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Introduction

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India's economic reform program has focused almost exclusively on improving the macro-economy. As a result, there has been **inadequate attention to the pressing issue of institutional reorganization and law reform.** Unless these are undertaken, **India will not be able to achieve its target of 8.5 per cent GDP growth per annum.**

Legal reform would comprise of two elements: firstly, repealing or modifying central and state statutes and, secondly, rationalizing subordinate government orders, rules and regulations. Judicial -- or procedural law reform -- is also crucial. In India's current judicial system, a typical case takes up to twenty years to be adjudicated.

• How Has India's Legal System Changed since 1991?

There are currently 3, 500 Central statutes, the first of which was passed in 1836. Many are dysfunctional. Since 1991, some **340 Central statutes have been repealed** thanks to the Jain Commission.

At the State level, the list of laws is not even available. Similarly, almost **no reform has occurred in the area of suboordinate administrative law.**

The **Supreme Court has dramatically reduced its backlog** of cases to 20,000 and lower level courts have, similarly, been successful in dispensing with their backlogs. In the High Courts, on the other hand, there is a backlog of 3.5 million, and it is increasing.

In 1996, a new Arbitration Act was passed. There are now several Lok Adalats. A new Civil Procedure Code and a new Criminal Code was also passed. As a result of these changes, there are now 1734 "fast-track" courts.

Law's Dangerous Evolution

Dietmar Doering
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Abstract: *While law was intended to protect the individual and underpin a free society, it has become increasingly politicized. As a result, law is now an expression of what those in power think. It is not the expression of the real needs and wishes of civil society..*

Non-governmental organizations have played a key role in politicizing the law-making process, by subverting it to social engineering objectives. Law is now a long way from what it was originally intended to be – an agreed set of rules that governed societal transactions, facilitated economic activity, and required minimal interference by Government.

The law-making process could be significantly depoliticized by introducing legal decentralization, direct democracy on specific issues, and privatized dispute setllement..

The topic "Law as a Constraint to Development" would have puzzled Europeans or Americans living two or three hundred years ago, when modern law was evolving. **Law was intended to be the underpinning of a free society and the expression of moral principles.**

- ## Common Law: Rules Made By the People, for the People

Law made each individual into an independent person, or somebody who possessed him or herself. The legal organization chosen for the expression of this concept was the common law. **Common or customary law was inherited, not legislated**. For example, in Germany the early legal textbooks were not compiled by a ruler or by the Government but by citizens and was based on customary practices. The law was made by courts, not by legislators

The key objective of customary law was to enhance the effectiveness and efficiency of person-to-person interactions. It laid out rules of behaviour that served the interests of both people in a transaction of a dispute. Common sense principles and juries were used in judging the case.

When it came to creating a civil society in the 19th century, civil law courts picked up customary law and condensed them into written law. Civil law courts most often just picked up customary merchant law. **The idea was that law should not be a constraint, but should generate self-regulating processes.** For instance, laws about how to create shareholders' companies did not need constant intervention or subsidy by the legislator. **These laws created growth and economic welfare by themselves.**

A good example was in Prussia in 1869, there was a law on "cooperatives and mutualities". This was based on **people's idea at that time that we do not need the state to create welfare, we do not need redistribution, for it would have a demoralizing effect on society.** It recognized that not all people could help themselves, but could do so if they would associate. The law on cooperatives and mutualities gave legal form to this idea. It introduced the concept of limited liability, for instance, so that working class people who organized it were not constantly facing financial ruin joined in a cooperative.

- ## Legislated Law: Rules Imposed on the People, By Politicians

Today, most people would ridicule the idea that law should be made by courts. Most law is legislated by politicians. It does not relate to the behaviour of individual parties involved in a dispute, but is a function of who is in control of the legislation process. **Law is made by the Government and is passed by those in power.**

Legislation today does not fulfil the real needs of a civil society. It only pretends to do so, for all laws are imposed from above.

Law arising from tort cases is an exception, but there is no pure common law system anywhere today. American law-suits **can be quite nonsensical**, moreover. The New York Subway, for example, allocates close to US$50 million a year to fight law suits. In another example, an American toy company producing Batman outfits for children was sued and is now compelled to print "Cape does not enable user to fly" on every costume.

However**, even legislated law can be based on principles that are compatible with a free society.** In the 19th century, constitutional law was the framework within which legislation took place and served very much the same function that law originally did.

- ## Non-Governmental Organizations Are Politicizing Law-Making

Today, **non-governmental organizations are the successors to the cooperative and associative arrangements seen in Europe in the 19th century**. This is because most cooperatives have become part-and-parcel of the local administrative or governmental machinery. As a result, non-governmental organizations of all sorts **claim to represent civil society.**

At the same time, **law has become very politicized**. It is now **used for socially engineering or reforming society**. This type of politicized law **is not compatible with an open society**, however, for it sets certain goals and excludes others.

Non-governmental organizations are today very engaged in the legal process. They often get funds from Government, which means that their aims may be distorted, since

they may adjust their own goals in order to get funding. They may create certain popular tendencies or, as in the case of the environment, certain panics. Many live by the political process they have created, and are an engine for legislation. You see this particularly at the international level, where legislation is still in an almost unborn state and has not been developed.

Internationally, non-governmental organizations are using sovereignty for social engineering. In Bosnia, for instance, **non-governmental organizations have succeeded in introducing practices they would never dare to in their own countries**. Among these is the new women's quota in the Bosnian Parliament. This was not an idea floated by the Bosnians, but was imposed on them by international non-governmental organizations.

- ## How Can Modern Law Making Be Depoliticized?
    - **Decentralization - Decentralizing the law making process would create competition among a country's various machineries**. For instance, if one state or local government is creating more effective and efficient law than others, it would draw more economic activity or create a better living environment. This would put pressure on other states or legislative bodies to design better law. Germany has a legislative system, combining legal decentralization with federalism. However, it must be said, that decentralization will not necessarily result in better law.

    - **Transparency - Introducing direct democracy on specific issues or in certain areas would represent real civil society.** It would make the key political issues and the law-making process more transparent, and ensure that it is not only the most highly organized and directed groups that win. The drawback of a parliamentary process is that interest groups pretend to represent real civil society, when they do no.

    - **Privatization of law - This involves disputants setting up their own independent mediation arrangements.** Although it is a radical idea, it is already happening on the ground. In Europe, for instance, insurance companies settle most of their disputes out of court, to save themselves the three-year wait. German liberals are making proposals to strengthen this process, within a state framework. They want to revive the system in which people representing both parties make an agreement and register it. Such a "registered dispute resolution" system could bring down legal costs enormously and restore law to its original intention.

To conclude, **it is important to find ways by which to diminish state power in the law-making process and reduce regulation**. As the French economist, Frederic Bastian said, " The state is a great fiction where everybody tries to live at the expense of everybody".

Law and Economic Reform in India

S. Chakravarthy
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Abstract: *India's static system of law is posing a severe impediment to the economic reform process. While law should adapt to facilitate a country's changing economic objectives, in India it does not. Moreover, protracted legal procedures are stymieing important investment proposals. Similarly, the Judiciary has tended to get unnecessarily involved in the politics of the reform process and to further stall progress*

However, in two recent landmark judgements, the Supreme Court has ruled that the Judiciary is not to interfere in the economic reform process, since it reflects the democratic will of the people. This will considerably alter the framework for ongoing reform in India.

Since Independence in 1947**, the economic philosophy of the Government of India has been that of `LPG'.** While, until 1991, LPG stood for Licensing, Planning and Government Control, it now stands for Liberalization, Privatization and Globalization.

• Law is Posing a Constraint to Economic Reform in India…

While laws should be subservient to the economic goals and philosophy of a country and adapt to changing realities, in India they are not. In India, it is the law that dictates the pace and direction of economic reform, rather than the other way around. **The philosophy that law should serve economic reform is not yet accepted in India.**

• …But the Supreme Court is Smoothing the Way

However**, two recent landmark judgements by the Supreme Court have significantly altered the relationship between law and economic reform** in the country**.** They have affected the interface between the Judiciary and the Parliament, and have delineated the correct ambit of law-making for the Executive. These two rulings relate to the

- **Bharat Aluminium Company (BALCO) disinvestment -** In this case, the Supreme Court ruled that the judiciary should not interfere with economic reform, unless it has been prompted by fraud. Since India is a democracy, the reform process represents the will of the people It is the first time that the Indian Supreme Court has desisted from pronouncing judgement on whether a particular government policy is right or wrong.

- **The Contracts Act --** The Supreme Court overturned the Act's earlier stipulation that a company, outsourcing activities to contractors, must absorb or regularize them. This ruling was a major *volte face* from existing Government policy.

• Courts Must Be Held Liable For Delays

The continuing delay in courts' processing of cases is particularly worrisome, for it is costing the country dearly. This is clear from the Cogentrix case. After the company signed its contract with the Government, someone filed a case against it. The court hearing was protracted and, after that, it took a year for the court to make its ruling. The foreign collaborator found the wait too long, and the project fell through.

India needs to devise a system by which to hold judges, lawyers, or others directly accountable for such delays. If the legal process is too protracted, desired investors may pull out. Moreover, Parliament and the Executive cannot act until the court decides.

This is particularly pressing, for 8 public interest litigations have already been filed on various disinvestment decisions by the Government. This is over and above the BALCO case. More than half of these cases relate to the disinvestment of ITDC hotels. Disinvestment cannot move forward until the courts makes a ruling in each case.

In India, as far back as 323 B.C., Kautilya said, "When a judge threatens, browbeats, sends out or unjustly silences any one of the disputants in his court; if he does not ask what he ought to be asking or asks what ought not to be asked, makes unnecessary delay in discharging his duties and giving decisions, makes the parties leave the court by tiring them with delay, evades or causes to evade statements that lead to the settlement of the case, he shall be punished and fined". Yet, two thousand years later, India is still not able to impose such standards on our judges and courts.

• What is the Role of Law?

Through history, various thinkers have outlined the role of law. Roscoe said, "Law must be stable, but it must not stand still. It should change". Cicero said, "The good of the people is the chief law". Oliver Goldsmith, "Laws grind the poor, and the rich men rule the law." Similarly, the word jurisprudence comprises of "juris", or law, and "prudence", or foresight. For law to be effective, it must be implemented with foresight.

Law must evolve to keep pace with economic reforms. For instance, economic competition had a certain shape in India until WTO. Now, with the pressure to reduce tariffs and prices, **India needs a revised competition law**. This is because competition from cheaper imports may make domestic producers less competitive in the market. While, until now, the Monopolies and Restrictive Trade Practices Act governed

competition in the Indian economy, it is now obsolete. Competition law needs to reflect this reality.

- **Unsolved dilemmas**

In India, **there is often an antagonism between the legislature and the judiciary,** which blocks governmental action. There are, for instance, cases in which the judiciary has ordered the police to arrest a corrupt parliamentarian. The Parliament threatens the police that an arrest would amount to contempt of the Legislative. Yet, non-arrest would be contempt of the Judiciary. So, the police is caught in a bind? As yet, India has found no effective solutions to such dilemmas.

Similarly, judicial activism has tended to get in the way of economic reform. While public interest litigation is intended to help the poor, it is most often used to stall Executive decisions. In other words, the ambit and the scope of the judiciary is activated in such a way that judges go beyond what they are supposed to do. Here too, no solutions have been found to balance conflicting concerns.

Finally, it is vital that law must `defoliate' from time to time – as trees and snakes do. Only in this way can it revitalize itself. In India, sadly, law tends to stand still and become obsolete.

`Good' Law Versus `Bad' Law

Leon Louw
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Abstract: *Developed countries are beginning to look closely at the processes by which they make laws, to ensure that these are effective, cost-efficient and constitutional. It is important that developed countries also adopt such mechanisms, for the societal and economic costs of bad law are very high.*

Surprisingly, not many people involved in the law-making process understand the fundamental role of such institutions as Constitutions, Bills of Rights, and bicameral parliaments. These were all created to act as checks on governmental power. Similarly, not many people understand the difference between common law and legislated law, and how they impact civil society. While common law is an expression of how ordinary people think situations should be handled, legislation reflects what politicians and powerful interest groups do.

In speaking of the law as a constraint, I will look at laws from a technical perspective – that is, **the ways in which laws are actually made**. I have, for many years, researched the diversity of ways in which laws are made all over the world.

I have focused, particularly, on **understanding how those that make the law understand the process and the role of institutional checks and balances within a system**. I have found that, most often, people do not really understand the rationale for complex constitutions, bills of rights, bicameral parliaments, state and provincial assemblies, and local governments.

• How Common Law Is Different from Legislation?

• Common Law

Common law is made by ordinary, everyday people and reflects what they think should happen in a given situation. It is, in Hayek's words, a "spontaneous order" and a consequence of human action rather than of human desire. **It is intuitive and culture-specific.** Common law in Britain is, therefore, completely different from that in Afghanistan or a tribal community in South Africa. Common law arises simply as a result of people living together. What the lawyers and courts do is `discover' the law; they do not make the law.

Common law is dynamic, rather than static, and evolves over time in keeping with values and practices. In South Africa, for instance, adultery used to be a common law

crime. Then, as social mores changes, the courts stopped prosecuting it and, now, it is no longer a crime.

Common law is the rule of law, rather than that of men. It applies equally to all, and leaves no room for the application of bureaucratic discretion. The role of the courts is to discover and interpret what ordinary people regard as law. The role of Government is to ensure that common law is properly enforced. It must ensure that there are good institutions to see to this – such as independent courts, judges, magistrates, and tribunal chiefs with permanent tenure. Thus, they cannot be fired if they make politically unpopular decisions.

- **Legislation**

Legislation includes subsidiary, secondary and derivative law, such as decrees, regulations, directives, administrative procedures and even documents that have to be filled in.

Legislation is different from common law in that it **is a manifestation of power**. **Whoever is in power decides what it will be**. It, therefore, **tends to lead to patronage, privilege, protectionism**. It tends to be **arbitrary and unpredictable**. For instance, the restaurant licensing law in Delhi may change radically next year, depending on who influences the legislative process. Legislation does not change and evolve; it is simply what the law-man says it should be.

Moreover, legislation is often unclear and its interpretation is complicated. This is why people have to employ lawyers. Since legislation also creates discretion, it tends to lead to corruption and abuse. We see this with licensing, for example.

• What Is the Best Way to Make Law?

It is to check these possible abuses of law that democratic constraints and institutions have been created. Firstly, **constitutions dictate the rules of the game. They tell Governments what they can and cannot do.** They require Governments to, for example, hold elections, have bicameral parliaments, establish independent courts with tenure, and separate power between the Executive, the Legislature and the Judiciary.

In most countries, the importance of this separation is forgotten. The Executive tends to make what are essentially judicial decisions and to make laws through regulation.

Bills of Rights cover such things as **`first generation'** or basic, classical rights. These stipulate **what the Government must not do** to its citizens. **`Second-generation**' or pseudo rights stipulate **what the Government must do**, such as providing housing, education, and employment. The problem with second generation rights is that the Government may not have the money to enforce them. We see this particularly in India and South African. As a result, the Government simply cannot do what it is supposed to

do under its Constitution. This is why it may be more sensible to stick to first generation rights.

Nowadays, you are even getting **fourth and fifth generation rights**, which are absurd and essentially fantasy rights. They are completely non-justiciable and unenforceable. For example, many Constitutions say that the Government must secure a safe environment, but how can this be achieved given man's inability to control natural disasters.

Subsidiary, dynamic, static and prescriptive constitutions essentially comprise third, fourth and fifth generation rights.

- ## The `Good' Law Checklist

To make `good' law, three factors need to be considered. Firstly, are the correct procedures followed in making laws? Secondly, are the laws constitutional? Thirdly, do they keep with judicial and jurisprudential concepts?

The South African Government is drawing up **a check-list of what is `good law', so that a legal or judicial commission or government agency can check laws against it**. Many countries have launched a series of interesting initiatives in this direction. In Holland, there is the Quality of Law Academy. In Britain, there is the Regulatory Impact Assessment Unit within the Cabinet. Various countries, such as Australia, have introduced a number of very creative and very good ideas.

These principles **give governments formal mechanisms and institutions by which to check the constitutionality of every single clause and law before it is passed**. For instance, in South Africa's constitution, no law can be passed unless the Government has undergone a participatory process, and its Constitutional Court has already found a law unconstitutional on this count.

Good law is objective and non-discretionary. If the law gives officials a choice as to who benefits, then corruption results. The criteria must be completely clear and universally-applicable. For instance, when licensing taxi operators, everyone who satisfies the same conditions should have the same eligibility. For example, all those with a road-worthy vehicle, which has a permissible level of pollution.

The Free Market Foundation has developed a list of twenty-five principles and sub-clauses that constitute `good' law. These include separation of powers, general participation, universal application of laws, non-discrimination, and non-retroactivity. Legal minimalism is also key, that is, governments should use the least law to achieve a desired objective. The language should be unambiguous, and simple for ordinary people to understand.

Most importantly, laws should be enforceable in the real world. India and South Africa, for example, tend to pass laws that nobody obeys, such as building and health codes. An overwhelming majority of the public thinks such laws are stupid. Moreover, officials do not enforce them, except to intimidate citizens and collect bribes.

The Government must also ensure that the courts are accessible to the common man and the poor.

• Measuring the Costs and Benefits of Law

Many advanced countries are now running cost-benefit assessments of their laws. They now require that **before any law is passed, the Department concerned, an independent government agency, or a private consulting firm evaluates its direct and indirect costs**. These include the implementation cost incurred for the Department concerned, the compliance cost for the private sector, other costs to the Government (such as, what would other Departments have to do to implement the law), and indirect non-government costs. For example, minimum wage laws often have the unintended consequence of increased unemployment.

Governments are also increasingly introducing **mechanisms for monitoring and error-correction** in existing laws.

• Conclusions

Good law-making processes protect people from each other, especially from governments, and are a constraint on power. Good law is certain, predictable and fair, and should be adopted after consultation, participation, and evaluation against formal checklists. It is monitored for unintended consequences, and corrected or abandoned if necessary. Finally, the least amount of law should be used to achieve an intended consequence.

What is important is not what the law ought to say, but that it is made well. Developing countries need especially to create procedures, institutions, principles, and checks and balances to protect against the making of bad law and to foster the creation of good laws.

The Drawbacks To India's Legal System

Amir Ullah Khan
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Abstract: *India has had the tendency to pass new laws to remedy the problems caused by old ones. However, this only creates a greater load on India's severely overburdened legal system. There are currently 30, 000 laws in India, passed by the Central, State and local governments. Similarly, there are 25 million outstanding cases throughout the country, and 20, 000 in the Supreme Court alone.*

While it is relatively easy to pass new law, it is virtually impossible to repeal it. Indian law is also inherently biased against business, which is posing a severe drag on economic reform. Further inefficiencies are India's unique system of differentiated law and of adversarial justice – in which all testimony is oral and lawyers are allowed to argue a case for years.

If India is to achieve its targets for economic and social development, it must now focus very hard on a fundamental reform of its entire legal system.

In the early 1980s, India realized that its legal process was in a mess. The courts were overcrowded -- there were too many cases, too many petitioners, too many lawyers. All the courts, moreover, were right in the centre of town, and were the focus of tremendous activity.

The Government, therefore, set up separate Consumer Protection Courts, outside the existing system and away from the hustle and bustle of the city. In these, legal procedures were to be simple and cases settled within ninety days. Now, ten years later, these courts have become as crowded as traditional ones. It takes complainants about two years to even get the Consumer Protection Court to hear their case.

• India Needs Less, Not More Law

Thus, **legislating away problems – including `process' problems – does not fundamentally solve them.** India has a particular tendency to use more law to address the inefficiencies resulting from earlier ones. The results are clear, as shown by India's experience with Consumer Protection Courts. Fortunately, there is some good news. The total number of cases outstanding in India has dropped from 30 million to 25 million.

• Indian Law is Biased Against Business

Three thousand years ago, the *Arthashastra* said, "All businessmen are thieves and liars." Even today, the law in India is predicated on this assumption. Its basic objective is to protect India's poor and innocent citizens against these `thieves', who will cheat them unless courts intervene. No one considers the possibility that citizens might be able to take care of themselves by applying the principle of `caveat emptor'. As a result, **India now has 30, 000 laws, made by Central, State and local governments.**

- ## Making New Law is Easy, Repealing Outdated Law Is Difficult

In Parliament, laws are made in the following manner. A Member of Parliament tables a Bill. If it is passed, it becomes an Act and is then notified. The process is protracted. Most often, **a game of one-upmanship** ensues**, with various MPs tabling Bills** to outdo each other. We see this **particularly in the case of environmental legislation**. Every ministry has presented an environmental protection Bill, and many of these have become laws.

But what is the danger in such a process of law-making? Laws are intended to evolve and respond to changing needs and realities. In actual fact, **in India law is not dynamic. Once law is made, it becomes religion and is almost impossible repeal**.

Adding to the difficulty is the fact that each law is prefaced with a two or three line preamble, espousing a noble objective, such as protection of the poor, or of the girl child, and so on. Anyone who seeks to overturn a law, therefore, is perceived as questioning its very noble basis.

This is a serious issue. Every new law that is passed in India presents one more document that will never get repealed. **The only time that India has repealed laws in the last fifty years is when the British left.** Even then, while 350 laws were repealed, the other 3, 000 were left standing.

This vast body of enacted or inherited legislation is putting great pressure on our judiciary. There are currently 25 million outstanding cases throughout the country, and 20, 000 cases in the Supreme Court.

Computerization has dramatically reduced the number of cases in the Supreme Court. In addition, each judge heard up to 80 cases a day, which gives cause for concern. Since judges work an effective three hours day, each case was probably heard for just two or three minutes. **Despite the Supreme Court's achievement in dramatically reducing the number of cases, it is somewhat worrying that such detailed cases -- questioning the essence of law and involving millions of rupees – were so summarily heard.**

- ## India's Adversarial System of Justice Is Inefficient…

Another problem in India's judicial system is its unique, adversarial system of justice. The judge serves as the audience to the arguments of the two lawyers, and is not supposed to

interfere in this process. The principle is democratic – that is, since most Indians cannot write, they should be allowed to talk. Moreover, the assumption is that if people are allowed to argue, the truth will eventually out. This is why **Indian judges allow oral arguments to go on for fifteen or twenty years.**

• …As Are the Differentiations in Indian Law

Lastly, Indian law has a strange peculiarity. **Despite being founded on principles of equality and egalitarianism, Indian law differentiates between varying groups of people.**

For instance, labor laws have one set of stipulations for those who earn more than Rs 3,000 a month, and another for those who earn less. Similarly, there are different laws for `labour' and for `managers'. Moreover, only factories employing over 20 workers must have toilets, those employing over 50 must have canteens, and those employing over 1,000 must have creches. Such **differentiations in the law enable government officials to arm-twist citizens and results in tremendous corruption.**

• India Must Now Focus on Legal Reform

The law is serious business. Having liberalized, India must now focus on reforming its system of law, for it is posing a tremendous constraint to economic development. Law reform has, so far, been tremendously neglected. **What is needed to galvanize the reform process is good law, simple law, and little law.**

The only contribution made by India's present convoluted system of law is in defusing political tensions. The Government, for instance, defused the Babri Masjid issue by asserting that it could not take any action until the courts decide. Fortunately, the courts have still not decided.

Property Rights: Unlocking The Assets of the Poor

Ian Vasquez
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Abstract: *In developing countries, excessive bureaucracy and Government control have pushed the poor out of the formal economy. As a result, the poor – who operate in the informal economy -- have no legal title to the assets they own, whether it is their businesses, their houses, or their land. This lack of property rights severely impedes the poor from accumulating capital and moving out of poverty.*

By giving the poor formal title to their wealth, governments can unlock its vast developmental potential. The informal assets of the poor in developing countries greatly exceed the value of aid and foreign direct investment flows. Legal reform, including the reduction of bureaucracy and the introduction of property rights for the poor, is far more effective than economic reform in ending poverty.

A Nobel Economist once wrote, "Economics, over the years, has become more and more abstract and divorced from events in the real world. Economists, by and large, do not study the workings of the actual economic system, they theorize about it." An English economist said, "If economists wished to study the horse, they would not go out and look at horses. They would sit in their studies and say to themselves, "What would I do if I were a horse?"

Similarly, in every developing country, there is a huge gap between the law – or the policies, rules and regulations that govern the land -- and the way that people actually live. **For the vast majority of people, namely the poor, the cost of legality is prohibitively expensive.** As a result, the poor opt to operate in a huge informal economy and to keep out of the purview of the state. In India, for instance, 80 to 90 per cent of the population is estimated to work in the informal sector.

• Why Is the Informal Economy So Large in Developing Countries?

It is the size of the informal economy that is a key differentiator between rich and poor countries. **The dominance of the informal economy in developing countries is an indicator that something is wrong with their legal systems.**

The reasons for the large informal sector in developing countries are a) bureaucracy and b) the lack of private property rights.

- **Bureaucracy**

In the 1980s, the Peruvian economist, Hernando de Soto, and his team of economists did a well-known study of all the procedures required to legally set up a business and, so, be part of the formal economy. They attempted to set up a garment shop employing one person. The rule was not to bribe anybody along the way.

They found that, everyday, they had to spend six hours waiting in line to fill out the necessary forms and to get the required licensing. It took them two-hundred and eighty nine days to open the shop. Despite their resolve, they were forced to bribe one or two officials along the way. If not, they would not have received the permissions necessary to open the shop. The total cost of legally setting up the business was US$1, 231 – or thirty-one times the minimum monthly wage.

It is obvious, therefore, how prohibitively expensive the law in Peru is. Moreover, De Soto's team found that it took six years and eleven months, fifty-two visits to Government offices, and two hundred and seven steps of bureaucracy to build a house on Government land.

We see the same pattern in most developing countries. A recent study by the United States' National Bureau of Economic Research did such a comparison. In Canada, it takes just two days, two bureaucratic procedures, and US$280 in fees to open a simple business. In Bolivia, by contrast, an entrepreneur must pay US$ 2, 696 in fees, wait eighty-two business days, and go through twenty procedures. In Hungary, he or she must wait fifty-three business days, go through ten procedures, and pay US$3, 640 in fees.

In virtually every sector of the economy, from housing to food to transportation, this heavy bureaucracy pushes people out of the formal economy. In Egypt, 92 per cent of urban housing and 83 per cent of rural housing is informal;. in Haiti, the corresponding ratios are 68 per cent and 97 per cent.

- **The lack of property rights**

As a result of being pushed out of the formal economy, poor people do not have legal title to their housing, their businesses or their land. The private property rights of poor people are not legally recognized by the state in every developing country. Yet, private property is essential to a modern economy and to modern government. In Peru, for instance, 70 per cent of poor people's property is not recognized by the State.

This lack of property rights, which the elite in developing countries enjoy, **puts severe limits on the ability of people to create wealth**. For, without property rights, people are not able to use their property as collateral in getting loans, obtaining insurance, or for long-term planning. The absence of property rights breeds economic insecurity, inefficiency and low productivity in the informal economy. The poor are compelled to borrow money from friends, relatives, or money lenders at high interest rates.

One of the most important functions of property is collateral. In the United States, for instance, 70 per cent of credit to new businesses is awarded on the basis of titles to

property. Formal titles to property also have other functions. They help establish credit history. Similarly, they facilitate the setting up of public utilities, since those who own property generally have clear addresses.

Thus, the function of property rights extends beyond mere possession and helps in the creation of wealth.

- ## The assets of the poor surpass the value of global aid flows…

Hernando De Soto also found that the poor are not actually poor and have tremendous savings. He calculated that **the value of all the assets that the poor own globally is equal to forty times the value of all foreign aid since 1945.**

In Peru, for example, the extra-legal real estate sector is worth US$74 billion – or fourteen times the value of all the foreign direct investment it has received in documented history. In Haiti, the assets of the poor are one hundred and fifty times the value of the foreign direct investment it has received since the early 1800s. De Soto calculates that **if the United States were to increase its foreign aid to developing world, as per the stipulations of the United Nations, it would take one hundred and fifty years for it to transfer the same value of resources already held by the poor in these countries.**

- ## …but the lack of property rights prevents their full utilization

There is, therefore, a tremendous amount of wealth waiting to be unlocked in developing countries, but the poor just do not have the institutions to allow them to participate. India is a very good example of this. A recent McKinsey report found that the real estate market is so distorted that it is actually reducing the growth of the Indian economy by 1.3 per cent. This is probably understated because it does not take into account all the ways in which property titles contribute to growth.

This slowdown is tremendous, when compounded over time. The Harvard University economist, Robert Barrow, studied the importance of small increments in GDP growth. He showed that the United States grew at a rate of 1.75 per cent from 1870 to 1990. If it had grown just 1 percentage point faster, the United States would today have had a per capita income of US$60,000, or three times the estimated actual rate. Conversely, if growth had been just 1 percentage point slower, the United States level would today have the same level of wealth as Mexico.

- ## Legal reform is the pre-requisite to ending poverty

The current legal framework in many developing countries is, therefore, imposing a tremendous growth constraint on their economies and on their people.

The results of titling property have been impressive, although few countries have yet taken the initiative. In Peru, one of the first countries to take steps in this direction, new businesses have been created, production has increased, and asset values have increased by about 200 per cent. Credit is now flowing to areas and activities, which it earlier avoided.

So, ending what amounts **to legal discrimination against the poor is the most important social reform** that any country can do**. It is not enough to just reform economic policies** – that is, to open up to trade, investment, end inflation, and do what India and other developing countries have been doing over the past ten years. Institutions matter, and may, in fact, matter even more.

This is actually good news for poor countries, who are always told that the reason they are poor is due to reasons beyond their control. In particular, the `cultural' argument is very fashionable – that is, that developing country culture is not compatible with a forward looking, hard-working and wealth-creating type culture.

Yet, the reality is different. All around the world, the poor have essentially rejected this cultural argument – they are entrepreneurial, they are hard-working and they have built up a tremendous amount of assets. **The poor, in effect, have rejected the paternalistic state for a popular embrace of capitalism.** So, **the Government's role should be to allow the poor to fully participate in the capitalism they started to introduce over the past 10 years.** If they do not, there will be a continuation of the `swing' pattern of economic development, in which Governments first open their economies and then close them, when capitalism has not delivered on its promises. This pattern is particularly marked in Latin America.

What has never been seen is **a system that protects the property rights of the poor**.

All developing countries can learn from the experience of rich countries in this regard. While they have focuses only on macro-economic, they have tended to ignore the institutional histories of rich countries, especially the private property laws of rich countries.

It would be fruitful for developing countries to study the institutional evolution of the United States and Western Europe. Just 150 years ago, these countries' property rights systems looked very much like those that prevail in developing countries today. They had messy pluralistic legal systems, in which there were contending claims on property. This was particularly the case in the United States West. Over time, a centralized property rights system emerged that everybody recognized, and that secured the property of the poor.

- **Introducing property rights for the poor**

How should poor countries get around to introducing these legal systems? The first step is to **reduce bureaucracy – particularly, the ability of government officials to exercise discretionary power.**

The second is to begin to introduce property rights for the poor. Many consider that this will be unduly difficult. But, in fact, there are ways of doing it. People have devised ways by actually looking at how people live in communities. In most communities, people will know to which family or individual a cow belongs, or where one property ends and another begins. De Soto points out that even dogs will start to bark if someone crosses from the neighboring property into theirs.

So, **for the state to formalize these informal property rights, it has only to observe how poor people actually live and how they resolve their conflicts.** Most often, they do not go to the courts but find other mechanisms of settling disputes. In other words, the **legal system must move away from `imposing' law to `discovering' law**, and be based on real-world practice. In this way, by formalizing the economy, one is also formalizing the legal sector.