



## LESSON PLAN

### **The Future of Democracy and the Market Economy in Latin America**

*Prerequisite: CIPE Development Institute video interview with Hernando de Soto*

#### **I. Message**

Hernando de Soto is an internationally recognized Peruvian economist who champions property rights and the need for the inclusion of vast informal sectors into the formal economies of countries around the world. His two bestselling books, *The Other Path* and *The Mystery of Capital*, blazed a trail of new understanding of the need for the legal empowerment of the poor for the proper functioning of markets. De Soto also emphasizes in his work that efficient markets cannot exist without good democratic governance, since it is the political system in each country that establishes the legal institutional framework. This framework should be inclusive of the entire population, so everyone can participate in the market on equal footing. However, the reality in many developing countries – particularly in Latin America – is that most people have no title to the property they occupy and work informally without the protection and proper recourse of the law. The goal of institutional reforms is to change that norm – as difficult as it may seem given the appeal of populism and the entrenchment of existing institutions.

#### **II. Objectives**

1. Discuss the key themes of Hernando de Soto's work.
2. Understand why so many countries in Latin America and other developing regions have such large informal economies.
3. Understand the importance of property rights for a functioning market economy.
4. Identify common legal barriers to conducting business.
5. Discuss the roots and dangers of the democratic deficit.

#### **III. Discussion questions**

1. What are the key ideas in de Soto's work?
2. What are property rights and why are they important to development?
3. Why are so many people living and working outside of the formal economy?
4. Is populism the answer to empowering the poor? Why or why not?
5. What are some of the findings of the Commission on Legal Empowerment of the Poor that Hernando de Soto co-chairs?
6. What is the nature of the democratic deficit in many electoral democracies?
7. What are some of the challenges to legal and institutional reforms? How can they be overcome?



#### **IV. Reading list**

Required readings:

- De Soto, Hernando, "Listening to the barking dogs: property law against poverty in the non-West," *Focaal - European Journal of Anthropology*, no. 41 (2003), 179-185, [http://www.cato.org/pub\\_display.php?pub\\_id=5183](http://www.cato.org/pub_display.php?pub_id=5183)
- De Soto, Hernando, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Basic Books, 2000.
- De Soto, Hernando, *The Other Path: The Economic Answer to Terrorism*, Harper & Row Publishers, 1989.

Optional readings:

- CIPE, "Impact in Peru: Strengthening Democracy through Property Rights and Rule of Law," [http://www.cipe.org/regional/lac/pdf/ILD\\_0208.pdf](http://www.cipe.org/regional/lac/pdf/ILD_0208.pdf)
- The Commission on Legal Empowerment of the Poor, <http://www.undp.org/legalempowerment/who/>
- De Soto, Hernando, "Most People Cannot Participate," Speech given at the International Conference on Globalisation, Belgium, October 30, 2001. <http://www.cato.org/speeches/sp-hds103001.html>
- Kuchta-Helbling, Catherine, "Barriers to Participation: The Informal Sector in Emerging Democracies," The Center for International Private Enterprise, 2000, <http://www.cipe.org/programs/informalsector/index.htm>
- Miller, Matthew, "Poor Man's Capitalist." *New York Times*, July 1, 2001, <http://query.nytimes.com/gst/fullpage.html?res=9506E1DE1030F932A35754C0A9679C8B63>
- Molkner, Keith "Legal Structures to Promote Economic Growth" CIPE, Reform Focus 1997, [http://www.cipe.org/publications/ert/e23/E23\\_07.pdf](http://www.cipe.org/publications/ert/e23/E23_07.pdf)
- Tokman, Victor E. (ed.), *Beyond Regulation: The Informal Sector economy in Latin America*. Boulder, CO: Lynne Rienner, 1992.
- Woodruff, Christopher, "Review of de Soto's 'The Mystery of Capital'." *Journal of Economic Literature* (December 2001), 1215-1223.

#### **V. Lesson plan**

##### **Speaker's background**

- Introducing Hernando de Soto and the work of the ILD

##### **Understanding the Braudel's "bell jar"**

- The "bell jar" metaphor was introduced by French historian Fernand Braudel and famously quoted by de Soto in *The Mystery of Capital*
- Addresses the question of why at its inception Western capitalism served only a privileged elite much the way it does in developing countries today



- *“The key problem is to find out why that sector of society of the past, which I would not hesitate to call capitalist, should have lived as if in a bell jar; cut off from the rest; why was it not able to expand and conquer the whole society?”*
- De Soto believes that the answer to Braudel’s question lies in restricted access to formal property rights, which gives rise to the informal sector
  - Students can provide examples of the informal sector in their countries

### **The importance of property rights**

- Property rights are necessary for:
  - Innovation and creation of new businesses
  - Growing a business (property as loan collateral)
  - Trade and investment
  - Economic growth and development

### **The sources and dangers of populism**

- When the benefits of macroeconomic liberalization are captured by the elite, populist sentiments rise
- Anti-market sentiments ignore the fact that great majorities of populations in developing countries function in the markets – informal ones
- Populism does not address the institutional reasons for informality

### **Legal reform as a necessary counterpart to economic reform**

- Macroeconomic reforms are not enough
- In most developing countries, free markets are not complete
  - They lack many institutional underpinnings
- Laws and regulations create incentives that shape economic behavior
- Deficient legal frameworks result in deficient markets

### **Challenges to legal and market reforms**

- Lengthy time horizon for reforms and the danger of elites hijacking reforms
- The need to overcome the inertia of pre-existing institutions

### **Democratic deficit vs. legal empowerment**

- Democratic governance goes beyond electoral democracy
- What happens between elections matters as much as voting
  - Day-to-day government decision-making, responsiveness, accountability
- Even countries with free and fair elections may lack democratic governance

### **Property rights as a part of larger institutional framework**

- Property rights are the necessary first step of market-oriented reforms
- BUT in-depth institutional reforms need to go further to:



- Ensure better democratic governance
- Reduce corruption and build the rule of law
- Create a better business environment
- Make economic growth more inclusive

## **VI. Sample test questions**

- 1. Hernando de Soto's work deals primarily with**
  - a. Property rights
  - b. Informal sector
  - c. Legal reform
  - d. All of the above
  
- 2. Braudel's "bell jar" is**
  - a. A type of curve used in econometrics
  - b. A metaphor for restricted access to formal property rights
  - c. A bell-shaped type of glassware exported by Peru
  
- 3. Examples of formally owned property include all of these except for**
  - a. A home with a title
  - b. A registered business
  - c. A car with a deed
  - d. Land someone occupies without documentation
  
- 4. Property rights make assets fungible. This means that**
  - a. Two given assets have equal market value
  - b. Legal representations of the assets can be combined, divided, or mobilized, and can be used to stimulate business deals
  - c. Assets have just their physical utility (e.g., a house as a place to live) and cannot be used in business transactions
  
- 5. Legal reforms are a necessary part of market reforms because**
  - a. Laws and regulations create economic institutions and incentives
  - b. Inadequate laws fuel corruption
  - c. People not protected by law cannot fully participate in markets
  - d. All of the above
  
- 6. The democracy deficit hinders economic reforms because**
  - a. Elected officials are not knowledgeable enough about economic theory
  - b. Weak democratic governance disconnects people from the reform process
  - c. There is no democratic deficit as long as free and fair elections take place



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