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## How to Build in Third World Countries Successful Capitalism And Not the Small Enclaves Of Economic Well-Being Surrounded by the Ocean of Poverty

(based on Hernando de Soto's concept)



Hernando de Soto

1. It is not enough to create the economy based on private ownership and governed by market principles to make it prosperous.
2. Capitalist principles must be all-embracing. Otherwise capitalism flourishes in few, small enclaves surrounded by the oceans of poverty – typical situation in developing countries, including Iraq
3. In the West capitalism and market triumph and make the economy and people more prosperous than elsewhere in the world because there is the unique and ubiquitous system of transformation of any more valuable piece of property into capital.
4. This transformation is possible because the formal property rights system has been created during last one hundred years
5. What was exactly done?
  - *property rights register systems were centralized throughout each country*
  - *process and rules of their registering was formalized and simplified*
  - *registering rules had been based on the uniform and internationally accepted principles*
6. This formal property systems produce six effects that allow citizens to generate capital
  - *Fixing the economic potential of assets*
  - *Integrating dispersed information into one system*
  - *Making people accountable*
  - *Making assets fungible*
  - *Networking people*
  - *Protecting transactions*
7. Much of the marginalization of the poor, who are the vast majority in developing nations comes from their inability to benefit from the six effects that formal property provides.

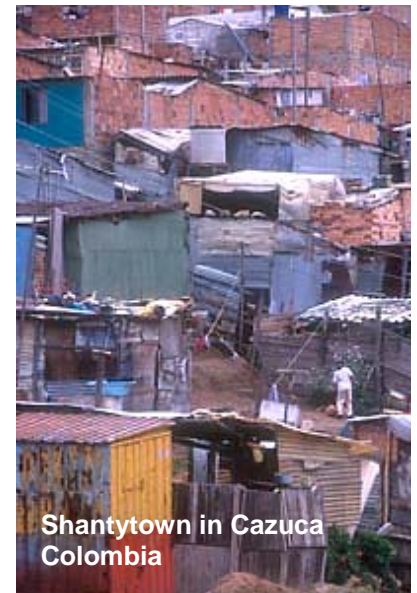
Capital is not the accumulated stock of assets but the potential it holds to deploy new production.

## WHY DID THAT HAPPEN?

8. During last fifty years a kind of third economic revolution has begun in third world countries. One of its immediate effects was **enormous migration from villages to cities**. No dam could stop it whatever country it was: China, Iraq, Latin America or Russia. Between 1950 and 1995 the number of cities with more than 1 million inhabitants in developing countries increased more than six-fold, from 34 to 213 (in industrialized countries from 49 to 112). Baghdad itself underwent the same process.

9. This flood of immigrants - to survive - started to set up and run their own businesses. But the **legal systems in developing world have failed to cope with this gigantic entrepreneurial explosion**. That failure has produced shantytowns on the outskirts of city in the developing world.

10. In country after country in the developing world, **the obstacles to obtaining legal titles defeat most of the poor**. In Lima, Peru, for example, to get all certifications required to operate, according to the letter of the law, the garment workshop with only one worker, it took 289 days of bureaucratic hurdles, 6 hour a day. The total cost of legal registration was \$ 1,231 – thirty one times the monthly minimum wage. In Egypt building a legal dwelling on former agriculture land required 6 to 11 years of bureaucratic wrangling. This explains why 4.7 million Egyptians have chosen to build their dwelling illegally. In Baghdad, formal procedures also discourage most of newcomers. Throughout the third world countries the newcomers settle in the ever growing cities, they set up their businesses but their property is extralegal, outside the formal, legally registered economy.



Shantytown in Cazuca  
Colombia

11. **THE FIRST RESULT – third economic revolution produced the huge amount of property in hands of poor. But this is the extralegal property**, both in real estate and in production assets. E.g. in Egypt, the assets of the poor, (only real estates), total \$ 240 billion - 55 times greater than the value of direct foreign investment over the past 200 years, including the cost of the Suez Canal and the Aswan Dam. 92% of Egyptian city dwellers have extralegal housing. In the whole Middle East and North Africa around 86% of urban dwellings are informal or extralegal. In turn, extralegal property in the industry, trade, and services delivers significant share of unofficial output. Many surveys assess these figures in so called transition economies in the range between 10 and 60 per cent. In Turkey unofficial economy is estimated as high as US\$ 55 billion, or between third and two-third of the economy. In North Africa (Algeria, Morocco, Tunisia, Egypt) informal sector employes 48% of the whole non-agricultural employment. Contribution of extralegal sector to GDP in some North Africa countries reaches the level 39-45 per cent (Tunisia and Morocco) The similar situation is in all developing countries. **So, the poor are, in fact, not so poor.**

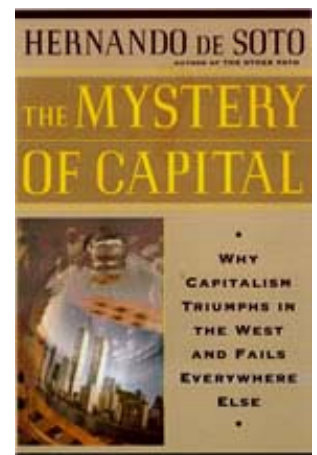
12. **THE SECOND RESULT – this property, however, is dead capital**. Because the people don't have legal title to their land, homes, or businesses, they can't use them as collateral for loans. They cannot raise the capital, often can't get services such as

water and electricity. And if they do accumulate any wealth, they're vulnerable to shakedowns by the authorities. Because of this risk, they cannot enjoy the economy of scale. They must limit themselves to small size businesses. Any contractual relationships are difficult to set up when ownership is unclear.

13. **The capitalism cannot succeed without local capital** - and therein lies the rub. Global capitalism's orthodox remedies - balanced budgets, free trade, foreign investments, and stable currencies – are necessary but they are not everything. Although they can aid economic growth, local development is decisive for success. But local development founders in most poor nations because a critical catalyst, local capital, is missing. Property rights remain primitive, and what little the poor do have (assets such as huts or small businesses) cannot be used as capital to propel economic growth
14. **The conclusion – to animate dead capital.** The challenge of economic development is not to facilitate a redistribution of the wealth from the First World to the Third World, but finding a means of integrating the wealth that already exists in the Third World – and is already widely spread among the population – into the formal legal systems and thereby into the global economy at large.
15. There is no legal vacuum. Property of the poor is governed by the law, but it is not formal, legal system of the country. The squatters' rights prevail. Many attempts to integrate extralegal property into formal legal systems which neglected existing squatters' rights failed. **What needs to be done is to give full legal protection to the *de facto* property rights that are observed informally by the (typically poor) people now living beyond the formal law.** In other words, turning squatters into mini-capitalists by giving people legal title to what they already consider theirs.
16. De Soto explains how the **U.S. did exactly that in the 19<sup>th</sup> century**, when Congress and the Supreme Court grudgingly granted property rights to squatting settlers and gold prospectors.
17. Also in the 20<sup>th</sup> century Americans proved that they know how to counteract polarization and trigger economic development. **After World War II, General Douglas MacArthur and the new Japanese government deprived the feudal-military establishment of its constituents by replacing a feudal legal system with a property-based law that protected individuals, including the poor.** That change was instrumental in making Japan's phenomenal economic growth possible. America likewise helped Taiwan create a new prosperity through the Joint Commission on Rural Reconstruction and acted similarly in South Korea
18. Implementation of the idea of **DEAD CAPITAL ANIMATION** consists in: *(based on the program of Institute for Liberty and Democracy (ILD) of Hernando de Soto's)*

- **Understanding that the Institution of Property is the Hidden Architecture of Capital**

It is necessary to create property systems by representing assets in standardized and universally accepted records. Next, it needs to make sure that beneficiaries of property programs



are also in a position to access the instruments that store and transfer the value of their assets, such as shares of corporate stock, patent rights, promissory notes, bills of exchange, and bonds. Finally, to design the property system so that addresses can be systematically verified, assets described according to standard business practices, people can be made to pay their debts, and authors of fraud and losses can be easily identified in an expanded

**It must be a comprehensive program for reforming property institutions in developing nations with the aim of opening them up to the majority of the population,** thus solving the underlying causes of transition failures and the rise of extralegal market

#### *○ Bringing the Poor and their Customs into Center Stage*

The problem with many property reform programs to assist the poor is that they are carried out as if reformers were landing on the moon. They presume that the poor have no property, and all they have to do is fill this vacuum with mandatory law. In most countries, however, the poor already own a huge amount of property - houses, businesses, vehicles. But they own these assets outside the official legal system

**It is necessary to build a property system that is rooted in these extralegal social contracts,** to build a legal and political structure, a bridge, so well anchored in poor people's own extralegal arrangements that they will gladly walk across it to enter a new, all encompassing property law that will connect them to the market economy and to capital

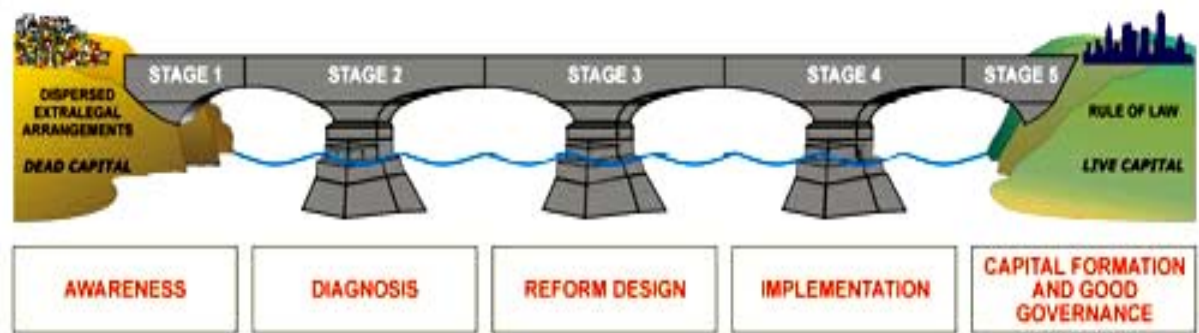
#### *○ Making the Head of State the Champion of Market Reforms —and the Poor*

Most programs in the developing world are purely technical endeavors, contracted by lower echelon government surveying, mapping, and recording organizations. Such home-grown, low-level bureaucratic efforts are in no position to achieve the kinds of reforms necessary to make a market economy work.

The route to an enduring pluralistic market economy is bringing the poor and their assets inside the formal economy, thereby reducing poverty, corruption and black markets - while increasing government revenues. In order for any government to commit to a decision as far-reaching as **creating a market-based system by reforming their property institutions is a giant political undertaking that requires the unflinching support of the head of state.**

19. The Institute for Liberty and Democracy (ILD) has the implementation program for the transition to the rule of law and inclusive capitalism. The ILD Program consists of

five stages:



### ✚ Awareness

**ILD gets an invitation from a head of state** of a developing nation and prepares for the him a customized presentation explaining how replacing huge extralegal markets with an inclusive property system will help to resolve the nation's most fundamental economic and political problems

### ✚ Diagnosis

**The political leadership is provided with a diagnosis of the size and nature of the country's extralegal sector** along with hard information on what is wrong with the present legal system and why its citizens prefer to stay outside it.

In this respect the first task is to identify the feudal, tribal, or black market organizations, and the extralegal rules that they have created to organize themselves and that they are willing to respect. With that information in hand, we can design a legal capitalist property system that consolidates the meaningful aspects of the disparate and dispersed extralegal arrangements into one codified system that they can relate to.



### Reform Design

ILD legal experts are skilled at drawing up a deliberate plan for statutory nations to make the transition from a feudal, tribal or patrimonial system to a market economy. They **can identify, define, consolidate, and codify the rules of the disparate and dispersed extralegal arrangements that govern extralegal markets and then use them to build a legal capitalist property system.**

With an ILD diagnosis, ILD experts can completely redesign any national legal system in such a way that those working outside the law will choose to enter the system freely with a minimum of resistance from official bureaucracies and the formal private sector.

Redesigning for example business registration procedures may encompass:

- ✚ cutting unnecessary procedures and fees (e.g. Bolivia)

- ✦ single registration form and single registration number (e.g. France, Finland)
- ✦ statutory limits on response time (e.g. Vietnam, Armenia)
- ✦ "silence is consent" rule (e.g. Italy, Bulgaria)
- ✦ one stop shop (e.g. Latvia)
- ✦ internet information (e.g. Venezuela)
- ✦ eliminating court and notary involvement (e.g. Honduras and Nicaragua)
- ✦ reducing or eliminating capital requirements

### ✦ Implementation

With the new legal framework in place, **an organization is created to implement the program to bring extralegal real estate and enterprises progressively into the new legal order** through a national formalization campaign

### ✦ Capital Formation and Good Governance

The ILD will formulate and help implement recommendations for relating newly legalized property to larger national and international market opportunities, so that property can be leveraged to generate additional wealth, create capital, and achieve sustainable development.

21. At the end it is necessary to state that dead capital animation is not to replace macroeconomic reform in developing countries like e.g. Iraq. Both programs are of equal importance.
22. Although this paper has presented methods of dead capital animation developed by Hernando de Soto and his ILD, it must be said that many other organizations deals with the problem of converting extralegal (informal, illegal) economy into the official one

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