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the annual Proceedings of the wealth and well-being of nations
Introduction

Emily Chamlee-Wright

As the Elbert Neese Professor of Economics, it is my privilege to introduce the second Annual Proceedings of the Wealth and Well-Being of Nations.

Under the banner of the Miller Upton Programs, the department of economics and management at Beloit College has developed an ambitious initiative to advance understanding of the ideas and institutions necessary for widespread prosperity and human development. The centerpiece of these programs is the annual Wealth and Well-Being of Nations: a Forum in Honor of Miller Upton. Every fall, the Upton Forum brings to Beloit College a distinguished, internationally recognized scholar who works within the classical liberal tradition. The Upton Scholar engages with students, faculty, alumni, and civic leaders in an informed dialogue around the nature and causes of wealth and well-being. In 2009, we were honored to feature Hernando de Soto, president of the Institute for Liberty and Democracy (ILD) as the second Upton Scholar.

Alongside our Upton Scholar, we featured leading researchers whose work complements the work of Mr. de Soto and the ILD. We assemble this cadre of scholars to demonstrate that the intellectual enterprise of understanding the nature and causes of wealth and well-being is an ongoing project. The essays collected in this volume capture in written form many of the ideas exchanged, challenges posed, and questions considered during the Upton Forum and over the course of the academic year.

Before introducing the substance of the contributions made within this volume, let me say a few words about the man for whom the forum is named. R. Miller Upton was the sixth president of Beloit College, from 1954–75. A nationally recognized leader in higher education, President Upton was known to harbor two intellectual passions. The first was a steadfast commitment to the liberal arts. He believed that the small residential liberal arts college was the ideal place to engage the “great questions,” as it is here that students are expected to acquire the intellectual habits necessary for critical thinking and open civil discourse. His second passion was for the ideals of the liberal society: political freedom, the rule of law, and the promotion of peace and prosperity through the voluntary exchange of goods, services, and ideas. He understood that transforming the ideals of liberal democracy into real institutions was at the heart of increasing the wealth and well-being of nations and peoples. We believe that the Upton Forum represents a confluence where these enduring passions meet.
Let me now formally introduce the 2009 Upton Scholar, Hernando de Soto, president of the Institute for Liberty and Democracy in Lima, Peru. Through their research of the “extralegal” or “informal” economies of the developing world and post-Soviet countries, Hernando de Soto and his colleagues at the ILD have become leading voices in economic development circles. The principal aim of the ILD is to identify the assets of the world’s poor and to design reform strategies that move those assets from the extralegal sector to an inclusive market economy. By “inclusive market economy,” I mean one that is governed by secure and defensible property rights, a legal climate conducive to entrepreneurial initiative, innovation and growth, and systems of identification and documentation that enable business people and property owners to signal others unknown to them the value of their enterprises, their credibility in contractual obligations, and their worthiness to secure credit and financial investment.

To understand the significance that Mr. de Soto’s work has had in the professional discourse on economic development, we must go back to the post-World War II period when the West began turning its attention to improving the economies of lesser-developed countries through international development organizations such as the World Bank Group and the International Monetary Fund. The dominant thinking among economic development theorists and policy makers from the 1940s through the 1960s was that poor countries would be lifted out of poverty if we could replicate the West’s Industrial Revolution in the developing world. The thinking at the time was that a crucial factor was missing if such progress was to be realized. It was assumed that there was no entrepreneurial force robust enough to drive economic progress in the developing world. Governments could create prosperity, so the thinking went, if they filled the so-called entrepreneurship gap through sector-wide development planning. And despite abysmal results in terms of economic stagnation and decline, inefficient state-owned enterprises, and widespread public corruption, policies favoring heavy-handed state control of the economy persisted into the 1970s. It was in the mid-1970s that frontline development organizations started to take notice of entrepreneurs operating in the informal sector as the primary mechanism by which poor people met their day-to-day needs and often improved their material conditions.

But academic economists were still skeptical. While it was a “quaint idea” to study the quaint habits and operations of quaint indigenous entrepreneurs, surely such activities, most economists assumed, represented only a small piece of the overall economy in any given country and were thus hardly worth the attention of any serious economic researcher. Enter Hernando de Soto. In 1988, Hernando de Soto published The Other Path, in which he describes in meticulous detail the economic vitality of the informal sector. Through extensive field work, de Soto and his team of researchers estimated that nearly 40 percent of Peru’s gross domestic product was created and exchanged within the informal sector. This was accomplished by entrepreneurs who were operating outside the official legal framework, without legal title to their
property, and without documentable evidence of their business operations. And the size of the informal sector and its significance to the overall Peruvian economy was growing rapidly.

At first blush, such an account might suggest that 40 percent of Peru’s economy was chaotic, if this vast informal sector was operating outside the official legal framework. But far from being a lawless or norm-less context, the informal sector had developed its own systems of informal property, contract, dispute resolution, and other institutions of social coordination.

Mr. de Soto’s research also helped us to realize that while most people operating within the developing world have assets—in the form of land that they cultivate, houses that they build and occupy, equipment that they use in production, and businesses that they develop—these assets are often held in defective forms. Poorly defined systems of property mean that ownership cannot be conveyed beyond the local sphere. Further, legal barriers regulating and limiting entry into industries as basic to day-to-day existence as food processing, transportation, and construction drive the entrepreneur underground, cutting him or her off from potential clients, suppliers, creditors, and investors. De Soto coined the phrase “dead capital” to refer to assets that cannot be effectively leveraged into productive capital because of poorly defined systems of property and legal frameworks that limit the size and scope of business ventures.

In his book *The Mystery of Capital*, de Soto catalogues the hurdles that a typical person must overcome if he or she is operating in the extralegal sector. At the time of the publication of his book, De Soto reports that in the Philippines, acquiring legal title to land could take anywhere from thirteen to thirty-five years and could include 168 discrete bureaucratic steps involving fifty-three different agencies. In Haiti, before land could be purchased, one would have to first lease it from the government for five years. This would take 65 discrete steps and approximately two years. To actually buy the land would require another 111 bureaucratic steps and an additional twelve years (de Soto 2000, 34).

In 2000, when *The Mystery of Capital* was published, de Soto estimated that the total value of assets held but not owned in the developing and post-Soviet worlds was $9.3 trillion. At the time, $9.3 trillion was twice the total U.S. dollars circulating in the money supply, nearly as much as the value of all the companies listed on the main stock exchanges of the world’s twenty most developed countries. Additionally, $9.3 trillion was twenty times the total direct foreign investment into all developing and former communist countries from 1989–99, forty-six times as much as all the World Bank loans of the previous thirty years, and ninety-three times as much as all development assistance from all advanced countries to the developing world in the same period (de Soto 2000, 35).

If the international development community was going to help countries realize the potential of all this dead capital, the approach would have to shift from one that focused only on resources that could be brought in from the outside to an approach that focused on tapping the potential of resources that were already there. Realizing this potential would require reform processes that scaled up titling and scaled down
regulatory barriers that stifled entrepreneurship.

But the story does not end there. Ideas have consequences. As the paradigm shift began to take hold, the international development community and political leaders searching for practical solutions to meet the challenges of institutional reform looked to the ILD for technical assistance to design titling programs and streamline the regulatory environment. Mr. de Soto and consultants from ILD have worked in twenty countries in Latin America, Africa, the Middle East, the former Soviet Union, and Central Asia. The most dramatic impact of such efforts can be seen in Peru’s urban centers. According to a study published by the World Bank, by 2003, the titling program had titled more than 1.3 million properties. Survey analysis conducted to measure the economic impact revealed increased investment in homes and business, increased access to credit, the creation of a real estate market, and increased property values. Women represented more than half of the beneficiaries of the program. Because families no longer had to ensure that someone stayed close to home to protect their property, the titling program fostered increases in labor participation by adults, which in turn reduced the incidence of child labor (Cantuarias and Delgado 2004). The successes won in Peru have inspired similar programs across five continents.

It is not just in the developing and post-Soviet worlds that de Soto’s ideas have relevance. The 2008 financial crisis in the developed world inspired de Soto to inquire whether the wealthiest nations in the world might be suffering from some of the same kinds of issues that plague much of the developing world—namely, the problems associated with poorly defined property rights. It is this inquiry that inspired de Soto’s keynote address during the 2009 Upton Forum. De Soto’s central argument is that at the heart of the 2008 financial crisis was a weak institutional framework of poorly defined property rights governing financial products. De Soto argues that avoiding such calamity in the future requires a rethinking of how property rights are defined and recorded in the financial sector.

**Advancing the Intellectual Enterprise**

Although de Soto and the ILD have played a critical role in advancing our understanding of how to tap the capacity of developing countries to rise out of poverty, the effort to craft effective economic development policies and programs is still in its infancy. Further, despite the fact that the economics discipline now clearly recognizes the important connection between property rights and other institutional “rules of the game” and economic development, the scholarly work in this field is still growing, posing new and more difficult questions. During the Upton Forum and over the course of the academic year, we were honored to feature some of the key scholars advancing understanding of the connections between social institutions and the prospects for economic development.

One question that still puzzles development economists is why, despite tremendous efforts to the contrary, we do not see a consistent pattern of convergence between wealthy and poor countries. In his essay “The Biggest Idea in Development That No One Really Tried,” Michael Clemens considers the role that dramatically
reduced immigration restrictions might play in closing the gap between the wealthy and poor around the world. Clemens recalls that de Soto’s account of the extralegal economy begins as a story of migration. In Lima, for example, it was urban policies limiting the participation of rural migrants in the formal economy that fueled the growth of the informal sector (de Soto 1989). Much of de Soto’s work has been aimed at reversing such restrictive policies. Similarly, Clemens argues that the most effective tool the developed world has to combat global poverty is to dramatically scale back restrictions that limit the ability of poor people to migrate to wealthier countries. Clemens considers both the economic and political implications of this idea and argues that such a proposal would be very similar in scale and impact as that of post-Apartheid South Africa when black South Africans were allowed to migrate to central Johannesburg.

The role that political rules play is a central focus within development economics, with most of the attention placed on national and global politics. But state-level and even village-level politics can also play a critical role in either promoting or inhibiting economic prosperity. In his essay “The Microeconomics of Public Choice in Developing Economies: A Case Study of One Mexican Village,” Tyler Cowen describes the significant problems associated with the cargo system of local governance in San Agustín, Oapan, in the state of Guerrero, Mexico. Despite these problems, Cowen argues that ineffective local governance can sometimes benefit residents in warding off attempts by outside parties to exert pressure on local officials.

De Soto’s case favoring the establishment and enforcement of clear property rights is part of a larger discussion on the connection between economic freedom, prosperity, and well-being. The intuition is that in contexts with greater economic freedom, individuals have greater incentive to pursue productive activities, invest in their businesses, and create opportunities for employment, all of which may in turn lead to overall poverty reduction, improved nutrition and health standards, and other quality-of-life factors. While intuitively appealing, the thesis that economic freedom leads to improvements along these lines is an empirical question, requiring some way to measure the consistency of a country’s institutions and policies with economic freedom. But quantifying economic freedom in a meaningful way is a tall order. In his essay “Economic Freedom and the Wealth and Well-Being of Nations,” Robert Lawson describes the Economic Freedom of the World (EFW) project that accomplishes exactly that by capturing and distilling the key elements of economic freedom within a single index. Lawson also discusses what the EFW index can tell us about the relationships between economic freedom and political freedom and between economic freedom and patterns of economic performance.

One of the principal advantages of the EFW index is that it allows us to examine, from a bird’s-eye view, the general patterns that emerge as economic freedom varies over time and across countries. Two essays within this volume deploy the EFW index to empirically test some of the ideas central to de Soto’s case favoring the establishment of private property rights. In their essay “Property Rights and the Return to Capital,” Benjamin VanMetre (’10) and Joshua Hall draw upon the Austrian and new institutional schools of economics and empirically test de Soto’s thesis to
show that secure property rights enhance economic development. The results of this analysis support the work of Hernando de Soto in that they show that secure property rights are crucial to the return on capital and, consequently, to economic development.

In her essay “The Two Sides of de Soto: Property Rights, Land Titling, and Development,” Claudia Williamson examines whether property rights improve economic development by enhancing the ability and incentives for capital formation, and again, she finds empirical support for de Soto’s argument. But Williamson also examines whether land titling actually leads to greater security in property rights. Williamson’s empirical analysis suggests that while property rights lead to capital formation, land titling on its own has not led to greater property rights security in some of the most ambitious titling programs. Williamson considers what these results might mean for land titling programs in achieving greater economic development.

Even in contexts in which private property rights are well-established and well-enforced, government itself can represent a threat. Government takings of property can be the source of heated controversy in both the developing and developed worlds, but the nature of the takings process and its effects can differ in significant ways. In his essay “Property Takings in Developed Versus Developing Countries,” Edward Lopez compares government takings in the United States with takings in lesser-developed countries. Lopez argues that institutional differences account for important disparities in when and how government takings emerge and in the distributional effects these takings have on the rich and poor in the two contexts. Some differences that account for such disparities are the presence of the rule of law and ideologies that support takings under some circumstances but not others.

We close with essays by two distinguished Beloit College alumni, Robert Peck Christen (’78) and Lyle Gramley (’51). In his essay “Beyond Microcredit: Delivering Financial Services to the Poor through Agent Banking,” Christen discusses the development of the agent-banking model that links the delivery of financial services to mobile retail networks such as cell phone service providers. It is through innovations such as this, Christen argues, that the delivery of financial services to the world’s poor can be dramatically scaled up.

We bring the discussion full circle by returning to the 2008 financial crisis. In his essay “The 2008 Financial Crisis: Causes, Response, and Consequences,” Gramley offers a different but complementary story to the one presented by de Soto. In this essay, Gramley discusses the developments in the mortgage market that led to the crisis, the steps that the Federal Reserve and the Treasury took to respond to the crisis, and the long-term consequences (both positive and negative) that these steps will likely have for the future. In both the de Soto and Gramley essays, the point is clear that the right institutional rules of the game are essential to avoiding financial calamity in the future.
With Many Thanks

On behalf of Jeff Adams, the Allen-Bradley Professor of Economics, and the other members of the department of economics and management, I want to extend our thanks to everyone who has played a part in making the 2009 Upton Forum and associated programs a success, including the many scholars and alumni professionals who presented during the forum and over the academic year. In addition to the contributors to this volume, I would like to thank Laura Grube (‘08) and Rexford Widmer (‘00) for their participation in the alumni panel discussions. The students in my 2009 Senior Seminar on the Wealth and Well-Being of Nations were integral to the success of the forum. Their willingness to dive deeply into discussions of classical and contemporary works is the lifeblood of an intellectual enterprise such as this. A special thanks goes to Jennifer Kodl, program assistant to the Upton Programs and managing editor of this volume, for her tireless dedication to excellence and her generous spirit.

Through their financial support, exceptionally good counsel, and willingness to serve as campaign chairs for the Miller Upton Memorial Endowments, Bill Fitzgerald (‘86) and Bob Virgil (‘56) laid the foundation for this initiative. Bob Virgil was also instrumental in securing the participation of Mr. de Soto as our 2009 Upton Scholar. By underwriting the first three years of the Upton Forum, the Lynde and Harry Bradley Foundation has played a critical role in ensuring the early success and the long-term viability of this program. I am especially indebted to Janet Riordan, director of community programs at the Bradley Foundation, for her guidance and encouragement in launching the Upton Programs. The Charles G. Koch Charitable Foundation has also played an essential part in advancing the mission of the Upton Programs by providing resources early on and continuing to support the Student Research Colloquium and Speaker Series directed by Joshua Hall. The financial support provided by alumni, friends, and charitable foundations have ensured that the Miller Upton Programs will serve as a fitting memorial to Miller and provide a signature experience for Beloit College students for many years to come.

During the 2009 Upton Forum, I had the honor of announcing that the Upton Forum keynote address will henceforth be the June and Edgar Martin Memorial Lecture, in recognition of a significant gift from the June and Edgar Martin estate. Several years after alumna June Bjorkland (‘40) graduated from Beloit with a degree in economics, she and her former professor Edgar Martin, who served as a faculty member in the economics department from 1939–42, struck up an extended correspondence. That correspondence blossomed into a romance, and in 1946, just one month after Edgar completed his service as captain in the army quartermaster corps, they were married. Throughout their marriage, they credited Beloit College for the role it played in advancing their fulfilling careers in New York state government and for making their life together possible. We are grateful to Albert Roberts, longtime friend and advisor to the Martins and executor of their estate, for his thoughtful stewardship and for helping to craft a gift that is a fitting memorial to the love that
June and Edgar shared, to the ideas they held dear, and to the college where they first met.

References


