habrá provisto del diseño, las herramientas y los conocimientos necesarios para llevar a cabo una reforma integral del marco legal que regula las actividades empresariales. Los beneficiarios indirectos serán: a) 25 millones de personas que se encuentran actualmente en una situación de pobreza moderada; b) 4 millones de propietarios de micro negocios y sus proveedores de insumos y servicios que operarán dentro de un marco legal mejorado, utilizando procedimientos eficientes, seguros, de cumplimiento fácil y rápido, que podrán operar con costos bajos y tener acceso a más opciones comerciales y financieras, además de poder optimizar su estructura del capital a través de contratos de asociación e inversión y aprovechar las ventajas de la división del trabajo; y c) los poseedores de activos empresariales y prediales, cuyo valor aumentará al formalizarlos, y que serán aceptados por el mercado, y podrán ser transferidos con mayor facilidad, rapidez y seguridad.

B. Riesgos

6.4 Se requiere de la cooperación de los gobiernos federal, estatales y municipales, entidades públicas federales y locales, registros públicos de propiedad predial y empresarial, y notarios, así como otros programas públicos que tengan alguna vinculación. También se requiere la formación de acuerdos entre los diversos legisladores para llevar a cabo las reformas legales que se planteen. La carencia o deficiencia de este apoyo podría limitar los beneficios del Proyecto. Al respecto, el Proyecto, que se circunscribe dentro de la estrategia del gobierno mexicano para abatir la pobreza moderada, tiene un respaldo del más alto nivel del gobierno a través de la Coordinación de Políticas Públicas de la Presidencia, asegurando una efectiva coordinación con las diferentes agencias e instancias. Por otro lado, el Proyecto mitigaría el riesgo al poner en marcha y mantener la adecuada estrategia de comunicación y retroalimentación con la población. Además, este riesgo se mitiga con el compromiso firme del gobierno de tomar todas las acciones necesarias dentro de su competencia para emprender la implementación en las cuatro localidades con el fin de demostrar las bondades económicas para el país de las reformas, y de proveer los recursos financieros necesarios para la implantación a nivel nacional.

VII. Viabilidad Ambiental y Social

7.1 El abstracto de Proyecto fue aprobado por el Comité de Impacto Ambiental y Social (CESI) el día 7 de noviembre de 2003. Al tratarse de desarrollo de un paquete de reformas legales, el Proyecto no tiene impactos adversos directos de tipo ambiental ni social. Por otro lado, la certidumbre jurídica: (i) alienta la inversión en el mejoramiento de propiedades (viviendas y negocios) bajo el régimen adecuado, posibilitando soluciones eficientes a conflictos ambientales; y ii) facilita cumplir reglas básicas de salud, higiene y seguridad a las empresas formalizadas. El Proyecto tendrá también impactos sociales positivos, ya que: (i) incrementaría el bienestar de los trabajadores al tener mejor acceso a la seguridad social y permitir mejorar relaciones contractuales con sus empresas legalizadas; (ii) liberaría a las personas de la necesidad de proteger excesivamente sus propiedades, aumentando la posibilidad de invertir en actividades más productivas. Además, esto hará menos necesario depender de árbitros no controlados por el estado o el tráfico de influencias (corrupción, extorsión, intermediación indebida).

VIII. EXCEPCIÓN A LAS POLÍTICAS DEL BANCO

8.1 Se solicita una excepción a la licitación pública internacional sobre contratación de consultores para la contratación directa del ILD para la ejecución de los componentes 1 y 2. ILD es una organización privada sin fines de lucro con sede en Lima, Perú. Sus actividades comenzaron en 1982 con el propósito de ayudar a crear un marco legal adecuado para la economía de mercado, dando inicio a sus estudios sobre la informalidad. A partir de los años 90, el ILD diseñó y puso en marcha programas de reforma institucional para la formalización de la propiedad en el Perú, tratando de incorporar a las personas a la esfera de ley mediante el acceso a los derechos de propiedad formal y el aporte de herramientas para liberar el capital encerrado en los activos que ellos poseen, lo cual ha producido beneficios importantes. En el caso peruano, el ILD diseñó, logró la aprobación e implementó programas de titulación y registro de empresas –cuya gerencia luego transfirió al gobierno– que han permitido formalizar más de 1.5 millones de predios urbanos y una cifra similar de predios rurales, además de la formalización de 300,000 empresas en sus cuatro primeros años de funcionamiento. Esto último significó la creación de 550,000 nuevos puestos de trabajo formales, un incremento de US$ 1,200 millones en mayores impuestos y un ahorro para las empresas de US$ 700 millones en trámites administrativos.

8.2 Desde 1996, ILD ha expandido sus actividades internacionales, y está trabajando en diferentes países con sus respectivos gobiernos para proveer un enfoque pragmático para construir un sistema legal inclusivo que permita la amplia participación de los ciudadanos. Los servicios del ILD (sensibilización, diseño de reformas y estrategias de implementación) están siendo ejecutados de manera directa a pedido de los jefes de estado en cada caso en los siguientes países: Egipto, Ghana, Haití, Honduras, Filipinas, Nigeria y Tanzania, así como lo ha hecho en México bajo contratación por el USAID (ver párrafo 1.6). El Gobierno de México pretende continuar la formulación de políticas de derechos de propiedad que afectan el segmento de pobreza moderada, con base a los trabajos anteriormente realizados por ILD.

8.3 Un aspecto importante que se diferencia de otros proveedores de servicios es la metodología que ILD ha desarrollado para identificar las normas que regulan los acuerdos informales particulares y dispersos que gobiernan los mercados informales, o que la población informal ha creado voluntariamente para organizarse. El ILD ha documentado las prácticas informales más comunes sobre las transacciones comerciales, y sabe codificar dichas normas de manera que puedan ser usadas para crear un sistema empresarial adecuado para la inversión productiva, y racionalizarlas como aceptables junto con otras normas formales que puedan respetarse. Con base a su vasta experiencia en sus trabajos en el campo, efectuados por más de dos décadas entrando en la economía subterránea más profunda, y en el análisis de experiencias históricas exitosas en la transición hacia la creación de economías de mercados en Europa, EEUU y Japón, el ILD ha desarrollado métodos especiales para: i) aproximarse y analizar sistemáticamente las causas ocultas que alimentan el crecimiento de mercados informales y los problemas institucionales que obstaculizan o encarecen no solamente la formalización de las empresas sino también su mantenimiento en la formalidad; ii) determinar los costos de la

informalidad; y iii) proponer las reformas para incrementar las ventajas de la legalidad. El USAID, quien contrató directamente al ILD para los trabajos sobre propiedad de bienes raíces y los trabajos preliminares para el tema de la informalidad a formalidad empresarial, considera que el ILD tiene una perspicacia y percepción cultural única para apreciar y evaluar los acuerdos informales en sitio, lo que le permite un entendimiento más firme del valor y los costos de lo que los dueños informales poseen, y desarrollar soluciones más prácticas. La administración del FOMIN considera que estas ventajas técnicas también justifican la contratación directa de ILD en este proyecto, bajo la política del Banco.

IX. CONDICIONES CONTRACTUALES ESPECIALES

9.1 El primer desembolso del financiamiento estará condicionado a que SEDESOL presente evidencia de la conformación de la Unidad Coordinadora.

9.2 Previo al desembolso para el componente 3, SEDESOL deberá firmar un convenio con cada una de las cuatro localidades diagnosticada para la implementación de las reformas necesarias, con el compromiso de la localidad de realizar las acciones que sean pertinentes.

ANEXO I. MARCO LÓGICO

Apoyo al Programa de Incorporación de los Activos Empresariales a la Formalidad (ME-M1002)

RESUMEN NARRATIVO DE OBJETIVOS	INDICADORES VERIFICABLES	MEDIOS DE VERIFICACION	SUPUESTOS
Fin: Mejorar la capacidad de generación de ingreso de la población en pobreza moderada a través de la creación de incentivos para la entrada y permanencia de los negocios informales a la formalidad.	A fines de 2008, • El número de negocios legalmente establecidos aumentado en mínimo 20% en comparación con los datos del final de 2006 • Los costos de transacción reducidos para los empresarios en el inicio, mantenimiento y cierre de operaciones de negocios formales en mínimo 20% en comparación con los datos del final de 2006 • Aumento, en mínimo 10%, del ingreso familiar de la población en situación de pobreza moderada para que sean considerados en el decil de ingreso inmediato superior, en comparación con los datos del final de 2006	• Encuesta Nacional de Ingreso Gasto de los Hogares (ENIGH) • Encuesta Nacional de Micro Negocios (ENAMIN) • Registro Federal de Trámites y Servicios (RFTS) • Sistema de Información Empresarial México (SIEM) • Registro Federal de Contribuyentes del SAT • Información estatal y municipal de trámites para negocios • Publicación de SEDESOL. • Informe Final del Proyecto • Evaluación (BID)	• Marco macroeconómico y político adecuado. • Se aprueban las reformas propuestas por el gobierno mexicano para el combate a pobreza moderada. • El gobierno cuenta y asigna el presupuesto para la implementación.
Propósito: Desarrollar e implantar un paquete de propuestas de reforma dirigidas a mejorar las condiciones que incentiven la incorporación de los negocios informales a la formalidad, con una estrategia de ámbito nacional para su implementación inmediata.	Al término de ejecución del Proyecto, • Anteproyectos de reformas normativas de ámbito federal • Anteproyectos de reformas normativas de ámbito municipal y estatal • Estrategia de implementación a nivel nacional	• Informe Final del Proyecto • Evaluación (BID) • Publicación de SEDESOL. • Visitas • Anteproyectos entregados de manera oficial a COFEMER	• Marco macroeconómico y político adecuado • El gobierno federal cuenta y asigna el presupuesto para la implementación. • El gobierno federal se compromete a la implementación de las medidas propuestas de manera coordinada e integral dentro de las dependencias

			federales que generan trámites para los negocios. • Aprobación de las reformas propuestas por este proyecto y las que resulten del proyecto de formalización de la propiedad inmobiliaria dentro del programa integral del gobierno mexicano para el combate a pobreza moderada. • Aprobación de anteproyectos por COFEMER
Componentes: **1. Diagnóstico** Las causas, características y costos de permanencia en la informalidad, y los costos de acceso y permanencia en la formalidad identificados a partir de la información recogida en 4 localidades (Es recomendable que se incluyan el Distrito Federal, y 3 localidades correspondientes a la zona norte, centro y sur del país)	• Normas escondidas y prácticas informales identificadas que imperan a los negocios en su actividad informal. • Los costos (número de trámites, tiempo y dinero) de la incorporación a la formalidad (Mes 9)	• Informes de avance del Proyecto • Informes de consultores	• Convenios de colaboración con los estados y municipios para la elaboración del diagnóstico y las propuestas de reforma • Puesta en marcha inmediata de la oficina de administración del proyecto. • Contratación oportuna del equipo local
2. Desarrollo del paquete de propuestas de reforma **Reingeniería del sistema legal**. Medidas alternativas concretas de impacto nacional desarrolladas para resolver los problemas identificados.	Informe de propuestas preliminares de cambios legales e institucionales para definir alcances de las reformas en coordinación con el gobierno mexicano en 4 localidades. (Mes 12)	• Informes de ejecución del Proyecto • Informes de consultores	• Convenios de colaboración con los estados y municipios para la elaboración del diagnóstico y las propuestas de reforma • Contratación oportuna de los consultores especializados locales

Diseño del paquete integral de reformas legales para la entrada y permanencia de los negocios a la formalidad. Paquete de propuestas de reforma legal para el acceso y mantenimiento de las empresas en la formalidad, con cuantificación del impacto económico a partir de la generalización de los resultados de 4 localidades	• Anteproyectos de reforma normativa (ámbito federal, estatal y municipal) • Estimación de la reducción de costos de transacción (monetarios, trámites, tiempo) por efecto de las propuestas de reforma (Mes 21)	• Informes de avance • Informe final del diseño de las propuestas de reformas	• Los gobiernos estatales y municipales de los lugares elegidos para el proyecto se comprometen a aplicar las medidas propuestas. • Contratación oportuna de los consultores especializados locales
Estrategia de implementación. Lineamientos de ámbito nacional para ejecutar las reformas, los cuales incluyen: etapas de implementación, estrategia de comunicación y plan de capacitación.	• Flujo-grama de pasos • Manuales desarrollados para la comunicación, difusión y capacitación • Documento con metodología específica de implementación (Mes 24)	• Plan de acción • Estrategia de comunicación diseñada para una cobertura nacional • Diseño del plan piloto • Informes de avance	• Contratación oportuna de los consultores especializados locales

3.Implementación de las propuestas de Reforma Un paquete de reformas puesto en marcha en las cuatro localidades conforme la guía de ejecución inmediata.	• Las condiciones mejoradas en términos de reducción del porcentaje de trámites, de requisitos, de tiempo (días) y de dinero necesarios para la incorporación de los negocios a la formalidad. • El gobierno ha confirmado los recursos presupuestarios necesarios para implementar las reformas a nivel nacional, más allá del período de ejecución del proyecto • Modelos de implementación del paquete de reforma los cuales se podrán replicar a nivel nacional • Las autoridades locales capacitadas (número de personas) • Los estudios de casos elaborados • Materiales didácticos desarrollados (Mes 33)	• Informes de ejecución del Proyecto • Informes de consultores • Información estatal y municipal de trámites para negocios	• Contratación oportuna de los consultores especializados locales
Actividades: Componente 1 1.1 Firmar contrato global con IIED 1.2 Reclutar al personal local y capacitarlo 1.3 Establecer una oficina para la administración del proyecto.	PRESUPUESTO	• Contratos con IIED • Contratos de consultores • Informes de consultores • Visitas • Convenios con los estados y municipios	• Convenio del gobierno mexicano con el FOMIN, asignación de la contrapartida provista por el gobierno mexicano y contratación del consultor especializado (IIED para los componentes 1 y 2).

Componente 2 2.1 Contratar a consultores especializados locales en la re-ingeniería de las reformas. 2.2 Contratar a consultores especializados locales en el desarrollo de paquete de las propuestas de reforma 2.3 Contratar a consultores especializados locales en el desarrollo de la estrategia de la implementación 2.4 Firmar convenios con los estados y municipios seleccionados Componente 3 3.1 Contratar a consultores especializados locales en la re-ingeniería de las reformas 3.2 Firmar convenios con los estados y municipios seleccionados		seleccionados	• Aportación oportuna de recursos de contrapartida local • Los gobiernos estatales y municipales de los lugares elegidos para la implementación se comprometen a aplicar las medidas propuestas. • Contratación oportuna de los consultores especializados locales

PROGRAMA DE INCORPORACIÓN DE LOS ACTIVOS EMPRESARIALES A LA FORMALIDAD

PRESUPUESTO

PROYECTO SEDESOL	Costo Unitario (Mes)	Cantidad (hombre-mes)	Total (30 meses)			Subtotal
			FOMIN	SEDESOL		
			%	Efectivo	Especie	
Componente 1: Diagnóstico						
A. Consultores ILD						
Consultores Abogados Economistas Senior	12,840	3		38,520		38,520
Consultores Abgados Economistas	11,100	34		377,400		377,400
Consultores Abogados Economistas Junior	8,000	18		144,000		144,000
Consultores Ingenieros en Sistemas de Informacion	3,000	2		6,000		6,000
Sub-Total				**565,920**		**565,920**
B. Consultores Locales Subcontratados						
Consultores Abogados Economistas Senior	11,600	9	104,400			104,400
Consultores Abogados Economistas	7,300	12	87,600			87,600
Consultores Planificador Urbano	4,400	26	114,400			114,400
Consultores Abogados Economistas Junior	2,200	13	28,600			28,600
Consultores de cort plazo (Comunicacion)	5,800	14	81,200			81,200
Consultores de corto plazo (Sector extralegal)	3,500	8	28,000			28,000
Sub-Total			**444,200**			**444,200**
C. Overhead						
Overhead básico	21,670	9		195,030		195,030
Otros	3,000	9		27,150		27,150
Sub-Total				**222,180**		**222,180**
D. Viajes y Viáticos						
Pasajes a México	800	22		17,600		17,600
Viáticos	200	945		189,000		189,000
Otros	150	22		3,300		3,300
Viajes al interior	1,000	36		36,000		36,000
Sub-Total				**245,900**		**245,900**
Total Componente 1			***444,200***	***1,034,000***	***0***	***1,478,200***
Componente 2: Reingeniería						
A. Consultores ILD						
Consultores Abogados Economistas Senior	12,840	1	12,840			12,840
Consultores Abgados Economistas	11,100	12	133,200			133,200
Consultores Abogados Economistas Junior	8,000	6	48,000			48,000
Consultores Ingenieros en Sistemas de Informacion	3,000	1	3,000			3,000
Sub-Total			**197,040**			**197,040**
B. Consultores Locales Subcontratados						
Consultores Abogados Economistas Senior	11,600	3		34,800		34,800
Consultores Abogados Economistas	7,300	5		36,500		36,500
Consultores Planificador Urbano	4,400	9		39,600		39,600
Consultores Abogados Economistas Junior	2,200	5		11,000		11,000
Consultores de cort plazo (Comunicacion)	5,800	5		29,000		29,000
Consultores de corto plazo (Sector extralegal)	3,500	0		0		0
Sub-Total				**150,900**		**150,900**
C. Overhead						
Overhead básico	15,670	3	47,010			47,010
Otros	3,000	3	9,050			9,050
Sub-Total			**56,060**			**56,060**
D. Viajes y Viáticos						
Pasajes a México	800	0		0		0
Viáticos	200	0		0		0
Otros	150	0		0		0
Viajes al interior	1,000	0		0		0
Sub-Total				**0**		**0**
Total Componente 2			***253,100***	***150,900***	***0***	***404,000***

Coordinacion de Derechos de Propiedad
Secretaria de Desarrollo Social

2 Diciembre 2003

PROGRAMA DE INCORPORACIÓN DE LOS ACTIVOS EMPRESARIALES A LA FORMALIDAD

PRESUPUESTO

Componente 3: Paquete de Reformas						
A. Consultores ILD						
Consultores Abogados Economistas Senior	12,840	3	38,520			38,520
Consultores Abgados Economistas	11,100	36	399,600			399,600
Consultores Abogados Economistas Junior	8,000	14	112,000			112,000
Consultores Ingenieros en Sistemas de Informacion	3,000	1	3,000			3,000
Sub-Total			**553,120**			**553,120**
B. Consultores Locales Subcontratados						
Consultores Abogados Economistas Senior	11,600	9		104,400		104,400
Consultores Abogados Economistas	7,300	14		102,200		102,200
Consultores Planificador Urbano	4,400	27		118,800		118,800
Consultores Abogados Economistas Junior	2,200	14		30,800		30,800
Consultores de cort plazo (Comunicacion)	5,800	15		87,000		87,000
Consultores de corto plazo (Sector extralegal)	3,500	4		14,000		14,000
Sub-Total				**457,200**		**457,200**
C. Overhead						
Overhead básico	19,780	9	178,020			178,020
Otros	3,000	9	27,060			27,060
Sub-Total			**205,080**			**205,080**
D. Viajes y Viáticos						
Pasajes a México	800	22		17,600		17,600
Viáticos	200	765		153,000		153,000
Otros	150	22		3,300		3,300
Viajes al interior	1,000	9		9,000		9,000
Sub-Total				**182,900**		**182,900**
Total Componente 3			***758,200***	***640,100***	***0***	***1,398,300***
Componente 4: Estrategia de Implementación						
A. Consultores ILD						
Consultores Abogados Economistas Senior	12,840	1	12,840			12,840
Consultores Abgados Economistas	11,100	12	133,200			133,200
Consultores Abogados Economistas Junior	8,000	5	40,000			40,000
Consultores Ingenieros en Sistemas de Informacion	3,000	0	0			0
Sub-Total			**186,040**			**186,040**
B. Consultores Locales Subcontratados						
Consultores Abogados Economistas Senior	11,600	3		34,800		34,800
Consultores Abogados Economistas	7,300	5		36,500		36,500
Consultores Planificador Urbano	4,400	9		39,600		39,600
Consultores Abogados Economistas Junior	2,200	5		11,000		11,000
Consultores de cort plazo (Comunicacion)	5,800	5		29,000		29,000
Consultores de corto plazo (Sector extralegal)	3,500	0		0		0
Sub-Total				**150,900**		**150,900**
C. Overhead						
Overhead básico	19,000	3	57,000			57,000
Otros	3,000	3	9,060			9,060
Sub-Total			**66,060**			**66,060**
D. Viajes y Viáticos						
Pasajes a México	800	10		8,000		8,000
Viáticos	200	195		39,000		39,000
Otros	150	10		1,500		1,500
Viajes al interior	1,000	0		0		0
Sub-Total				**48,500**		**48,500**
Total Componente 4			***252,100***	***199,400***	***0***	***451,500***

Coordinación de Derechos de Propiedad
Secretaría de Desarrollo Social

2 Diciembre 2003

PROGRAMA DE INCORPORACIÓN DE LOS ACTIVOS EMPRESARIALES A LA FORMALIDAD

PRESUPUESTO

Componente 5: Proyecto Piloto						
A. Consultores (No ILD)						
Consultores Abogados Economistas Senior	7,500	4	30,000			30,000
Consultores Abgados Economistas	6,000	2	12,000			12,000
Consultores Abogados Economistas Junior	5,000	4	20,000			20,000
Consultores Ingenieros en Sistemas de Informacion	4,000	4	16,000			16,000
Consultores Abogados Economistas Senior	4,500	6		27,000		27,000
Consultores Abogados Economistas	4,000	6		24,000		24,000
Consultores Planificador Urbano	3,500	6		21,000		21,000
Consultores Abogados Economistas Junior	3,000	6		18,000		18,000
Consultores de cort plazo (Comunicacion)	5,000	3	15,000			15,000
Consultores de corto plazo (Sector extralegal)	4,000	3	12,000			12,000
Sub-Total			**105,000**	**90,000**		**195,000**
C. Viajes y Viáticos						
Viajes al interior	500	6		3,000		3,000
Viáticos	200	15		3,000		3,000
Sub-Total			**0**	**6,000**		**6,000**
Total Componente 5			***105,000***	***96,000***	***0***	***201,000***
ADMINISTRACIÓN DEL PROYECTO						
A. Coordinación del Gobierno Mexicano						
Director del Proyecto (30%)	3,650	30			109,500	109,500
Especialista Económico (30%)	2,300	30			69,000	69,000
Especialista Legal (30%)	2,300	30			69,000	69,000
Especialista Relaciones Públicas (30%)	2,300	30			69,000	69,000
Especialista Supervisión y Control (30%)	2,300	30			69,000	69,000
Asistente Financiero Administrativo	7,250	24	174,000			174,000
Asistente Administrativo, Contable y Presupuestal	2,600	24	62,400			62,400
Secretaria (30%)	500	30			15,000	15,000
Asistente Administrativo Junior	3,500	24	84,000			84,000
Sub-Total			**320,400**		**400,500**	**720,900**
B. Gastos Generales						
Comunicaciones	300	30		9,000		9,000
Transporte local	900	30		27,000		27,000
Utiles de oficina y consumibles	1,700	30		51,000		51,000
Materiales de información	3,000	1		3,000		3,000
Alquiler de oficinas	0	30		0		0
Mantenimiento y reparaciones de equipos	300	30		9,000		9,000
Seguros de equipos y vehiculo	5,000	1		5,000		5,000
Misceláneos	600	30		18,000		18,000
Sub-Total				**122,000**		**122,000**
C. Equipos						
Equipos de cómputo	34,700	1	34,700			34,700
Vehiculo	25,000	1		25,000		25,000
Sub-Total			**34,700**	**25,000**		**59,700**
Total Administración			***355,100***	***147,000***	***400,500***	***902,600***

Evaluación Intermedia	20,000			20,000
Evaluación Final	25,000			25,000
Auditoria	40,000			40,000
Imprevistos	47,300	32,100		79,400

TOTAL	**2,300,000**	**2,299,500**	**400,500**	**5,000,000**

Porcentajes de FOMIN y Contraparte	**46.00**	**45.99**	**8.01**	**100**

Coordinación de Derechos de Propiedad
Secretaría de Desarrollo Social

2 Diciembre 2003

PROGRAMA DE INCORPORACIÓN DE LOS ACTIVOS EMPRESARIALES A LA FORMALIDAD

PRESUPUESTO
(Resumen)

		FOMIN	*SEDESOL*		
COMPONENTE	**DURACIÓN**	**Efectivo**	**Efectivo**	**Especie**	**Total**
1.- Diagnóstico	9 meses	444,200	1,034,000	0	1,478,200
2.- Reingeniería	3 meses	253,100	150,900	0	404,000
3.- Paquete de Reformas	9 meses	758,200	640,100	0	1,398,300
4.- Estrategia de Implementación	3 meses	252,100	199,400	0	451,500
5.- Proyecto Piloto	6 meses	105,000	96,000	0	201,000
Administración del Proyecto	30 meses	355,100	147,000	400,500	902,600
Otros Gastos (Evaluaciones)	----	132,300	32,100		164,400
TOTALES	**30 meses**	**2,300,000**	**2,299,500**	**400,500**	**5,000,000**
Porcentajes	----	46.00	45.99	8.01	100.00

RESEÑA	**Porcentaje**	**Total**
FOMIN	**46.00**	**2,300,000**
SEDESOL	**54.00**	**2,700,000**
TOTAL	**100.00**	**5,000,000**

Notas:

1.- Las cantidades están en dólares americanos.
2.- No incluye impuestos por pagos a un organismo extranjero (33% adicionales en los pagos al ILD)
3.- En el presupuesto sólo se considera el 30% de los sueldos del grupo representante del Gobierno Mexicano.
4.- No se consideran los costos proporcionales por concepto del espacio físico de las instalaciones de Sedesol para el personal del ILD.
5.- El pago en Especie del Componente 5 se refiere a los sueldos del grupo de personas que implementarán las estrategias en los municipios correspondientes.

Coordinación de Derechos de Propiedad
Secretaría de Desarrollo Social

2 Diciembre 2003

INSTITUTO LIBERTAD Y DEMOCRACIA

PROGRAM TO FORMALIZE THE ASSETS OF THE POOR OF TANZANIA AND STRENGTHEN THE RULE OF LAW

Prepared for H.E. Benjamin Mkapa
President of the Government of Tanzania

by:

The Institute for Liberty and Democracy
Lima, Peru

February 2004

TABLE OF CONTENTS

PART I:

1. SUMMARY AND INTRODUCTION.....ERROR! BOOKMARK NOT DEFINED.

1.1 OBJECTIVES OF THE PROPERTY AND BUSINESS FORMALIZATION PROGRAM.....ERROR! BOOKMARK NOT DEFINED.

1.2 OUR PROPOSAL FOR TANZANIA .....ERROR! BOOKMARK NOT DEFINED.

1.3 EXPECTED BENEFITS OF THE PROGRAM .....ERROR! BOOKMARK NOT DEFINED.

1.4 TIMETABLE AND BUDGET .....ERROR! BOOKMARK NOT DEFINED.

1.5 FINANCING.....ERROR! BOOKMARK NOT DEFINED.

1.6 LEADERSHIP.....ERROR! BOOKMARK NOT DEFINED.

1.7 ACTIONS TO BE TAKEN BY THE GOT .....ERROR! BOOKMARK NOT DEFINED.

PART II:
THE BRIDGE TO THE CREATION OF CAPITAL FROM DEAD ASSETS. THE ILD APPROACH TO A PROPERTY AND BUSINESS FORMALIZATION PROGRAM FOR THE POOR

2. THE PROBLEMS FACING DEVELOPING AND FORMER SOVIET NATIONS..... ERROR! BOOKMARK NOT DEFINED.

3. THE ILD SOLUTION: A COMPREHENSIVE NATIONAL PROPERTY AND BUSINESS FORMALIZATION PROGRAM .....ERROR! BOOKMARK NOT DEFINED.

PART III:
THE PROPOSED PROGRAM FOR TANZANIA

4. DIAGNOSIS – PROJECT DESCRIPTION AND SCOPE OF WORKERROR! BOOKMARK NOT DEFINED.

4.1 OBJECTIVES OF THE DIAGNOSIS PROJECT .....ERROR! BOOKMARK NOT DEFINED.

4.2 METHODOLOGY .....ERROR! BOOKMARK NOT DEFINED.

4.3 STEPS OF THE DIAGNOSIS PROJECT.....ERROR! BOOKMARK NOT DEFINED.

4.4 DELIVERABLES FROM THE DIAGNOSIS PROJECT .....ERROR! BOOKMARK NOT DEFINED.

5. REFORM DESIGN - PROJECT DESCRIPTION AND SCOPE OF WORKERROR! BOOKMARK NOT DEFINED.

5.1 OBJECTIVES OF THE REFORM DESIGN PROJECT .....ERROR! BOOKMARK NOT DEFINED.

5.2 STEPS OF THE REFORM DESIGN PROJECT.....ERROR! BOOKMARK NOT DEFINED.

5.3 DELIVERABLES OF THE REFORM DESIGN .....ERROR! BOOKMARK NOT DEFINED.

6. TIMETABLES AND BUDGETS .....ERROR! BOOKMARK NOT DEFINED.

6.1 STAFFING.....ERROR! BOOKMARK NOT DEFINED.

6.2 PROJECT TIMETABLE .....ERROR! BOOKMARK NOT DEFINED.

6.3 BUDGET ESTIMATES .....ERROR! BOOKMARK NOT DEFINED.

7. FINANCING .....ERROR! BOOKMARK NOT DEFINED.

ANNEXES

Annex 1 – Impact of Proform and Busform in the Peruvian Economy between 1991-2002
Annex 2 – Impact for ILD Formalization Reforms.
Annex 3 – Tanzanian Staff – Personnel Profiles
Annex 4 – Budget Detail for Diagnosis Project
Annex 5 – Budget Detail for Reform Design Project

EXHIBITS

Exhibit 1 – Dead Capital of the Poor in Egypt
Exhibit 2 – Diagnosis Project Organization and Staffing
Exhibit 3 – Fieldwork Tasks
Exhibit 4 – Selected Study Areas
Exhibit 5 – Project Timetable for Diagnosis and Reform Design Projects

PROGRAM TO FORMALIZE THE ASSETS OF THE POOR OF TANZANIA AND STRENGTHEN THE RULE OF LAW

PART I

1. SUMMARY AND INTRODUCTION

President Benjamin Mkapa has made it very clear that he is committed to "the empowerment of all those Tanzanians that are marginalized in the emerging modern formal economy". In fact, he stated:

> *"Tanzania's macroeconomic performance has continued to improve consistently in recent years. The economy has, in macroeconomic indices, stabilized, which, among other things, explains its growth and sustainability, its attractiveness to foreign direct investment, and improvements in the monetary sector. The decline in the inflation rate from 30 percent in 1995 to 4.3 percent has been of great benefit.*
>
> *Unfortunately, persistent income poverty has meant that the benefits of a low inflation are mostly enjoyed by those few in the urban money economy, and only partially among the majority of our population with low purchasing power. This is the major challenge ahead."*

To support the efforts of the Government of Tanzania (GOT), the Institute for Liberty and Democracy (ILD) proposes to design and help implement a Property and Business Formalization Program for Tanzania which will make property and business accessible to all citizens, but will be specifically directed to empowering the poor by allowing them to capitalize the value of their assets if they so desire, and will help Tanzania create an expanded market economy based on the rule of law. This program goes far beyond registering land or business assets. What we are proposing is to create a property and business legal system as an entry point into formality for the poor with the purpose of reaching the following five crucial objectives.

1.1 Objectives of the Property and Business Formalization Program

a) **To build an architecture of property and business rules** that will bring together, standardize, and modernize the dispersed customary arrangements that currently prevail in Tanzania so as to create one Tanzanian property and business legal system that incorporates all sectors of society. This would include the institutions required to identify and locate people, real estate and businesses, as well as the institutions needed for associated transactions and the enforcement mechanisms that would allow all Tanzanians to hold property and operate businesses, and exchange goods and services, on a national scale.

This system will be devised to ensure that the poor and traditional local communities will find it convenient and profitable to abide by rules applied on a national basis because they will integrate their customary practices and offer them access to the expanded markets at both national and international levels, if they and the government so wish. Our research demonstrates that no matter how unintended, the exclusion of poor people from the law —separated from each other by existing local extralegal property conventions— is largely responsible for some of the most fundamental economic and political problems of poor countries, such as:

- little or no investment
- lack of access to credit
- widespread insecurity
- an unenforceable tax system and narrow tax base;
- constant fiscal crises, stagnant economic growth;
- class alienation and persistent poverty.

The absence of widespread and inclusive property and business rights limits the awareness of how positive a role the central government can play in the lives of the people. History shows that the inability to resolve the aforementioned problems provides fertile ground for extralegal markets, corruption, organized crime, and, in some cases, divided sovereignty and terrorism.

b) **To foster national integration** by assisting the GOT to move beyond its present situation of parcelized sovereignty to a nationally integrated State that can govern the nation's market activities.

All governments in the world are founded, to one degree or another, on territorial or property arrangements. No country has ever created a sustainable market system unless all economic activity was already taking place within an all-encompassing institutional

framework. To have an integrated national economy, there must be a national system that guarantees property rights —while integrating traditional, local ways of doing business— so that it can help pull the whole nation together and secure public order.

c) **To ensure that the assets of the poor can be used to create liquidity**. The assets of most Tanzanian citizens are probably held and exchanged outside the existing legal system —and thus cannot be adequately recorded in standardized and universally accepted property records so that they can secure the interests of third parties. Such assets are, therefore, dead capital —that is, they are useless because they cannot be used as guarantees for credit and contracts; nor can they be divided and represented in shares that allow owners to raise capital.

d) **To develop means to achieve broad-based support for change** from both traditional community leaders and the poor for a national property framework that can help realize the potential of a modern market economy. Major changes require a broad constituency. By creating a property and business legal system that is accessible to all parties, that explicitly respects the practices of the currently excluded traditional economy; and that is not seen as privileging particular interests, the GOT should be able to form a consensus that supports one system for all parties, including the poorest.

e) **To enable overall economic policies and supporting mechanisms,** such as monetary and fiscal stimuli, so that they will actually work once most people are working in a legal market economy. It is not widely understood that most economic agents in the Third World operate in the extralegal sector and don't pay taxes. Legal incentives mean nothing in the extralegal economy, and tax cuts are equally useless to people who do not pay taxes.

1.2 Our Proposal for Tanzania

The Property and Business Formalization Program that the ILD is proposing comprises four Stages: 1) **Diagnosis**, 2) **Reform Design**, 3) **Implementation**, and 4) **Capital Formation and Good Governance**. Each of the four stages of the Program is conducted as a discrete project with clearly defined objectives, tasks, and deliverables.

This proposal to the GOT is to carry out the first two stages of the program, the **Diagnosis** and **Reform Design**, which encompass both the business and real estate sectors of the Tanzanian economy.

A proposal and action plan for the Implementation and the Capital Formation stages will be prepared upon approval of the Reform Design.

Deliverables of the Program

If the Diagnosis and Reform Design of the Property and Business Formalization Program are carried out according to the proposed project timetable (see **Exhibit 5**), the GOT will obtain the following deliverables.

1. ***By month 10, upon finalizing the Diagnosis:***

- Hard information on the obstacles that hinder the development of a single national property and business legal system, and therefore, an integrated national market that includes the poor majority, in addition to practical descriptions of the extralegal property groups in Tanzania and how their customary/traditional property regimes function.
- The means to build widespread support for reform and overcome opposition to such reform by demonstrating that immediate benefits will go to all Tanzanians and not only the small minority that can use the present legal system.
- A landmark presidential policy statement, announcing the results obtained during the diagnosis, and stating the principal pillars on which major poverty reduction and wealth creation program of the future will rest.
- All the elements required for a major Presidential announcement of the initiation of the work to draw up concrete institutional reforms.

2. ***By month 17:***

- The first outline of reforms, starting with the business component and immediately followed by the real estate component (see **Exhibit 5**).
- A master plan to substantially increase the per capita GDP growth rate in Tanzania and the identification of the policies needed to do so.
- A strategy for transmitting these policies and thereby establishing a Tanzanian leadership in the transition to a modern economy.

3. ***By month 30, at the end of the Reform Design stage:***

- A manageable plan for building an inclusive market economy based on the creation of a national property system. This system will bring together existing official Tanzanian rules that work and the meaningful aspects of the different customary and extralegal arrangements. It will pull together both of these realities into one official legal system that all citizens can relate to and are willing to respect.

These deliverables will provide most Tanzanian owners and businesses with the three basic legal tools required to generate substantially more wealth and thus increase the nation's welfare overall:

- organizational forms to divide labor in house;

- records, standard rights, and obligations to facilitate contracting with unfamiliar parties in the expanded market; and
- property rights to capture capital.

Apart from creating new institutions, some of these tools are obtained by reducing the real costs of gaining legal access to property and entering, operating, expanding and exiting a business in the legal sector. The reduction of the real cost of running a legal business will provide incentives for extralegal firms to enter the legal economy. The legal economy will also contain institutions that will help newly formalized entrepreneurs to divide labor efficiently within their enterprises while allowing them to break out of the limits of their neighborhood or tribe and specialize within the wider Tanzanian market.

Improvements in the division of labor and scale of operations will also increase the productivity of most factors of production —and thus increase Tanzania's global competitiveness. Since extralegal businesses tend to be small, undercapitalized, and labor intensive, the additional return on capital is likely to be very high, thereby making these businesses particularly attractive for new investment. And any increase in capital is bound to enhance the productivity of labor. The result will be a "productivity push" that could become Tanzania's principal engine of economic growth.

At the same time, the formalization of all property rights in Tanzania will facilitate capital formation by allowing economic agents to capture the additional value of their now legal assets that will be able to perform additional functions unavailable to them in the extralegal sector, for example, as collateral to guarantee credit or as rights to be sold against investment. This new and inclusive property and business legal system will thus make it possible for the holders of informal real estate and extralegal businesses in Tanzania to transform their assets from "dead capital" to "live capital".

1.3 Expected Benefits of the Program

The ILD Experience

How do we know that the reforms we are proposing will lead to such positive effects for Tanzania? From 1982 to 1996, with an investment of US$ 18.2 million, the ILD created a program to bring the poor majority in Peru from the extralegal economy, where they were susceptible to recruitment by terrorist organizations, into the formal economy. The well-documented result: the poor of Peru have obtained US$ 9.4 billion in net benefits between 1991 and 2002 —equivalent to an average annual rate of return of 173%, or a cost-benefit ratio of US$ 2.70 for each US$ 1.00 invested in the program. It is important to note that this figure does not even include benefits that are not economically quantifiable, such as the 28% reduction in child labor among formalized property owners.

Other Experiences in the World

History, too, supports the potential economic benefits to rural areas once formal property rights are extended to the people. The results of the 1946 reforms in Japan designed to provide poor citizens with property far exceeded even the most optimistic projections: within four years, approximately 50% of the land was formalized and by 1952, just six years later, farmer income had increased by 80%.

Between 1953 and 1963 in Taiwan, newly titled rice farms increased their production by 60%, while their owners increased their income in 150%. Similar results were obtained in South Vietnam where between 1993 and 1998 the government granted rights of 20 and 50 years for annual and multi-annual harvests, respectively. Annual production increased 3.4% where farmers had these rights, and the overall percentage of the population below the poverty line decreased dramatically —from 58% to 37%.

In China, the property formalization carried out between 1980 and 1990 helped to increase the gross agricultural output by 86%, and that extraordinary success does not include the benefits of technical reforms, such as the green revolution. More impressively, the per capita income of Chinese farmers over the eleven-year period between 1978 and 1988 increased 192%. Between 1978 and 1984, total factor productivity in the agricultural sector grew 41% for institutional reasons alone, while the productivity growth of total crop output grew 48% —as a result of the change in the property rights regime.

A recent three-year survey of a commune in the Ukraine has shown that the 3 million members who were given title to their land earned an income that is 81% higher than that received by the 3.7 million people who were not titled. In Russia, only 5% of the agricultural land has been titled (Dachas) in favor of the holder over the same period. Yet, today this same 5% produces 50% of Russia's agricultural output, while the remaining 95% of untitled land produces the other 50%.

Models to estimate the impact of proposed Reforms (Scholarly Confirmation)

Recent statistical analyses and econometric research support the correlation between property and business reforms and increased prosperity.

Generally, we are suspicious of these efforts because we feel that there is no economic model in the academic world that includes all of the institutional variables and policy recommendations that the proposed Tanzanian program incorporates. Moreover, most of the academic models either overlook the institutional variables or capture only a portion of their effects, thereby underestimating their importance as principal variables for economic growth.

Estimate of the Effects of the Tanzanian Reform Program

Human economic activity is quantifiably unpredictable because life is more complex than any model that economists can construct. We believe that we have shown ample evidence and logical considerations to sustain that formalization can only do good. Others, of course, might disagree, and we certainly realize that government authorities do require some acceptable forms of estimates of the impact of the proposed reforms on major economic indicators.

To this end we have conducted a macroeconomic estimate of the impact that some of the institutional reforms that we will be proposing will have on Tanzania's per capital GDP growth rate. With a team led by Prof. Gwartney ([1]), who heads the "Economic Freedom of the World Index" at Florida State University, that also included Prof. Lawson of Capital University, and Prof. Benson of Florida State University; under the hypothesis that the institutional reform could be contained in 20 proposals, it was possible to fit into their cross country regression analysis model four of the twenty reforms that could be carried out by Tanzania (entry into business, contract enforcement, bankruptcy procedures, and credit coverage). They indicate that if these four reforms were 60 to 80 percent successful, they would enhance Tanzania's long run growth rate of per capita GDP between 0.8 and 1.5 percentage points per year. Obviously, with more reforms implemented, these rates should increase.

In conclusion, while information on the impact of the reforms we are proposing is certainly dispersed and hardly homogeneous, no matter what source of evidence one considers, one factor is constant: business and property reforms that incorporate the extralegal economy into the rule of law in an effective way should increase economic growth and raise welfare.

The legal protection of property rights and the reduction of real costs, should lead to an enhanced division of labor and specialization, which, in turn, lead to the creation of capital and an increase in productivity, which should ultimately generate more and better investment and an expansion in production. In technical terms, this means that in a first stage Tanzania will be able to reach its potential production frontier; and in a second stage —as reforms continue to foster productivity and the accumulation of capital— Tanzania will be in the position to move its production frontier out and upward.

All of the above will have positive and sustained effects on the growth rate of Tanzania's domestic product, which will permit increases in employment and per capita income, thereby reducing poverty. At the same time, the increase in economic activity and the

([1]) Professor Gwartney heads the "Economic Freedom of the World Index" at Florida State University.

reduction in extralegality will lead to a commensurate increase in tax revenues, which will, in turn, provide more funds for investment in infrastructure, for assisting the poor, to assure a more equitable distribution of opportunities and to improve healthcare and education — all of this without an increase in the national deficit. In short: economic growth and well being with macroeconomic stability.

1.4 Timetable and Budget

The timetable and budget for this proposal cover Stages 1 and 2 (Diagnosis and Reform Design) as outlined above.

The Diagnosis will be initiated immediately after funding is made available, and will take some 9 months to complete with a budget of US$ 1.5 million.

The Reform Design will start immediately after the finalization of the Diagnosis (by month 10-11), and upon approval of the proposed scope of work, timetable, and budgets. The Reform Design would take at least 22 months to complete. On the other hand, certain reforms may take less time to complete, and could thus be implemented earlier.

It is important to note that it is virtually impossible to design a reform program without the diagnosis, i.e., knowing what the real situation of the poor is. Whatever design is drawn up will have to combine the best legal practices with the best extralegal practices that are acceptable to the Tanzanian people.

European best practices are known to everyone and technical designs are already standardized. That is not the problem. The problem is how to formulate local practices and new designs that are acceptable to all Tanzanian citizens —and are politically acceptable for GOT, and will therefore be enforceable. Moreover, whatever organization is set up to implement the reforms may have to break with the past systems that have not worked.

The ILD recommends that the GOT execute the Diagnosis and the Reform Design in one continuous manner to avoid a break between the two phases, having to demobilize project teams and incur other such delays that would affect the momentum of the program.

At this time, the cost of the Reform Design is estimated at approximately US$ 5.5 million. This cost will be evaluated during the Diagnosis Stage. The budget for the Reform Design may have to be amended accordingly.

1.5 FINANCING

It is recommended that a decision be taken to launch the Program based on a budget of US$ 7.0 million, keeping in mind that the contract amount to execute Stage 2 could be amended after the completion of Stage 1. Of course, upon completion of Stage 1, the project could be terminated if the GOT so decides.

ILD understands that the GOT will need donor assistance to execute the project. We refer you to a letter from President Mkapa to Hernando de Soto, dated 9th July 2003, which informs that the Norwegian Minister of International Development, Ms. Hilde F. Johnson, has confirmed that her Government is well disposed to finance, through grant assistance, a program for Tanzania with ILD.

We would suggest sending a formal application to the Government of Norway to finance the project for an estimated amount of US$ 7.0 million dispersed over a period of three years starting in 2004. ILD is willing to assist in preparing such an application, as soon as the GOT has formally decided to proceed with the program.

1.6 LEADERSHIP

Experience has proven that achieving a viable set of legal reforms, such as those previously described, will only be possible if the strategy and ongoing support to perform these changes is championed by the head of state. Only the head of state and his office can grasp all the benefits that the capitalization of the poor can bring to the country; calculate the impact of such reforms; command the attention of indifferent elites; and garner the overwhelming political support required to wipe out the willful inertia of the *status quo* and the resistance of those running the existing system should that occur.

Also, it is only the head of state that has the power to prevent the bureaucratic infighting that inevitably paralyzes legal and institutional reforms. Clearly, a decision as far-reaching as creating a market-based system by reforming the legal property system that will give every citizen the opportunity to create wealth and will emancipate the poor is a giant political undertaking that must be put in the hands of the head of state right from the start and continue to be one of his top priorities.

ILD believes that having President Mkapa, through his office, as the focal point for this initiative is the best way to achieve success.

1.7 ACTIONS TO BE TAKEN BY THE GOT

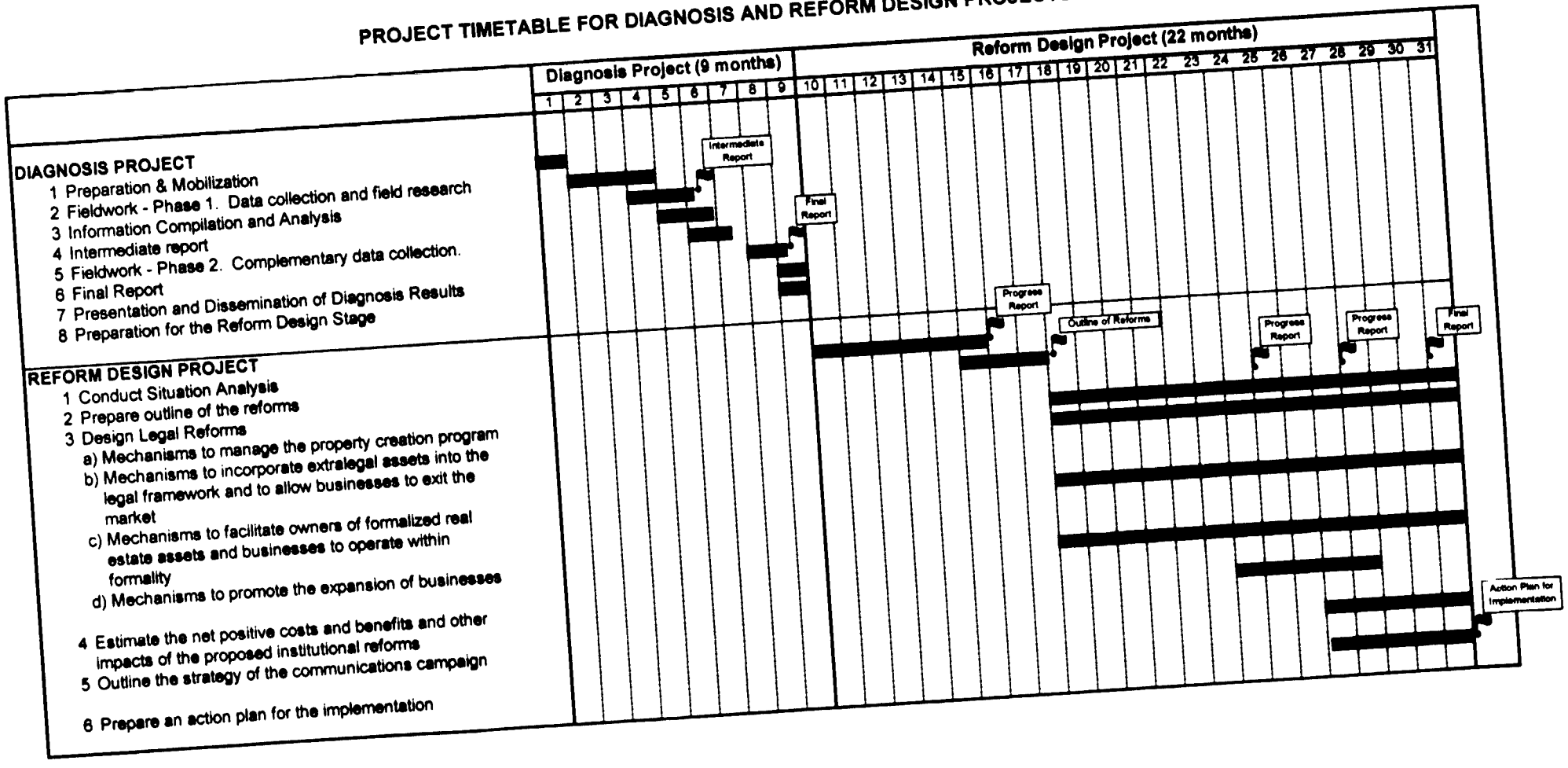
Based on this document the GOT is invited to make the following decisions:

- To formally decide or reconfirm to start a Property and Business Formalization Program for Tanzania based on the principles and program stages developed by ILD.
- As a first step, to engage ILD to execute the first two stages of the Program —the Diagnosis and the Reform Design— as outlined in this document.
- To approach the Government of Norway for financing the Diagnosis and Reform Design projects of the overall Program for the total amount of US$ 7.0 million.

** ** ** **

EXHIBIT 5

PROJECT TIMETABLE FOR DIAGNOSIS AND REFORM DESIGN PROJECTS



THE UNITED REPUBLIC OF TANZANIA

OPENING ADDRESS BY THE PRESIDENT OF THE UNITED REPUBLIC OF TANZANIA, HIS EXCELLENCY BENJAMIN WILLIAM MKAPA, AT AN AWARENESS PRESENTATION AND SEMINAR ON THE FORMALISATION OF PROPERTY RIGHTS IN TANZANIA, KARIMJEE HALL

Dar es Salaam, *8th Septe[illegible], 2003*

PRINTED BY THE GOVERNMENT PRINTER, DAR ES SALAAM [illegible]

H.E. BENJAMIN WILLIAM MKAPA
PRESIDENT OF THE UNITED REPUBLIC OF TANZANIA

OPENING ADDRESS BY THE PRESIDENT OF THE UNITED REPUBLIC OF TANZANIA, HIS EXCELLENCY BENJAMIN WILLIAM MKAPA, AT AN AWARENESS PRESENTATION AND SEMINAR ON THE FORMALISATION OF PROPERTY RIGHTS IN TANZANIA, KARIMJEE HALL, DAR ES SALAAM, 8 SEPTEMBER 2003

Hon. Dr. Ali Mohammed Shein,
Vice President of the United Republic of Tanzania;

Hon. Amani A. Karume,
President of the Revolutionary Government of Zanzibar;

Hon. Cleopa D. Msuya,
Former Prime Minister of the United Republic of Tanzania;

Honourable Ministers, and Deputy Ministers;

Excellencies Heads of Diplomatic Missions;

Chief Secretary and Permanent Secretaries;

Mr. Hernando de Soto,
Founder and President of the Institute of Liberty and Democracy;

Mr. John S. Olaisen,
Managing Director of Norway Registers Development;

BEST AVAILABLE COPY

Distinguished Participants;
Ladies and Gentlemen:

I should like to thank all of you for coming, and for being prepared to contribute two days of your valuable time and effort to this important session focussing on the empowerment of people in the informal sector.

I want especially to thank the former Prime Minister, Hon. C. D. Msuya, for agreeing to my request to join us, not only as an elder leader in my Party, but also to bring into play the wealth of his experience in many aspects of the subject of our discussions today and tomorrow. I also thank him for agreeing to chair tomorrow's session.

We are privileged to have Mr. Hernando de Soto, the renowned economist and founder of the Institute of Liberty and Democracy (ILD) in Peru, among us. I should like to thank him for accepting my personal invitation to come to Tanzania and make a presentation of his model for the effective empowerment of the informal sector.

When I passed through London last month, I bought 70 copies of Mr. de Soto's book, The Mystery of Capital: Why Capitalism Triumphs in

the West and Fails Everywhere Else. All politica leaders in this room have received a copy. I trus most have read it and, therefore, Mr. Hernand de Soto does not need much introduction.

I should only add that Mr. de Soto is a Commissioner in the World Commission on the Social Dimension of Globalisation, which I am privileged to co-chair with President Tarja Halonen of Finland. That is where I first met him, and was impressed by his sharp analysis of, and clarity of thought on, why formal capitalism has problems in taking root in countries such as ours, and the prescription he offers in dealing with this problem.

I also thank the Norway Registers Development, represented today by its Managing Director, Mr. John Schjelderup Olaisen, for coming to this event. He will later present a Report on the Workshop on Formalisation of Property Rights in Tanzania held in May 2003, which seeks to prepare for a full ILD Programme for Tanzania.

Lastly, I want to thank the Norwegian Government for the grant assistance extended to us to finance this groundbreaking initiative in our war on poverty. I look forward to continued support.

Ladies and Gentlemen:

The people of Tanzania have the right to ask what it is I am trying to do, and why. My answer is a simple one. I am implementing the Policies and the Election Manifesto of my Party, Chama Cha Mapinduzi. I want to emphasise this point in the light of a recent, and on-going, debate in this country about the need for some form of affirmative action in the empowerment of our people. Let the record show that my party is committed to the empowerment of all those Tanzanians that are marginalized in the emerging modern formal economy. And I mean **all Tanzanians, without regard to gender, religious beliefs, race or ethnic origin. Tanzania is one, it must remain one, and it is completely wholesome as far as gender, faith, race and ethnicity are concerned. My Party is a mass party—a party of inclusion, not exclusion.**

Let me now state and reaffirm the policies of my Party, and therefore remind everyone of what is the guiding vision of this government. The CCM Election Manifesto for the 1995 General Elections, as well as for the 2000 General Elections, both of which brought me to power, laid **great emphasis on poverty eradication, and the empowerment of our people to self-develop.**

The Party Document, "The Orientation o CCM Policies in the Years 2000 – 2010" has whole chapter (chapter 3) on "Strategies for th Economic Empowerment of the People". Part o paragraph 51 in that chapter states as follows:

> "...The strategy of empowering our peopl economically is a mechanism bein developed to enable the majority o Tanzanians to own and to participate in th economy of their country. The principa concept here is **empowerment**, that is t establish a conducive environment tha would provide opportunities, among others for the people to own land, industries working tools, capital for investing in economic activities and to obtain the necessary education and skills to trade and engage in other economic activities. In implementing this strategy for economic empowerment of the people, the youth and women are to be accorded priority."

On its part, the CCM Election Manifesto for the 2000 General Elections, upon which I was re-elected, stated as follows in paragraph 6:

> "...Chama Cha Mapinduzi has developed a strategy for the **economic empowerment**

of the people, which will enable the majority of Tanzanians to own and manage economic activities in their country. The concept of **empowerment** entails creating a conducive environment to provide opportunities for Tanzanians to own and manage the economy of their country."

This strategy has two main components. The first one is about macroeconomic fundamentals. **In a liberal market economy, no amount of economic empowerment will bear long-term and sustainable results if the macroeconomic fundamentals are not in place**. This is what we did in the first five years of my administration, and the results are obvious. We have won the first battle in what is, in effect, a long war. All serious followers of developments in this country, including serious leaders of opposition parties, when talking in private, acknowledge this fact.

Macroeconomic fundamentals and good governance are necessary first steps in the war on poverty. They are means, not an end—a road, not a destination. And that is why those who criticise us for, allegedly but falsely, focussing too much on macroeconomic fundamentals and good governance in the first years of my administration are very wrong. We

never argued that macroeconomic fundamental and good governance would, on their own eradicate poverty. But we know, and all serious people know, that they are a necessary strong foundation of a growing economy, of increasing Foreign Direct Investment, of an internal dynamic investment momentum and hence of broad based development.

Tanzania's macroeconomic performance has continued to improve consistently in recent years. The economy has, in macroeconomic indices, stabilized, which, among other things, explains its growth and sustainability, its attractiveness to foreign direct investment, and improvements in the monetary sector. The decline in the inflation rate from 30 percent in 1995 to 4.3 percent has been of great benefit.

Unfortunately, persistent income poverty has meant that the benefits of a low inflation are mostly enjoyed by those few in the urban money economy, and only partially among the majority of our population with low purchasing power. This is the major challenge ahead, and we hope that what Mr. de Soto will tell us today will be part of the solution to this problem.

In other words, **we now embark on the second phase of our reforms geared to ensure**

the benefits of macroeconomic fundamentals and stability translate into a legally recognisable value and therefore better life for the men and women in the street. This is the second battle forward in our long war on poverty. We now have to move from the macro level to varying areas at the micro level—from trade, monetary and investment policies, to the web of legal, administrative and financial impediments entangling small initiatives and businesses, and those inhibiting and condemning the informal sector into a state of permanent marginalisation and exclusion.

A number of policy initiatives have already been taken in this regard, including the Small and Medium Enterprises Policy launched last month. Implementation of this policy will benefit greatly from the empowerment of our large informal sector, in which many of our people find sustenance.

Ladies and Gentlemen:

I must say one other thing. The time has come for the government, both central and local, and for the people in the public and formal sector as a whole, to accept the informal sector for what it is: a reality of life, and an important provider of goods and services, and a market for goods and services provided by the formal sector. A

thought recently crossed my mind. What woul happen if the entire informal sector in Dar e Salaam were to go on strike? The truth is that that were to happen, God forbid, much in thi city could grind to a halt. The informal sector i presently a key thread of the fabric of ou society, and of our economy. That is the reality But its owners, managers and speculators neec the help of every one of us in this room to give this role a better and legal legitimacy.

This is why we are here, and why I should like to pay tribute to the pioneering work carried out by our good friend, Hernando de Soto, and the Institute for Liberty and Democracy (ILD). The ILD model respects and promises the expansion of our formal economy by embracing the abundant potential and bubbling energies of the informal sector. The model proceeds from an acknowledgement that there is indeed an immense potential within the informal sector. It further acknowledges that this potential has been condemned to function outside the existing legal regime, constraining its ingenuity and productivity, and thereby denying the poor and the economy as a whole the benefits of the entrepreneurship that is vital to their self-determined well-being and the prosperity of their country.

Indeed, when you think about it, you realise that we live in a conspiracy of silence that benefits no one. The government pretends those people in the informal economy do not have assets so they do not have property rights, and those people pretend they do not have assets so they do not have to pay taxes on them or follow rules and regulations. I must admit that most of the real estate in our urban areas is outside the formal, legal, sector. Yet, if we could bring in all these assets and properties into legality, that legality would unleash a lot of investment capital.

This pursuit is also born out of the realisation that poverty in our country is not only manifested in poor access to quality health and education but to opportunities for investment capital as well. We shall continue to explore expeditiously all measures necessary to remove these barriers.

It is also true that regulatory obstacles and facilitation inadequacies prevent the informal sector, predominantly comprising of women and the youth, from working as agencies for empowering our people and communities. These obstructions also prevent considerable private capital that is lying idle in most of our banks from flowing into the informal sector. Consequently, many small businesses in the

informal sector are denied the ability to realis their full potential. **And, for me, developmen is about realising the full potential of ever citizen.**

The ILD model can help us to move thi sector from illegality to legality, from informalit to formality and from exclusion to inclusion Mr. Hernando de Soto brings with him his vas knowledge and experience on the constraints that the informal sector faces when struggling to unleash its potential. I should, perhaps, point out that during the time Mr. de Soto served as President Alberto Fujimori's Personal Representative and Principal Advisor, **he and the ILD were responsible for some 400 laws and regulations that have modernized Peru's economic system, opening it up to greater participation by the majority**. So he will not only talk theory, he will talk about proven prescriptions to some of the likely comparative problems we have.

On our part, we outline, first, the problem. But we also put in relief the target constituency, our knowledge of the sector reforms we have set in motion, and our political will and determined resolve to make this partnership work in the interest of our people, our economy and our country. Together with the support we get from

the Norwegian Government, we can create a partnership in the war on poverty that we can all be proud of.

The forcefulness and indeed the attraction of the Hernando de Soto's idea lies in its simplicity and its appeal: that alongside our efforts to attract foreign investment, equal energy can be directed at mobilising and unleashing domestic capital, otherwise lying dead. I see no reason why it should be possible in Western Europe for a modest home, a small plot of land, or merely a solid credit history, to be sufficient to secure a loan but that similar circumstances should not energize growth in Tanzania. Similar opportunities should not be denied our people and our economy, and certainly, we need to mobilise these assets to survive the pressures of globalisation.

I am pleased that our own participants at the Workshop on Creating an Inclusive Property System to Build the Capital of the Poor in Tanzania organised by the Ministry of Finance, NRD and ILD in Dar es Salaam in May 2003 broadly shared and advocated the logic of this paradigm. I note from the Workshop Report, for example, that "the ideas and recommendations given by the participants during the workshop support the necessity of establishing an

integrated system of property rights as the basis for a transition to a market economy where the assets of all Tanzanian citizens can be used to create capital."

This is really an opportunity for empowerment. I should, therefore, like to suggest four practical propositions through which I believe we can collectively make this vision inherent, and its goal achievable.

First, **political will**. We must act in concert and with singular determination to put in place a credible system of property ownership that would enable those with assets in the informal sector to have a properly recognised right to their assets--assets that can have an ascertained value and which can be transferable. This is basic in granting many in the informal sector the necessary empowerment and the opportunity to raise capital and participate further in wider economic activities.

Second, a **re-examination of our regulatory framework**. We should accept this as a challenge. It should not be enough that we have promulgated and legislated a new land policy and a new land law, and that we are prepared to review it further. Neither should it be sufficient that we have put in place the

necessary policy framework for small and medium enterprises, and the Business Environment Strengthening Programme for Tanzania (BEST). We should be bold enough to examine and embrace fresh concepts, ideas and other nations' experiences. We must change our attitudes. We must overcome our natural, almost knee-jerk, resistance to change. Without this disposition, we will not fulfil our responsibility and commitment to empower our people, most of who function in the informal sector.

Third, **involving the private sector**. We must draw from the best of our multifaceted experiences in business and the civil society, as well as the media. The private sector needs to see our effort in the transformation of the informal sector as a matter of its own self-interest. Formalising the informal sector would expand economic activities and strengthen the private sector as a whole. The formal private sector would, therefore, do well by considering itself a stakeholder in this enterprise whose overall impact will be to promote business and market expansion.

Fourth, **public awareness**. Our people must equally be sensitised that this idea can work; that it is not anti-people, but has their best interest at heart. I extend a special appeal to

everyone in the informal sector to cooperate with us. They are important partners to the success of this project. This poses another challenge to leadership at all levels, among all political parties and civil society. Our Local Governments have a key role and I invite them to come on board.

This project will not be accepted in the field if it is misconstrued to constitute Government intervention to dispossess and oust. The people must be assured that this is not the beginning of another exercise that can be considered a harassment of our fellow Tanzanians in the informal sector. It must clearly be understood for what it is: a programme to affirm and formalise existing interests as an element for titling and ownership. There will be powerful vested interests that may not necessarily see it that way. Indeed, they may want to project it differently in order to continue profiting from current illegality and disorder. Our resolve, and the aspirations of all those who are struggling to convert the assets they hold into valuable properties, must not be left in doubt. Again, the media and civil society have an important role to play. I urge them to be, if not paratroopers, then foot soldiers in this enterprise.

Let me conclude by once again thanking Mr. Hernando de Soto and Mr. John Schjelderup Olaisen for being here with us today, and for their willingness to share their thoughts and experiences with us. I know that some of their thoughts will seem heretical to some of us here, but sometimes heresy is the trigger for reform. I hope that the question and answer session that will follow Mr. de Soto's presentation will serve to clear many lingering doubts or suspicions.

Robert F. Kennedy once said, "Progress is a nice word. But change is its motivator and change has its enemies."

He was right. No one in this room or outside would say he or she is against progress. It is such a nice positive word. But not everyone is ready to pay the price for progress—the price of change. I appeal to my fellow Tanzanians that **the time has come for all of us to be motivators, not enemies, of change; to be not purveyors of backwardness, but agents of progress. For, that is the essence of ownership and of leadership for development.**

I thank you for your kind attention.

ANNEX 11

IMPACT OF PROFORM AND BUSFORM IN THE PERUVIAN ECONOMY BETWEEN 1991-2002

I. CONSOLIDATED IMPACT

The **PROFORM** (real estate) and **BUSFORM** (business) Formalization Programs designed by ILD have generated considerable **net benefits** in Peru between 1991-2002:

a) After recuperating *all* investment and operation expenses required for the Formalization Programs, the **net benefits** are in the order of some **US$ 9.4 billion**.
b) The **cost/benefit ratio** is **2.7.** This indicates that the Programs have generated **US$ 2.70 in *gross* benefits for each US$ 1.00 invested in them**.
c) The **average annual return** of the investment in the Programs is **173%**. This indicates that these programs have generated **US$ 1.73 in *net* benefits for each US$ 1.00 invested in them**.

II. INDEPENDENT IMPACTS

Impact 1

The cost incurred by a poor family to title and register its extralegal real estate property was **reduced** from **US$ 230** to **US$ 35.** In addition, the **94 months (almost 8 years)** of red tape involving **165 steps** in **14 public entities** was reduced to no more than **2 months,** in **25 steps** and only **2 public entities.** ([1]) With this achievement alone, the poor in Peru have been able to save approximately **US$ 254 million in a period of 7 years.**

Impact 2

By December 2002 nearly **1.3 million** of the country's previously extralegal real estate properties became individualized, titled and registered —which means that **49%** of all previously extralegal parcels have been formalized. ([2]) This massive formalization has benefited at least **6.5 million** of the roughly 14 million people living in poverty ([3]).

([1]) ILD research, 1993 and 2002 and Formalization Commission (COFOPRI) 2002.
([2]) COFOPRI, December 2002
([3]) COFOPRI, 2002 and Central Bank of Peru statistics on poverty. The poor represent **54%** of the total population.

Impact 3

The ILD program has brought into the formal market over **US$ 20.8 billion** of real estate property with a construction value of **US$ 15.6 billion** and land value of **US$ 5.2 billion**.

Impact 4

The newly formalized real estate assets (**US$ 20.8 billion**) could potentially guarantee loans worth up to **US$ 8.3 billion,** since banks usually loan up to **40%** of the value of assets given as collateral. In this connection, a number of banks have found that registering a mortgage loan in the special registry created for formalized areas (RPU) involves **one third** of the time required to do the same in the traditional Public Registry. ([4]) In addition, debts registered in the RPU have a **91%** recovery rate, quite similar to the **90%** rate found among traditionally legal homeowners. ([5])

Impact 5

Clear and secure real estate property rights have substantially reduced the frequency of land related conflicts to **virtually zero (0.006%)** in newly formalized areas. ([6]) Before the reform, land related conflicts involved at least **5%** of extralegal real estate. ([7])

Impact 6

With security of tenure, newly titled property owners increased the amounts invested in home improvement. By December 2002, the increase in property values was in the order of **US$ 2.2 billion.** ([8]) This represents a **12%** average increase in the wealth of a newly titled owner compared to that of a person holding an informal property.

ILD own estimates indicate that the increase in value of properties incorporated into legality is due to two effects:

a) *Instant capital gains because the real estate asset is recognized by the law and becomes part of the legal system.* The ILD analyzed representative samples of similar extralegal and legal areas in Greater Lima and found that the increase in the value of legalized properties for this reason fluctuated between **20%** and **40%.**

([4]) Banco del Trabajo, a financial entity specialized in loans to small entrepreneurs.
([5]) Superintendencia de Banca y Seguros, October 2002.
([6]) Urban Public Registry (RPU), April 2002
([7]) ILD estimates.
([8]) ILD estimates, 2003. By August 2000 property values had increased by more than **US$ 1,7 billion** (World Bank, 2001).

In order to obtain a conservative estimate of the increase in value of legalized properties, **20%** was considered adequate to apply to the **1,300,000** properties titled and registered by COFOPRI. This represents an increase of **US$ 3,200** in the value of an average property whose original value is **US$ 16,000**.

b) *An increase in the value of the properties because their owners are motivated to invest in them, adding on to them or finishing their construction.* The ILD studied the characteristics and costs of these improvements and found that the average value of this work was **US$ 2,651**. This figure was applied to the **352,000** properties (**27%** of the 1,300,000 properties titled by COFOPRI) which, according to the Base Survey carried out for COFOPRI by Apoyo Consultancy in 2000, were augmented and improved after titling.

c) By adding these two effects, the ILD estimated that the value of the **1,300,000** titled properties increased by **US$ 5.1 billion**. This is equivalent to an average increase of **US$ 3,900** in the value of **each** titled property.

Therefore, the increase in value of the **1,300,000** titled properties, estimated by projecting World Bank figures (**US$ 2.2 billion**), should be considered **conservative**; the value is equivalent to **44%** of the increase estimated by the ILD (**US$ 5.1 billion**).

Impact 7

Using their properties as collateral, close to **198,000** newly titled owners throughout Peru obtained **US$ 300 million** in loans between 1995 and 2002. ([9]) This has helped them **to increase economic activity and employment, especially in low-income urban areas**.

Impact 8

Families in newly formalized homes have been able to increase labor hours by nearly **45** hours per week. ([10]) At minimum wage this means about **US$ 118** of additional income per month per family. Assuming conservatively that half of this additional time is used by newly titled property owning families to work productively, it means that they are earning an additional **US$ 76 million per month** which in turn indicates that they have earned an additional **US$ 3.2 billion** in the last **7** years.

([9]) COFOPRI, November 2002.

([10]) *Entitled to Work: Urban Property Rights and Labor Supply in Peru*, Erica Field, Economics Department, Princeton University, October 2002, p. 24.

Impact 9

The ILD program has also produced a **28%** reduction in the probability of child labor ([11]) which means that children will have **more hours per day to attend school, improve their skills, and increase their probability of getting better paid jobs in the future**.

([11]) *Entitled to Work: Urban Property Rights and Labor Supply in Peru*, p. 3.