

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND

**MEXICO**

**SUPPORT FOR A PROGRAM TO INCORPORATE BUSINESS ASSETS  
INTO THE FORMAL SECTOR**

**(ME-M1002)**

**DONORS MEMORANDUM**

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## ABBREVIATIONS

CONAFOVI	Comisión Nacional de Fomento a la Vivienda [National Housing Commission]
ILD	Instituto Libertad y Democracia [Liberty and Democracy Institute]
GDP	Gross domestic product
SEDESOL	Secretaría de Desarrollo Social [Ministry of Social Development]
SHCP	Secretaría de Hacienda y Crédito Público [Ministry of Finance and Public Credit]
USAID	United States Agency for International Development

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## SUPPORT FOR A PROGRAM TO INCORPORATE BUSINESS ASSETS INTO THE FORMAL SECTOR

(ME-M1002)

### EXECUTIVE SUMMARY

<b>Executing agency:</b>	Ministry of Social Development (SEDESOL)
<b>Beneficiaries:</b>	The direct beneficiary will be the Government of Mexico, which will be equipped with the necessary designs and tools for a comprehensive reform of the legal framework for business activities. The project's indirect beneficiaries will be business owners, whose assets will increase in value when they acquire legal status. These business owners will also benefit because they will be operating within an enhanced legal framework, with low administrative costs and better access to commercial and financial options.
<b>Amount and source:</b>	MIF - Window I (nonreimbursable): US\$2,600,000 (46%) Local contribution: US\$3,000,000 (54%) Total: US\$5,600,000
<b>Objectives:</b>	The general objective is to help improve the income-generating capacity of the moderately poor population by creating incentives for informal-sector businesses to move into the formal sector and then continue to operate on a formal basis. The specific objective is to design and implement a reform package to pave the way for the incorporation of informal businesses into the formal sector, in conjunction with a nationwide strategy for its immediate implementation. The project includes the following components: (i) a diagnostic assessment of the business environment and system; (ii) the development of a proposed reform package; and (iii) the implementation of the proposed reforms.
<b>Execution timetable:</b>	Execution period: 30 months Disbursement period: 33 months

<b>Special contractual clauses:</b>	As conditions precedent to the first disbursement: (i) the Operating Regulations must have entered into effect under the terms agreed upon in advance with the Bank; (ii) the service delivery contract entered into between the Liberty and Democracy Institute [Instituto Libertad y Democracia] (ILD) and SEDESOL must have been submitted; and (iii) the deliverables timetable agreed upon between SEDESOL and the ILD for disbursement purposes must have been submitted.
<b>Exceptions to Bank policy:</b>	See Procurement below.
<b>Procurement:</b>	Waiver of the requirement to select consulting services through open competition is recommended, so that the ILD may be contracted directly to implement Components 1 and 2. The ILD will conduct any procurement, hiring of consultants, or other activities that may be required in accordance with Bank procedures. Such sole sourcing is consistent with section GS-403 of the Procurement Manual (see paragraphs 4.4 and 4.5). No funding for works is envisaged.
<b>Environmental and social review:</b>	The project was reviewed and approved by the Committee on Environment and Social Impact (CESI) on 7 November 2003, and their comments incorporated (see paragraphs 2.1, 2.5, and 7.1). The project is not expected to have any adverse environmental or social impact.
<b>Coordination with other development finance institutions:</b>	The Bank is coordinating with USAID and the World Bank on enhancing the business environment in Mexico (see paragraphs 1.3, 1.6, and 4.5).

## I. BACKGROUND AND RATIONALE

### A. The informal sector of the economy

- 1.1 The economic reforms carried out by Latin American countries have not yet yielded concrete benefits for much of the population. One of the problems in this regard is that informal economic activity takes place on such a large scale in the region that a sizeable segment of the population is unable to accumulate capital. This, in turn, limits the growth capacity of the economy as a whole. For microenterprises and small businesses, in particular, regulatory frameworks and administrative mechanisms for entry into the formal sector either do not exist at all or are too costly and complicated. In the absence of certainty as to the law, especially with regard to property rights, it becomes impossible to determine relative prices, without which efficient use and exchange of resources cannot take place, and the commercial advantages afforded by economies of scale and integration cannot be capitalized upon. Incorporating business assets into the formal sector is a necessary condition for the optimum operation of a market economy, facilitates access to financing and investment, and paves the way for increased productivity and innovation.<sup>1</sup>
- 1.2 The institutional and legal framework for real estate and business property rights involves more than simply the issuance of titles and deeds. It is the reflection of an invisible architecture that converts property into tradable goods by representing it in written form as a deed, share of stock, or contract. In developed economies, an asset such as a house, for example, holds out the potential of increasing in value above and beyond the value of its physical characteristics because it represents the possibility of securing mortgage-backed loans. A house is therefore no longer simply a dwelling (“dead capital”), but is instead transformed into a vehicle for creating wealth (“live capital”). If property deeds and titles are recognized and accepted by businesspeople, investors, and financial institutions, then markets will function efficiently. The transaction costs associated with business registration, permits, and other requirements are also an important factor in the conversion of dead capital into live capital. Even when entrepreneurs hold legal title to their assets, excessive regulation and institutional stumbling blocks can discourage them from operating within the formal sector by raising the cost above an economically reasonable threshold. In such cases, these obstacles will simply help to perpetuate the decapitalization of such businesses.

### B. The informal sector of the Mexican economy and the government’s strategy

- 1.3 The World Bank recently brought out this year’s edition of its “Doing Business” study, which reports that Mexico’s informal sector accounts for 30.1% of its gross

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<sup>1</sup> A number of studies have indicated that nations which define and guarantee property rights achieve higher economic and per capita income growth rates than countries in which such rights remain uncertain.

domestic product (GDP); by contrast, the United States' informal sector generates just 8.8% of its GDP. Although Mexico's large informal sector has provided a livelihood for many workers whom the formal labor market has not been able to absorb, it also generates perverse economic effects in production and commerce. These effects are harmful and clearly interfere with economic growth, given the high cost of doing business in the country. The study also notes that bureaucratic procedures, requirements, formats, and authentications need to be streamlined in order to promote investment and job creation and to reduce discretionality and opportunities for corruption.

- 1.4 Mexico has carried out a number of economic and political reforms with a view to ushering in a market-economy system. The current administration has undertaken major reforms designed to provide greater certainty as to the law for financial operations. Some of these measures have taken the form of a number of laws passed in 2003, which are known collectively as the "Miscellanea Secured Lending" ("Miscelánea de Garantías"). The aim of these statutes is to increase the supply of credit by fostering conditions that will reduce risk and by promoting the use of trust guarantees and chattel mortgages to provide both borrowers and lenders with legal safeguards and certainty as to the law.
- 1.5 Around 6 million households, or 25 million people (one fourth of the total population), are classified as "moderately poor;" 70% of these 6 million households have housing and businesses of their own (over 4 million microenterprises). Recognizing that the problems faced by this segment of the population are different than those confronting people living in extreme poverty, the current administration is working on a special coordinated policy package based on the promotion of capital formation and greater market access. This package is intended to provide people in this income category with the tools they need to lift themselves out of poverty. The package also places a great deal of emphasis on the formal recognition of real estate and business property rights as a way of facilitating investment loans.

### **C. The Liberty and Democracy Institute**

- 1.6 In 2001, the Liberty and Democracy Institute [Instituto Libertad y Democracia] (ILD) submitted a preliminary study to the Government of Mexico that estimated the real property held by poor Mexicans at US\$245 billion. In addition, it noted that 6.6 million businesses not registered with the Ministry of Finance and Public Credit (SHCP) possess assets valued at approximately US\$70 billion. Taken together, these two sums (US\$315 billion) are equivalent to about 30 times as much foreign investment as the country receives in a year. Nonetheless, this capital cannot be used as collateral for loans or investments, because formal title to these assets is not on file with the public registry office. Another of the study's findings is that these 6 million or so economic agents employ 47% of the economically active population and generate up to 13% of the country's GDP. The study also calculated, in approximate terms, that the paperwork and procedures required to start up a

business in Mexico's formal sector (including all federal, state, and municipal processes) can take up to 17 months to complete, and the associated costs can amount to over 40 times the average wage in Mexico. The government is aware that moderately poor people remain poor because they do not hold formal title to their assets and therefore cannot use them for investment, enter into contracts, or generate capital gains.

- 1.7 The Mexican government does not seek to coerce members of the informal economy into entering the formal sector. Instead, its aim is to generate the right kinds of incentives and conditions so that they will shift over to the formal sector and remain there. To accomplish this, the costs of operating in the formal and informal sectors have to be quantified. In order to design these types of incentives, it is very important to ascertain what standards or rules apply to the wide range of private informal agreements that govern street trade or that the participants in the informal economy have voluntarily created to organize themselves. Some of these unspoken rules can be converted into legally recognized regulations, which can then be combined with other formally constituted standards to create a reformed business framework. Informal commercial practices should therefore be carefully codified before making any legal modifications designed to lower the cost of operating within the formal sector.

## **II. PROJECT DESCRIPTION**

### **A. Objectives**

- 2.1 The general objective of the proposed operation is to help improve the income-generating capacity of the moderately poor population by creating incentives for informal-sector businesses to move into the formal sector and then continue to operate on a formal basis. The specific objective is to design and implement a reform package to pave the way for the incorporation of informal businesses into the formal sector, in conjunction with a nationwide strategy for its immediate implementation.<sup>2</sup>

### **B. Components**

- 1. Component 1: Detailed diagnostic assessment of the legal framework for business startup and operation (MIF: US\$444,200; Local: US\$1,034,000)**
- 2.2 During the first nine months of the project's execution, an in-depth, comprehensive diagnostic assessment will be made of the scale and characteristics of the informal sector. Concrete information will be gathered on the shortcomings of the existing

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<sup>2</sup> The Mexican government is conducting a project specifically addressing the real estate assets of low-income families, including ejido and communal property, which are not covered by the proposed project.

legal system and, more specifically, on the reasons why owners of microenterprises and small businesses prefer to remain outside that framework. The assessment will draw upon empirical data to determine the causes, characteristics, and costs of remaining in the informal economy, as well as the costs of gaining access to the formal sector and of remaining in it. This assessment will entail the following steps: (i) analysis of the public agencies and regulations governing firms' access to, operations in, and departure from the formal sector; (ii) identification of the monetary and non-monetary costs borne by businesses choosing to remain in the informal sector; (iii) determination of the costs for informal enterprises of entering and operating in the formal sector; and (iv) identification of the problems faced by businesses and determination of the costs they must bear in order to expand within the formal sector and to exit from it.<sup>3</sup> For the purposes of this assessment, four localities will be chosen that are representative of existing problems in Mexico: the Federal District and three municipios (one each in the northern, central, and southern regions of the country) chosen to reflect the different and varying types of informal economic activity in the country. Localities will be selected with a view to comprehensive reform at the federal and regional levels, taking into account their size and whether the component outcomes can be extrapolated.

## **2. Component 2: Development of a proposed reform package (MIF: US\$1,263,400; Local: US\$990,400)**

- 2.3 **Subcomponent a. Reengineering the legal system.** This subcomponent will finance the dissemination and systematization of the diagnostic assessment's findings, so that they can be extrapolated to the national level and used in the development of guidelines for reengineering the legal system to provide access to and permit the operation of businesses in the formal sector of the economy. Once the assessment is complete (nine months into the project), concrete options capable of having an impact at the national level will be identified. The importance of this subcomponent lies in the fact that it will yield a list of options whose political viability and compatibility with the existing legal framework can be analyzed. This analysis will then serve as a basis for the design of feasible regulatory proposals. As an additional output, this activity will make it possible to draw up an official roster of enterprises that have been brought into the mainstream economy and to compile a database on new financial and investment opportunities that can be used to inform the wider market about their existence. This will permit the country to pool all the economically useful descriptions of assets that have been moved into the formal sector and store them in a single database.

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<sup>3</sup> In determining the costs of business expansion, consideration will be devoted to the existing mechanisms for conducting secure transactions, obtaining credit, making use of limited liability provisions, reporting financial information, expanding a firm's market beyond the scope of personal contacts, obtaining equity in the firm, complying with major tax regulations, etc.

- 2.4 **Subcomponent b. Designing a package of legal reforms to help businesses enter and operate in the formal sector.** Based on extrapolation of the findings for the four selected localities (12 months into the project), which will furnish the necessary data for the design of general legal mechanisms and reforms and for a discussion within the Mexican government of the options proposed as part of subcomponent (a), this subcomponent will be oriented toward designing and framing a set of specific bills to reform the legal framework governing business activity. The proposed reforms will focus on providing access to the formal sector and helping businesses to gain entry rapidly and inexpensively and, once in it, to remain there. The package is to include a quantified estimate of the proposed reforms' economic impact and ensure that any new legislation or regulations are in keeping with the new legal system.
- 2.5 **Subcomponent c. Implementation strategy.** This subcomponent will finance the development of a national strategy for implementing these reforms. The strategy will cover the prioritization of areas and/or activities to be incorporated into the formal sector, the sequencing of their implementation based on a tentative timetable and a preliminary budget, an operational plan for agencies promoting these businesses' entry into the formal sector, a communications plan, a field operations plan, and a recruitment and training plan for Mexican staff members. The strategy should clearly illustrate the benefits of entry into the formal sector with a view to building consensus for the reforms' approval and contributing to businesses' incorporation into the mainstream economy. The strategy will include recommendations for publicity campaigns targeting owners of assets for which legal title has recently been obtained (as a means of publicizing the advantages of formal status) and encouraging owners of informal-sector assets to participate. The benefits of access to credit and greater interaction with financial intermediaries should be highlighted. This strategy will include proposals for setting up feedback mechanisms for queries from the general public with a view to demonstrating the advantages of formal-sector status to members of the informal economy, the business community, the authorities, or any group that tends to support the status quo. Information will be made available through various channels, including the Internet, for extensive public consultation.

### **3. Component 3. Implementation of proposed reforms (MIF: US\$405,000; Local US\$396,000)**

- 2.6 This component provides for the introduction of a reform package in the four locations covered by the diagnostic assessment (the Federal District and three municipalities). The strategy will be adjusted to allow the activities making up the first stage in its implementation at the national level; accordingly, this component will finance the startup of measures to reduce the costs borne by entrepreneurs. The federal government has committed to support implementation of the measures in the four localities in any way it can, including the introduction of laws and rules in the relevant states as deemed advisable under Component 2. This startup will serve

as a model for the reforms' speedy implementation at the national level. The implementation strategy, whose foundations will be developed during the period covered by Component 2, will include consensus-building tools, staff recruitment and training procedures, and handbooks and guidelines to help the authorities gradually bring informal enterprises into the new legal framework. The localities must sign agreements with SEDESOL, committing to supply financial resources (see paragraph 3.1) and take such other steps as may be required for implementation under this component.

- 2.7 Drawing upon preliminary studies and experiences in other countries, both within the region and elsewhere, the activities to be financed are designed to include, inter alia: streamlining and deregulation of the procedures required to secure licenses and permits; an integrated official registry for business enterprises with one-stop windows; data processing and files based on simplified, easily updated forms; reclassification of skills and inspections or checks to be conducted after the issuance of licenses; integrated management systems; and mechanisms for providing ready access to a limited-liability system. In addition, this component could include design of the agency that is to be responsible for moving businesses into the formal sector. This agency will also be the one in charge of ensuring that the legal and administrative costs of transactions involving business assets and operations within the formal sector remain reasonable, as well as of drafting regulations regarding organizational matters, procedures for entry into the formal sector, registration, and dispute settlement.

### **III. PROGRAM COST AND FINANCING**

- 3.1 The total cost of the project will be US\$5.6 million. Of this amount, US\$2.6 million will be financed with nonreimbursable MIF resources and the other US\$3 million will be provided by SEDESOL in the form of local counterpart resources, with US\$400,500 of the latter amount being furnished in kind. A portion of SEDESOL's counterpart contribution (US\$396,000) is expected to come from local governments. The project will be executed over a 30-month period, and the loan will be disbursed over 33 months. The starting point for both of these periods will be the effective date of the technical cooperation agreement. The project will have a multiplier effect because it will train civil servants to monitor the reform process and help develop best practices and instructional activities, thereby enhancing the sustainability of the project's effects.

ACTIVITIES (US\$)	MIF	LOCAL	TOTAL	%
<b>Component 1:</b> Diagnostic assessments	444,200	1,034,000	1,478,200	26.4
<b>Component 2:</b> Development of reform proposals	1,263,400	990,400	2,226,800	40.8
a. Reengineering	253,100	150,900	404,000	
b. Design of proposals	758,200	640,100	1,398,300	
c. Implementation strategy	252,100	199,400	451,500	
<b>Component 3:</b> Implementation of reforms	405,000	396,000	801,000	14.3
Administration	355,100	547,500	902,600	16.1
Evaluations	45,000	0	45,000	0.8
Audits	40,000	0	40,000	0.7
Contingencies	47,300	32,100	79,400	1.4
Total	2,600,000	3,000,000	5,600,000	100

#### IV. EXECUTING AGENCY AND IMPLEMENTATION

- 4.1 The Ministry of Social Development (SEDESOL) will be responsible for executing the project.<sup>4</sup> SEDESOL was under an executive order that amended, supplemented, and repealed various provisions of the Federal Public Administration Act of 25 May 1992. SEDESOL focuses on land-use planning, urban and housing development, and equal opportunity for vulnerable groups with a view to fostering community development and thus achieving greater cohesiveness among the various segments of society.
- 4.2 **Execution mechanism.** Under the leadership of the Director-General for Property Rights at SEDESOL, who will serve as Project Coordinator, SEDESOL will put together a team of attorneys, economists, engineers, and administrative personnel who will be in charge of the technical and operational aspects of the project's implementation. The core members of the team are already working at SEDESOL. They have received training from ILD staff and will continue to be provided with intensive training during project development. The SEDESOL team, which is already up and running, thus forms part of the President of Mexico's overall strategy for combating moderate poverty.

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<sup>4</sup> Nacional Financiera, S.N.C. will act as the fiscal agent. The use of a fiscal agent is a customary procedure in technical cooperation operations and grant programs in Mexico when a government institution serves as an executing agency or is a beneficiary.

- 4.3 **Accounting and auditing.** SEDESOL will process disbursement requests and the corresponding expense reports in accordance with Bank procedures. Disbursements will be made from a revolving fund equivalent to 5% of the total MIF contribution. SEDESOL will be responsible for submitting semiannual reports on the status of the revolving fund within 60 days after the close of each six-month period. It will set up and maintain accounting systems for handling the funds and will be responsible for keeping the necessary supporting documentation on file for project expenditures. The accounting system will be organized in such a way as to provide all necessary documents, facilitate the verification of transactions, and permit the preparation of the relevant reports. SEDESOL will be responsible for opening separate, specific accounts for the MIF contribution and for the counterpart funds. In addition, it is to submit audited financial statements to the Bank each year. Within 90 days after the last disbursement, SEDESOL is to submit final versions of the financial statements covering the Bank's contribution and the local counterpart funds. These statements must be certified by an independent auditing firm that is acceptable to the Bank. The audits will be conducted in accordance with the requirements established by the Bank on the basis of the terms of reference it has approved.
- 4.4 **Procurement.** Waiver of the requirement to select consulting services through open competition is requested, so that the ILD may be contracted directly to implement Components 1 and 2. Sole sourcing of the ILD is consistent with the technical advantage criteria of Procurement Manual section GS-403, "Norms for selection without competition (sole sourcing)," because it meets the executing agency requirements as described below.
- 4.5 To execute the two project components, SEDESOL requires the services of an institution that has (i) capabilities and experience in putting together a package of laws and reforms to bring businesses into the formal sector, based on exhaustive diagnostic assessments; (ii) an intervention methodology well-suited to informal-sector businesses; and (iii) cultural familiarity and a strong presence in the field, given the special features of the country and its regions.
- (i) *The agency possesses known ability and experience in the area of the professional services to be contracted.* The ILD is a private, nonprofit organization based in Lima, Peru, that has emerged as the only agency with international institutional experience. It has developed a methodology for identifying the standards and norms that govern the widely varying types of private agreements which are used in informal markets or which participants in the informal sector have created on their own in order to organize their activities. The ILD has documented the most common informal-sector practices for business transactions and knows how to codify these norms, so that they can be used to create an effective business framework for productive investment. It also has expertise in putting them into acceptable form and integrating them with formally constituted requirements. Based on its vast

experience in the field over more than two decades, during which it has plumbed the depths of the underground economy, and on its analysis of successful transitions to market economies in Europe, the United States, and Japan, the ILD has developed special methods for: (a) systematically investigating and analyzing the unseen factors that fuel the growth of informal markets and the institutional problems that block or increase the cost of shifting businesses over to the mainstream economy and of ensuring that they then continue to operate in the formal sector; (b) determining the costs of engaging in informal economic activity; and (c) proposing reforms that will augment the advantages of maintaining legal status.

- (ii) *The personnel to be assigned must have specific experience and qualifications, not easily available at the required level or in other agencies or firms; or the agency has access to specialized consultants, not usually available to other entities.* The ILD has permanent staff with the relevant specializations who hold university and graduate degrees, including professionals in such multidisciplinary areas as law, economics, and the social sciences. In the 1990s, the ILD began to design and set up institutional reform programs for the issuance of formal title to land in Peru. Its work in this area is part of an effort to bring people within the sphere of the law by providing them with access to formal property rights and furnishing tools for freeing up the capital locked in the assets they possess. This initiative has yielded significant benefits. In Peru, the ILD has designed, won approval for, and implemented business title and registration programs (whose management has since been transferred to the government) that have resulted in the mainstreaming of over 1.5 million urban plots and as many rural properties. It has also succeeded in bringing 300,000 firms into the formal sector during the first four years of these programs' existence, which has in turn resulted in the creation of 550,000 new formal-sector jobs and in the generation of US\$1.2 billion in tax revenues and US\$700 million in administrative savings for business enterprises. Since 1996, the ILD has expanded its international activities and is now working with the governments of various countries to develop a pragmatic approach to the construction of an inclusive legal system that will provide scope for broad citizen participation.
- (iii) *The agency is able to effectively coordinate several individual specialists and prepare specialized consolidated reports.* The ILD has demonstrated its coordination ability through the development and implementation of reform packages in Peru, El Salvador, and, most recently, in Egypt, bringing together the necessary multidisciplinary professionals in coordination with multiple public- and private-sector agencies. The Government of Mexico intends to continue with the development of policies on property rights that will affect persons living in moderate poverty, based on the work done earlier by the ILD under contract to USAID (see paragraph 1.6).

(iv) *The average performance evaluation, for similar work done for the Bank or beneficiary, is at least GOOD, under the Bank's performance evaluation system.* The ILD has done no similar work for the Bank, but USAID rated its performance very highly on the USAID/ILD operation in Mexico described above (see paragraph 1.6). USAID, which contracted the ILD directly to work on land rights and to undertake the preliminary stages of its study on businesses' transition from the informal to the formal sector, believes that the ILD has a unique insight into the culture and powers of perception that allow it to identify and evaluate informal agreements on the ground. These skills enable it to arrive at a fuller understanding of the value and costs of assets held without benefit of formal title and to develop more practical solutions.

4.6 **Readiness.** Preparations for the project are well advanced. SEDESOL, with support from the Bank, has drawn up the terms of reference for the principal project consultants, which will expedite implementation, and the project execution plan for the first 24 months, broken down by components, is ready.

## V. MONITORING AND EVALUATION

5.1 SEDESOL will prepare progress reports for submission to the Country Office in Mexico within 60 days after the end of each six-month period, as well as a project completion report within 30 days after the last disbursement. These reports will follow a format that has been agreed upon beforehand with the Country Office in Mexico and will cover project activities and finances together with the operation's outputs, measured in terms of the performance benchmarks outlined in the logical framework. The Country Office in Mexico will use these reports to oversee the progress made in implementing the project and will prepare a project completion report within three months after the last disbursement. The Bank will also engage individual consultants to carry out two project evaluations. A midterm review will be conducted once 50% of the project funds have been disbursed, and a final evaluation during the three months following the project's completion. On the basis of the midterm review, the Country Office in Mexico, in conjunction with the project team, will determine whether the project should proceed or should be cancelled. The Country Office in Mexico and SEDESOL will use the evaluation and oversight indicators listed in the logical framework (see Annex I) to monitor the project's impact. Baseline data will be gathered during execution of Component 1 for comparison. The indicators, means of verification, and assumptions will be reviewed in conjunction with the MIF Office once the reform package is ready, in order to more accurately reflect what is regarded as desirable delivery performance.

## VI. BENEFITS AND RISKS

### A. Benefits

- 6.1 Since the operation will help to improve the legal and institutional framework an essential step for a market economy to function properly, the project will generate a wide range of benefits associated with the mainstreaming of business transactions and will help to boost productivity and stimulate private investment. Its effects will be reflected in a deepening of the financial market in terms of both the volume and variety of commercial loans and mortgages available, as well as interest rates, since the demand for financial services and competition among intermediaries will be spurred by the increase in the number of eligible borrowers. In the long run, the certainty as to the laws governing contracts and transactions will foster greater confidence among economic agents, thereby reducing the level of institutional risk and contributing to economic stability. Capitalization will also open up access to larger financial, labor, and goods and services markets.
- 6.2 **Similar MIF projects in the country.** The MIF has financed a project of the National Housing Commission [Comisión Nacional de Fomento a la Vivienda] (CONAFOVI) on bankable property rights (ATN/MT-8245-ME), which calls for the implementation of reforms in the public real estate registry offices of three states. These reforms mainly involve the reengineering of land registration procedures in order to streamline them and reduce their cost, the refinement of management information systems, and measures to strengthen regulations governing the registration of property rights. Modernization of these real estate registry offices will play an important part in helping to shift economic activity into the formal sector. Project ATN/MT-8245-ME will complement this operation, which will work on building a legal infrastructure that will enhance and broaden the business environment, while permitting the economic integration of moderately poor Mexicans. This operation will develop proposals for the design of incentives not only for entry into the formal sector, but also for the maintenance of, or return to, formal status and the elimination of trade restrictions stemming from informal economic activity. These measures are expected to contribute to greater efficiency in the allocation of production resources.
- 6.3 The Mexican government will be the direct beneficiary of this operation, as it will be provided with the designs, tools, and expertise necessary to carry out a comprehensive reform of the legal framework that governs business activity. The project's indirect beneficiaries will be: (a) 25 million people who are currently living in moderate poverty; (b) 4 million owners of microenterprises and the suppliers who provide them with inputs and services, who will be operating within a better legal environment, using secure, efficient procedures that can be completed quickly and easily, be able to conduct low-cost operations, have access to more commercial and financial options, and have the ability to optimize their capital

structure through the use of partnerships and investment contracts and to capitalize upon the advantages offered by a division of labor; and (c) owners of real estate and business assets, which will increase in value once incorporated into the formal sector, will be accepted by the market, and can be transferred more easily, quickly, and securely.

## **B. Risks**

- 6.4 The project will require cooperation from the federal, state, and municipal governments, from federal and local government agencies, from real estate and business registry offices, from notaries, and from other relevant public programs. Members of Congress will also have to agree upon the proposed legal reforms. A lack of support in this respect could limit the project's benefits. Nevertheless, this project forms part of the Mexican government's strategy to combat moderate poverty and enjoys support at the highest level of government through the Bureau for Public Policy [Coordinación de Políticas Públicas], which is attached to the Office of the President and works to ensure effective coordination among the various agencies and levels of government. The project will also mitigate this risk by launching an effective communication and citizen feedback strategy and then ensuring its continued implementation. This risk is further mitigated by the government's firm commitment to make every effort to implement the project in the four selected localities as a way of demonstrating how good an economic fit these reforms are for the country and its pledge to furnish the funding needed for implementation at the national level.

## **VII. ENVIRONMENTAL AND SOCIAL VIABILITY**

- 7.1 The project abstract was approved by the Committee on Environment and Social Impact (CESI) on 7 November 2003. Since this project deals with the development of a legal reform package, it has no direct adverse environmental or social impact. It should be noted, moreover, that certainty as to the law has the following effects: (i) it encourages investment in property improvements (in both housing and businesses) under an appropriate regime that permits efficient solutions to be found for environmental conflicts or disputes; (ii) it gives owners of business assets the means to invest in safeguarding their resources and introducing more productive technologies; and (iii) it helps make it easier for businesses that have shifted into the formal sector to comply with basic health, hygiene, and safety regulations. The project will also have positive social impacts by virtue of the fact that it will: (i) enhance the well-being of workers by expanding their access to social security coverage and enabling them to improve their contractual relations with their employers once the firms have entered the formal sector; and (ii) free people from the need to use exceptional measures to protect their property, thereby giving them an opportunity to invest in more productive activities. This will also reduce the likelihood that people will find it necessary to resort to arbitration mechanisms that

are not controlled by the government or to engage in influence peddling (corruption, extortion, undue intermediation). The ILD will look at environmental factors and occupational health as part of its diagnostic assessment during execution of the first two components, and make final recommendations that have no adverse environmental impact.

## **VIII. SPECIAL CONTRACTUAL CONDITIONS**

- 8.1 As conditions precedent to the first disbursement: (i) the Operating Regulations must have entered into effect under the terms agreed upon in advance with the Bank; (ii) the service delivery contract entered into between the ILD and SEDESOL must have been submitted; and (iii) the deliverables timetable agreed upon between SEDESOL and the ILD must have been submitted.

**SUPPORT FOR A PROGRAM TO INCORPORATE BUSINESS ASSETS INTO THE FORMAL SECTOR (ME-M1002)  
LOGICAL FRAMEWORK**

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p><b>Goal:</b></p> <p>To help improve the income-generating capacity of the moderately poor population by creating incentives for informal-sector businesses to move into the formal sector and then continue to operate on a formal basis.</p>	<p>By the end of 2008,</p> <ul style="list-style-type: none"> <li>• The number of legally established businesses is at least 20% greater when compared to the figures for the end of 2006</li> <li>• Transaction costs for the startup, maintenance, and shutdown of operations in formal-sector businesses is at least 20% less when compared to the figures for the end of 2006</li> <li>• An increase of at least 10% in the household income of the moderately poor population, such that these households are now located in the next highest decile relative to the figures for the end of 2006</li> </ul>	<ul style="list-style-type: none"> <li>• National Household Income/Expenditure Survey [Encuesta Nacional de Ingreso Gasto de los Hogares] (ENIGH)</li> <li>• National Microenterprise Survey [Encuesta Nacional de Micro Negocios] (ENAMIN)</li> <li>• Federal Registry of Procedures and Services [Registro Federal de Trámites y Servicios] (RFTS)</li> <li>• Mexican Business Information System [Sistema de Información Empresarial México] (SIEM)</li> <li>• Tax Administration Service Federal Tax Roll [Registro Federal de Contribuyentes del SAT]</li> <li>• State and municipal information on business procedures</li> <li>• SEDESOL publication</li> <li>• Project completion report</li> <li>• Evaluation (IDB)</li> </ul>	<ul style="list-style-type: none"> <li>• A suitable macroeconomic and political framework is in place.</li> <li>• The reforms proposed by the Mexican government to combat moderate poverty are approved.</li> <li>• The government has the budgetary resources and allocates them for implementation.</li> </ul>

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p><b>Purpose:</b></p> <p>To design and implement a reform package to pave the way for the incorporation of informal businesses into the formal sector, in conjunction with a nationwide strategy for its immediate implementation.</p>	<p>Upon completion of project execution,</p> <ul style="list-style-type: none"> <li>• Preliminary drafts of federal regulatory reforms</li> <li>• Preliminary drafts of municipal and state regulatory reforms</li> <li>• Strategy for their implementation at the national level</li> <li>• Reforms implemented in four localities</li> <li>• The government has confirmed the availability of the necessary budgetary resources for implementing the reforms at the national level after the project's execution period has ended</li> </ul>	<ul style="list-style-type: none"> <li>• Project completion report</li> <li>• Evaluation (IDB)</li> <li>• SEDESOL publication</li> <li>• Visits</li> <li>• Preliminary drafts officially submitted to the Federal Commission for Regulatory Improvements [Comisión Federal de Mejora Regulatoria] (COFEMER)</li> </ul>	<ul style="list-style-type: none"> <li>• A suitable macroeconomic and political framework is in place.</li> <li>• The federal government has the budgetary resources and allocates them for implementation</li> <li>• The federal government is committed to the coordinated and comprehensive implementation of the proposed measures in the federal agencies that establish business procedures and requirements.</li> <li>• Approval is obtained for the reforms proposed by this project and by the project on bankable property rights as part of the Mexican government's overall program for combating moderate poverty.</li> <li>• The preliminary drafts are approved by COFEMER.</li> </ul>
<p><b>Components:</b></p> <p><b>1. Diagnostic assessment</b></p> <p>The causes, characteristics, and costs of remaining in the informal sector and the costs of entering the formal sector and continuing to operate on a formal basis, to be determined on the basis of the information gathered in four localities (preferably including the Federal District, with the other three localities being located in the northern, central, and southern regions of the country).</p>	<ul style="list-style-type: none"> <li>• “Unspoken” norms and practices governing business activity in the informal sector</li> <li>• The costs (paperwork, time, and money) of incorporation into the formal sector</li> </ul> <p>(Month 9)</p>	<ul style="list-style-type: none"> <li>• Project progress reports</li> <li>• Consultants' reports</li> </ul>	<ul style="list-style-type: none"> <li>• Cooperation agreements with the states and municipios for development of the diagnostic assessment and of reform proposals.</li> <li>• Immediate startup of the project's administrative office.</li> <li>• Recruitment of the local team is completed on schedule.</li> </ul>

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p><b>2. Development of proposed reform package</b></p> <p><b>Reengineering the legal system</b> Concrete alternative measures for resolving the problems identified at the national level.</p>	<p>Report on preliminary proposals for legal and institutional changes in order to determine the scope of the reforms, in coordination with the Mexican government, in the four localities</p> <p>(Month 12)</p>	<ul style="list-style-type: none"> <li>• Project performance reports</li> <li>• Consultants' reports</li> </ul>	<ul style="list-style-type: none"> <li>• Cooperation agreements with the states and municipios for development of the diagnostic assessment and of reform proposals.</li> <li>• Recruitment of specialized local consultants is completed on schedule.</li> </ul>
<p><b>Designing a comprehensive package of legal reforms to help businesses enter and operate in the formal sector.</b> Package of proposed legal reforms for providing businesses with access to the formal sector and permitting their continued operation in that sector; quantification of the economic impact based on an extrapolation of the findings for the four localities covered by the project.</p>	<ul style="list-style-type: none"> <li>• Preliminary drafts of regulatory reforms (at the federal, state, and municipal levels)</li> <li>• Estimate of the reduction in transaction costs (monetary costs, paperwork, time) that would result from the proposed reforms</li> </ul> <p>(Month 21)</p>	<ul style="list-style-type: none"> <li>• Progress reports</li> <li>• Final report on the design of reform proposals</li> </ul>	<ul style="list-style-type: none"> <li>• State and municipal governments in the selected localities make a commitment to implement the proposed measures.</li> <li>• Recruitment of specialized local consultants is completed on schedule.</li> </ul>
<p><b>Implementation strategy.</b> National guidelines for implementation of the reforms, to include the stages involved in their implementation, a communication strategy, and a training program.</p>	<ul style="list-style-type: none"> <li>• Flowchart of steps to be taken</li> <li>• Development of communication, dissemination, and training manuals</li> <li>• Document setting forth the specific methodology to be used for implementation</li> </ul> <p>(Month 24)</p>	<ul style="list-style-type: none"> <li>• Plan of action</li> <li>• Design of a communication strategy (national coverage)</li> <li>• Design of pilot plan</li> <li>• Progress reports</li> </ul>	<ul style="list-style-type: none"> <li>• Recruitment of specialized local consultants is completed on schedule.</li> </ul>



Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p>2.2 Engage specialized local consultants to develop a package of proposed reforms.</p> <p>2.3 Engage specialized local consultants to develop the implementation strategy.</p> <p>2.4 Sign agreements with the selected states and municipios.</p> <p>2.5 Develop the proposed reform package.</p> <p><b>Component 3</b></p> <p>3.1 Engage specialized local consultants to work on reengineering the reforms.</p> <p>3.2 Sign agreements with the selected states and municipios.</p> <p>3.3 Implement the proposed reforms.</p>	<p>MIF: US\$405,000 Local: US\$396,000</p>		<ul style="list-style-type: none"> <li>• State and municipal governments in the selected localities make a commitment to implement the proposed measures.</li> <li>• Recruitment of specialized local consultants is completed on schedule.</li> </ul>

**Support for a Program to Incorporate Business Assets into the Formal Sector  
(ME-M1002)  
Budget**

SEDESOL PROJECT	Unit cost (month)	Amount (person- months)	Total (30 months)			Subtotal
			MIF	SEDESOL		
			%	In cash	In kind	
<b>Component 1: Diagnostic assessment</b>						
<b>A. Consultants (ILD)</b>						
Senior attorney/economist consultants	12,840	3		38,520		38,520
Attorney/economist consultants	11,100	34		377,400		377,400
Junior attorney/economist consultants	8,000	18		144,000		144,000
Information systems consultants	3,000	2		6,000		6,000
<b>Subtotal</b>				<b>565,920</b>		<b>565,920</b>
<b>B. Subcontracted local consultants</b>						
Senior attorney/economist consultants	11,600	9	104,400			104,400
Attorney/economist consultants	7,300	12	87,600			87,600
Urban planning consultants	4,400	26	114,400			114,400
Junior attorney/economist consultants	2,200	13	28,600			28,600
Short-term consultants (communications)	5,800	14	81,200			81,200
Short-term consultants (extralegal sector)	3,500	8	28,000			28,000
<b>Subtotal</b>			<b>444,200</b>			<b>444,200</b>
<b>C. Overhead</b>						
Basic overhead	21,670	9		195,030		195,030
Other	3,000	9		27,150		27,150
<b>Subtotal</b>				<b>222,180</b>		<b>222,180</b>
<b>D. Travel and per diem allowances</b>						
Travel to Mexico	800	22		17,600		17,600
Per diem allowances	200	945		189,000		189,000
Other	150	22		3,300		3,300
Local travel	1,000	36		36,000		36,000
<b>Subtotal</b>				<b>245,900</b>		<b>245,900</b>
<b>Component 1 - Total</b>			<b>444,200</b>	<b>1,034,000</b>	<b>0</b>	<b>1,478,200</b>
<b>Component 2a: Reengineering</b>						
<b>A. Consultants (ILD)</b>						
Senior attorney/economist consultants	12,840	1	12,840			12,840
Attorney/economist consultants	11,100	12	133,200			133,200
Junior attorney/economist consultants	8,000	6	48,000			48,000
Information systems consultants	3,000	1	3,000			3,000
<b>Subtotal</b>			<b>197,040</b>			<b>197,040</b>
<b>B. Subcontracted local consultants</b>						
Senior attorney/economist consultants	11,600	3		34,800		34,800
Attorney/economist consultants	7,300	5		36,500		36,500
Urban planning consultants	4,400	9		39,600		39,600
Junior attorney/economist consultants	2,200	5		11,000		11,000
Short-term consultants (communications)	5,800	5		29,000		29,000
Short-term consultants (extralegal sector)	3,500	0		0		0
<b>Subtotal</b>				<b>150,900</b>		<b>150,900</b>
<b>C. Overhead</b>						
Basic overhead	15,670	3	47,010			47,010
Other	3,000	3	9,050			9,050
<b>Subtotal</b>			<b>56,060</b>			<b>56,060</b>
<b>D. Travel and per diem allowances</b>						
Travel to Mexico	800	0		0		0
Per diem allowances	200	0		0		0
Other	150	0		0		0
Local travel	1,000	0		0		0
<b>Subtotal</b>				<b>0</b>		<b>0</b>
<b>Component 2a - Total</b>			<b>253,100</b>	<b>150,900</b>	<b>0</b>	<b>404,000</b>

<b>Component 2b: Reform package</b>						
<b>A. Consultants (ILD)</b>						
Senior attorney/economist consultants	12,840	3	38,520			38,520
Attorney/economist consultants	11,100	36	399,600			399,600
Junior attorney/economist consultants	8,000	14	112,000			112,000
Information systems consultants	3,000	1	3,000			3,000
<b>Subtotal</b>			<b>553,120</b>			<b>553,120</b>
<b>B. Subcontracted local consultants</b>						
Senior attorney/economist consultants	11,600	9		104,400		104,400
Attorney/economist consultants	7,300	14		102,200		102,200
Urban planning consultants	4,400	27		118,800		118,800
Junior attorney/economist consultants	2,200	14		30,800		30,800
Short-term consultants (communications)	5,800	15		87,000		87,000
Short-term consultants (extralegal sector)	3,500	4		14,000		14,000
<b>Subtotal</b>				<b>457,200</b>		<b>457,200</b>
<b>C. Overhead</b>						
Basic overhead	19,780	9	178,020			178,020
Other	3,000	9	27,060			27,060
<b>Subtotal</b>			<b>205,080</b>			<b>205,080</b>
<b>D. Travel and per diem allowances</b>						
Travel to Mexico	800	22		17,600		17,600
Per diem allowances	200	765		153,000		153,000
Other	150	22		3,300		3,300
Local travel	1,000	9		9,000		9,000
<b>Subtotal</b>				<b>182,900</b>		<b>182,900</b>
<b>Component 2b - Total</b>			<b>758,200</b>	<b>640,100</b>	<b>0</b>	<b>1,398,300</b>
<b>Component 2c: Implementation strategy</b>						
<b>A. Consultants (ILD)</b>						
Senior attorney/economist consultants	12,840	1	12,840			12,840
Attorney/economist consultants	11,100	12	133,200			133,200
Junior attorney/economist consultants	8,000	5	40,000			40,000
Information systems consultants	3,000	0	0			0
<b>Subtotal</b>			<b>186,040</b>			<b>186,040</b>
<b>B. Subcontracted local consultants</b>						
Senior attorney/economist consultants	11,600	3		34,800		34,800
Attorney/economist consultants	7,300	5		36,500		36,500
Urban planning consultants	4,400	9		39,600		39,600
Junior attorney/economist consultants	2,200	5		11,000		11,000
Short-term consultants (communications)	5,800	5		29,000		29,000
Short-term consultants (extralegal sector)	3,500	0		0		0
<b>Subtotal</b>				<b>150,900</b>		<b>150,900</b>
<b>C. Overhead</b>						
Basic overhead	19,000	3	57,000			57,000
Other	3,000	3	9,060			9,060
<b>Subtotal</b>			<b>66,060</b>			<b>66,060</b>
<b>D. Travel and per diem allowances</b>						
Travel to Mexico	800	10		8,000		8,000
Per diem allowances	200	195		39,000		39,000
Other	150	10		1,500		1,500
Local travel	1,000	0		0		0
<b>Subtotal</b>				<b>48,500</b>		<b>48,500</b>
<b>Component 2c - Total</b>			<b>252,100</b>	<b>199,400</b>	<b>0</b>	<b>451,500</b>

<b>Component 3: Implementation</b>						
<b>A. Consultants (non-ILD)</b>						
Senior attorney/economist consultants	7,500	16	120,000			120,000
Attorney/economist consultants	6,000	8	48,000			48,000
Junior attorney/economist consultants	5,000	13	65,000			65,000
Information systems consultants	4,000	16	64,000			64,000
Senior attorney/economist consultants	4,500	24		108,000		108,000
Attorney/economist consultants	4,000	24		96,000		96,000
Urban planning consultants	3,500	24		84,000		84,000
Junior attorney/economist consultants	3,000	24		72,000		72,000
Short-term consultants (communications)	5,000	12	60,000			60,000
Short-term consultants (extralegal sector)	4,000	12	48,000			48,000
<b>Subtotal</b>			<b>405,000</b>	<b>360,000</b>		<b>765,000</b>
<b>B. Travel and per diem allowances</b>						
Local travel	500	48		24,000		24,000
Per diem allowances	200	60		12,000		12,000
<b>Subtotal</b>			<b>0</b>	<b>36,000</b>		<b>36,000</b>
<b>Component 3: Total</b>			<b>405,000</b>	<b>396,000</b>	<b>0</b>	<b>801,000</b>
<b>PROJECT MANAGEMENT</b>						
<b>A. Coordination: Government of Mexico</b>						
Project director (30%)	3,650	30			109,500	109,500
Economic specialist (30%)	2,300	30			69,000	69,000
Legal specialist (30%)	2,300	30			69,000	69,000
Public relations specialist (30%)	2,300	30			69,000	69,000
Specialist in monitoring and control (30%)	2,300	30			69,000	69,000
Administrative/financial assistant	7,250	24	174,000			174,000
Administrative, accounting and budgetary assistant	2,600	24	62,400			62,400
Secretary (30%)	500	30			15,000	15,000
Junior administrative assistant	3,500	24	84,000			84,000
<b>Subtotal</b>			<b>320,400</b>		<b>400,500</b>	<b>720,900</b>
<b>B. Overhead</b>						
Communications	300	30		9,000		9,000
Local transportation	900	30		27,000		27,000
Office supplies	1,700	30		51,000		51,000
Information materials	3,000	1		3,000		3,000
Rental of office space	0	30		0		0
Equipment maintenance and repair	300	30		9,000		9,000
Equipment and vehicle insurance	5,000	1		5,000		5,000
Miscellaneous	600	30		18,000		18,000
<b>Subtotal</b>				<b>122,000</b>		<b>122,000</b>
<b>C. Equipment</b>						
Computer hardware	34,700	1	34,700			34,700
Vehicle	25,000	1		25,000		25,000
<b>Subtotal</b>			<b>34,700</b>	<b>25,000</b>		<b>59,700</b>
<b>Administration - total</b>			<b>355,100</b>	<b>147,000</b>	<b>400,500</b>	<b>902,600</b>

Midterm review	20,000			20,000
Final evaluation	25,000			25,000
Audits	40,000			40,000
Contingencies	47,300	32,100		79,400

<b>TOTAL</b>	<b>2,600,000</b>	<b>2,599,500</b>	<b>400,500</b>	<b>5,600,000</b>
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<b>Percentages: MIF and counterpart</b>	<b>46.43</b>	<b>46.42</b>	<b>7.15</b>	<b>100</b>
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**Related projects in Mexico**  
**ME-M1002 – Support for a Program to Incorporate Business Assets into the Formal Sector**

**A. Similar or related projects**

<b>Project number/ Date of approval</b>	<b>Project title, executing agency, and amount</b>	<b>Date of signature and original disbursement period in months</b>	<b>Percentage disbursed</b>	<b>Comments</b>
ATN/MT-8245-ME 12 March 2003	Bankable property rights in Mexico, National Housing Commission (CONAFOVI) US\$2,000,000	17 June 2003 36 months	8%	Satisfactory performance with initial constraints that have now been overcome.

**B. MIF projects related to the same sector, beneficiaries, or executing agencies**

None.

**C. Similar or related Bank projects**

None.