



Economic Development, Poverty Reduction, and the Rule of Law

Lessons from East Asia: Successes and Failures

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Transforming the way in which the world's poor relate to their assets – changing them from a bundle of powers into a bundle of rights and obligations, defined as property under the rule of law – is a prerequisite for equal and upward social mobility. It is also essential in making the citizens stakeholders in the stability of economic, political, and social systems. Decades of scholarship on social movements reveal that holding assets in the form of a bundle of powers is doubly disadvantageous for the poor. Since their claims are challenged by counterclaims both from other poor people and the state, they have to devise elaborate mechanisms and devote considerable time to defending their extra-legal assets. Furthermore, as their assets are not held in the form of representation which the law defines as property, they cannot use them to create and expand wealth for themselves and their countries.

Usually, the problem is not the form, but the substance of the law. As Article 17 of the Universal Declaration of Human Rights declares, “everyone has the right to own property alone as well as in association with others”. The European Human Rights Convention is also explicit about the right to property ownership. ILD researchers argue that, by and large, the legislation and legal systems of most developing and previously communist nations formally comply with article 17. In substantive terms, however, some 80% of these countries' populations either do not have real access to these rights and obligations – or, when they do, are not empowered by them to increase their productivity and well-being as effectively as in developed market economies.

As Justice Kennedy has pointed out, the consensus around rule of law's centrality has emerged during the last four decades. A corollary of this observation is that during this period, the domains of the economy, and the law, have been viewed as separate silos, rather than as inherently interdependent relations. Consequently, much of the effort devoted to strengthening the rule of law has only been partial. It has been technically driven, rather than serving a coherent goal of empowering the poor. After sixty years of engagement in promoting economic development, international financial institutions can point to few examples of holistic success that serve as models for other countries. As the records of these institutions have not been available to independent researchers, the full extent of their failure or success cannot be evaluated. If the Commission on Legal Empowerment of the Poor (Legal Empowerment) called for the full disclosure of IFI records – and they were to accept the request – the picture could change dramatically.

Meanwhile, the Legal Empowerment could authorize lessons to be drawn from the experience of East Asia, and the policy-driven work of the ILD. It could also

emphasize the need for understanding risks, and devising risk management strategies, in programs directed towards the legal empowerment of the poor. I will briefly highlight some issues in each of these areas.

Learning from East Asia

East Asia has witnessed impressive growth as well as stalled developments. Japan, South Korea, Hong Kong, Singapore, and Taiwan have undergone remarkable transformations and joined the ranks of OECD countries. Malaysia and Thailand have both achieved major strides in poverty reduction; but it is not clear whether they have overcome the structural problems that exposed their weaknesses during the crisis of 1998. In Indonesia and the Philippines, on the other hand, we see that the model which served the rest of East Asia has also produced stalled development. Burma, Cambodia, and Laos underline the costs that predatory elites can inflict upon their countries. Meanwhile, China and Vietnam both offer significant examples of major transformations within one-party systems that increasingly stake their legitimacy on including their citizens through economic growth strategies.

Both the successes and the failures of East Asian countries have important implications for the legal empowerment of the poor across the globe. The goal of the work to be undertaken is to draw lessons as much from successful transformations as from stalled and failed efforts, paying particular attention to the role of law in either creating the enabling conditions for the empowerment of the poor, or the constraints to their inclusion. The following issues will be specifically investigated:

- A. Models, Adaptations, and Transfers. Japan engaged in a systematic effort to create a legal system for creating property and handling assets in the last decades of the 19th century. The best-known law from this period is the Japanese method of land adjustment. Instead of using the state's power of eminent domain to acquire land from unwilling citizens, this law requires consensus among groups of landholders for developing and allocating land for public infrastructure free of cost to the state.

The law was originally borrowed from Frankfurt, in Germany, but has now become a distinctive Japanese institution. Afterwards, the law was adopted in Taiwan and South Korea, and was tried on a pilot basis in some other countries. This is a good illustration of how laws can be appropriated and transformed to create and consolidate firm property relations. Policy-makers in many developing countries would learn much from examining this, and the other laws adopted by Japan from the end of the 19th century right through the first half of the 20th century. The extent to which these laws were then adopted by other East Asian countries is equally relevant.

- B. Land Reform and Rural Property systems. As Ira Adeleman has argued, land reform provided one of the necessary conditions for the East Asian model of development. However, the situations in which it has taken place have varied widely. Japan embarked on land reform under American occupation; while Taiwan adopted an ambitious land reform program under the very dictator whose refusal to address the rural question had cost him the loss of China. Most land titling projects have failed in developing countries. Even so, the role of successful land reform in empowering the poor with firm property rights needs to be explored. Another key factor is the extent to which the process is applied through market-based land reforms.
- C. Producing affordable housing in Singapore. Rapid urban growth has usually resulted in windfall profits for landowners, the growth of the informal sector, and rising housing costs for the urbanizing poor and emerging middle classes. Singapore stands as an exception to this general trend. The government regulated the use of land for housing, and adopted policies that have brought affordable housing within the reach of most citizens in the city-state. Many lessons for enhancing competitiveness between countries can be drawn from this policy of affordable housing, and how it was adopted and implemented. It is especially relevant to post-conflict conditions, where spiraling housing costs have been a factor in increased corruption.
- D. Producing public and private sector alignment around development. The state in most developing countries has been mercantilist, using law as an instrument of redistribution among elites. The developmental states of East Asia, however, were able to break out of this trap and usher in sustained growth rates that have produced broad-based middle classes. Establishing alignment between the public and private sectors has been critical to the transformation of these states. In Singapore and South Korea, the decade from the late 1950s to the early 1960s was perhaps the key period during which both sectors were reorganized around the pursuit of competitive growth. The laws, policies, and organizations that were adopted and designed all hold important lessons for leaders of developing countries. In particular, the institutional design of the Japanese and Korean ministries of finance and economy, on the one hand – and trade and industry, on the other – could be useful models for the design of institutional clusters.
- E. China’s clusters of growth. China’s rapid pace of development has been sustained by various nodes of growth, such as the Beijing-Tianjing cluster in the north, and a series of clusters in the coastal cities in the south. These offer unprecedented examples of development policies at work. They are also especially valuable since the institutional and organizational relations which underpin them differ significantly from the practices that have produced

clusters of growth in Europe and North America. The design of new institutional relations in countries ready to undertake transformative reforms could benefit greatly from an examination of such clusters. Of particular relevance here are the ways in which the bundle of property rights and obligations differ from their western variants, yet provide a firm anchor for sustained growth.

- F. Human capital policies. Successful East Asian countries have implemented human capital policies that have produced broad-based middle classes and capable public sectors. Lessons from these countries could prove valuable for leaders of countries determined to end the poverty of their citizens.
- G. Learning from stalled and failed developments. Both Indonesia and the Philippines appeared to pursue the top-down model of development associated with South Korea, Malaysia, Taiwan and Singapore. Yet these countries have failed to produce the institutional relations of their successful counterparts. An examination of the reasons why this model failed to deliver in these two countries could provide a useful corrective to the generalizations made about East Asian successes. Understanding the constraints arising in these countries from their failure to generalize and simplify property relations could be particularly salient to the distinctive role of law in development.

Learning from ILD

Three specific characteristics make the work of ILD researchers relevant to Legal Empowerment. Firstly, they were among the earliest group of people to systematically document the importance of the informal economy, and the extent of the assets held by the world's poor in the form of dead capital. Such assets cannot circulate in a system of functioning property rights, and are thereby unable to enhance wealth creation. Secondly, they have examined the genesis of property under the rule of law in developed countries, through urgent questions at the frontline of the struggle against poverty and the threat of terrorism posed by the Shining Path. Third, they are engaged in work in more than thirty developing countries, in a unique form of south-south transfer of policy-driven research.

Their key findings can be summed up in three propositions:

1. Most property rights (communal, collective, or private) over real estate in developing and former Soviet nations are not fungible.

That is, they do not permit poor economic agents and their assets to be identified and located in such a way that they can be used in the expanded national or global market.

This prevents them from being given economic effects that allow them to capture their highest possible economic value, such as:

- **To establish the asset's potential:** This means that their written property representations – titles, records, or contracts – must represent the asset's most relevant economic and social characteristics. These written representations must protect the interests of the owner and third parties, clarifying responsibilities, providing information, and establishing rules and mechanisms related to the obligations they undertake. The asset's potential value is in its capacity to be represented in standardized records and easily transmitted titles that not only allow the physical use of that asset, but also bestow it with a parallel life in which it can mobilize credit and capital.
- **To integrate dispersed information:** By pulling together dispersed legal and extralegal property arrangements into one, consistent and systematized network of representations that operates within the widest national consensus possible. This will give people the opportunity to do business in expanded markets under one legal system, with standardized titles and registrations.
- **To make assets fungible:** By representing them in such a manner that they can be easily mobilized, become more accessible to the market, and have more productive functions. This involves standardizing the definitions and representations of the assets to facilitate, among other things: a low cost measurement of an asset's attributes, the combination of assets to achieve their highest possible value, the division of assets into shares, the objective valuation of the shares, a record of transactions concerning the shares, etc.
- **To make people accountable:** By shifting property rights from local, political arrangements to the legitimacy and protection of a single rule of law. Once each asset is linked with its owner, they can be individually identified and located, thus depriving owners of their anonymity – and making them accountable. This encourages trust among ordinary people who now know that they can use property to create an additional guarantee for the enforcement of contracts, whether commercial or financial.
- **To place people in networks:** By creating the institutional framework to connect, at low cost, all the assets and their owners in the expanded market where they can interface with other agents for multiple purposes and product development. All of this takes place through registers, chains of organizations, and other business integration systems of diverse services – for instance, fiduciaries and insurance – which reduce transaction costs and risks.

- **To protect the transactions:** By securing not only the assets but their economic use, through mechanisms that provide information to the market about the life of the representation of an asset, from one owner or creditor to another. This creates a chain of buyers, investors, and third parties in general, as well as generating trust in them. It also allows assets to reach maximum value – with the paper representing the assets acting as additional money in the hands of its bearers.

Property rights in developed countries not only define and protect ownership through law, but also, in practice, empower the beneficiaries with multiple economic effects that go beyond ownership. This links people together at a national and international level, and gives them access to finance and capital. In poor countries, most of the citizens do not have the kind of legal property rights that allow such effects – or even the reasonable opportunity to get them.

2. The majority of the poor in most developing and former Soviet nations do not have easy access to property over the **legal organizational forms** required to govern the production and transaction of their assets efficiently.

For rights over assets to be properly protected and organized, enterprises must have the legal tools to:

- Organize all functions of the enterprise under one well-coordinated system of control. This enables the division of labor, combination of assets, and the interconnection of contracts between suppliers, clients, creditors and investors to take place.
- Ensure to everyone, including creditors, investors, managers and workers, that the enterprise is an entity which is separate and independent from its owners. This means that the rights of all parties can be protected even if the founders die, the owners change, or the enterprise dissolves or goes bankrupt.
- Have access to asset partitioning and limited liability. This protects the interests of all parties in enterprise, and facilitates participation in entrepreneurship, as well as access to material resources, credit, and investment.
- Have records reflect the above information, making details about the patrimony committed to the enterprise more transparent.
- Have bylaws that clearly set out the terms under which all parties are associated.
- Define the responsibility of everyone involved in the enterprise so as to facilitate the division of labor.
- Have access to standardized labor regulations that facilitate the incorporation of professional and technical personnel from outside the immediate circle of the enterprise owners.
- Have access to standardized organizational structures according to the type of enterprise. These reduce the costs of accessing information about the enterprise, and those dealing with it.

- Have access to the orderly succession of property, to ensure family and debtor rights.

The legal and administrative tools for achieving these objectives are not available to the majority of the world's entrepreneurs.

3. Most poor nations lack the kinds of **identity devices** that allow citizens and enterprises – if they want – to operate beyond the confines of their family and neighborhood circles. They therefore find it difficult to join the expanded market through the widest networks of the national and global economies.

In order for most poor entrepreneurs to prosper, it is necessary that they have the legal tools that allow them, among other things:

- To be responsible for their obligations through the clear establishment of their rights on enterprise assets.
- To demand – and to be demanded to have – rights and obligations that may be executed through the courts and other legally recognized alternative conflict resolution systems.
- To be subjected to clear and predictable rules as to their labor, tax and social benefits obligations. These include the amounts to be paid, as well as the procedures for discussing and resolving conflicts derived from such obligations.
- To protect their trading names and the trademarks of their products and services.
- To enter into contracts with suppliers and clients unknown to them, as well as with the Government.
- To import and to export.
- To advertise without the fear of being detected.
- To generate a complete database through the proper registration of all their contracts and the fulfillment of their commercial obligations.
- To present their financial situation and the results of their operations through financial statements based on official accounting standards.
- To contract insurance to cover risks in their operations.
- To obtain credit from the financial system.
- To issue and freely trade bonds, shares and other instruments of the capital market.

The ILD approach is pioneering, and has been the focus of much scrutiny and criticism. Legal Empowerment could, however, authorize that we draw lessons from this groundbreaking effort, in the following areas:

- A. Lessons learned from the prevalence of dead capital. ILD has systematically documented the prevalence of the dead capital that is locked in at present – and the extent of its potential value if it were to be released as living capital. In the Philippines, the amount of dead capital is US\$132.9 billion; in Peru,

US\$74.2 billion; in Haiti, US\$5.2 billion; in Egypt, US\$241.2 billion. These figures provide some indication of the magnitude of the situation; and they are based on painstakingly detailed typologies of informal urban dwellings. The first block of the program would therefore focus on learning from this existing work, and its rapid application to new contexts.

- B. Comparative lessons accounting for the prevalence of dead capital, and the much more limited extent of living capital. **The Other Path** provided a detailed analysis of how a mercantilist state in Peru – defined as “a supply and demand for monopoly rights by means of laws, regulations, subsidies, taxes, and licenses” (2002) – forced its citizens into the informal economy, depriving them of the benefits of democratic capitalism. Law, in this analysis, is both a potential instrument for including the poor in the webs of living capital, and an instrument for their exclusion. This section of the program would therefore focus on three interrelated themes: (1) the extent to which mercantilism has been and continues to be the dominant form of the political economy in developing countries; (2) the extent to which programs devised, adopted by or imposed on developing countries as part of the Washington consensus have resulted in dismantling, weakening, or reinforcing the mercantilist system in developing countries; and (3) how changes in the law-making process might be isolated for generalization, in the few cases where mercantilism has been genuinely transformed into democratic capitalism.
- C. Demonstrating the effects of transforming dead capital into living capital. De Soto provides a four phase methodology for enacting this change. Places where this methodology has been applied can provide the equivalent of a social science laboratory. They can help convince the skeptics and enable us to draw lessons from them for other countries. This section of the program will, therefore, focus on compiling case histories from places where the process of capitalization has begun in earnest. These will be particularly relevant in locations where the scale is reaching the potential tipping point. People who have managed this process could be especially valuable in helping form communities of practice in new places.
- D. Classifying the dominant urban and rural forms of property. The prevalence of dead capital in the cities of developing countries has been convincingly demonstrated. Furthermore, the case that there is a potential fortune lying at the base of the pyramid of wealth – and that the biggest discrimination against the poor has been in excluding them from the capitalist market – has also been recently made. But the issue of property rights in the rural areas of developing countries, and the potential that can be released through a genuine capitalist market, is yet to receive the same degree of attention. This section will, therefore, consolidate the challenge of providing the urban poor with firm property rights, while also taking stock of the problem confronting the

rural poor. Since the indigenous people, and women, are often portrayed as groups which are at particular risk from private property regimes in agricultural land, special attention will be paid to the needs of these categories.

- E. Desirability, Feasibility, and Credibility of Reforms. As reform has a positive connotation, it is often considered to be a good in its own right and, therefore, not in need of detailed analysis for preparation and implementation. **Bureaucrats in Business**, a World Bank publication, however, makes a useful series of distinctions between the desirability, feasibility and credibility of reforms – both to the leaders and managers that undertake them, and to the stakeholders that win or lose from their processes. A reform destabilizes an existing array of interests, before giving rise to a new constellation of stakeholders. There is often a risk that those set to benefit from a reform might be persuaded by those set to lose from it that the reform is intended to harm rather than assist them. Therefore choosing the time and sequence of reform is critical, and requires careful leadership and management. While leadership is about enabling what is desirable to become politically and bureaucratically feasible, management is about making the feasible credible. It achieves this through sequencing actions that create a sense of momentum and increasing consolidation. Various business techniques help in understanding the risks attendant on poorly conceived or implemented reform processes, and the feasibility of reforms in general. These include backward and forward mapping; organizing work into critical tasks for which the types of people, resources, and teamwork required must be delineated; and organizing flows of resources, people, rules, and information through hierarchical systems.
- F. Public and Private partnership. The dominant connotation of private property is access of individuals to property. However, it is the existence of property as a bundle of representational rights that makes collective forms of action possible. Therefore the issue of how this bundle of rights is to be framed – so as to permit rapid transformation into live capital – must be approached with an open mind. It is here that Japan’s experience in the area of land acquisition, and the rest of East Asia, can be especially revealing. Post-conflict countries, such as Lebanon, and rapidly growing economies, such as Dubai, can also be examined for positive and negative lessons.
- G. Information Management systems. Property relations can never be reduced to information management systems. However, information management specifically designed to release the potential of dead capital can be immensely valuable for the legal empowerment of the poor. Open source software, and advances in making information management systems serve the poor, through simpler processes and government procedures, can save citizens time and money, and help make governments accountable to them.

Risks and Risk Management Strategies

Social change is inherently risky. When routinized habits are broken, this unsettles peoples' relations with each other; some are empowered, while others emerge or perceive themselves as losers. Planned social change also carries the additional risk of having unintended consequences, as the intended beneficiaries can sometimes end up as losers. A clear understanding of the risks involved is one key way to mitigate them. Corresponding risk management strategies are also crucial, and need to be carefully monitored to ensure that programs intended to legally empower the poor achieve their intended objectives. Legal Empowerment could, therefore, authorize focus on the following issues:

- A. Differentiating the poor. As the poor are not a generic category, they must be understood both in terms of social categories that the social sciences have provided, and the cultural categories that are meaningful in a particular context. Gender, age, and location are examples of the former, while indigenous people, pastoralists or the Roma (“gypsies”) are examples of the latter. The question of communal forms of tenure requires particular attention.*
- B. Political will for reform. The will for reform differs widely, as it depends on a system's capacity to embrace change, as well as the nature of the constraints to the legal empowerment of the poor posed by the dominant elites.*
- C. Social consensus. Top-down reform programs can be greeted by suspicion, if not outright hostility, in political environments characterized by a history of poor governance, and low degrees of trust between citizens and government.*
- D. Mobilization for implementation. Both governments and IFIs have a history of misjudging the complexity of implementation processes. Likewise, the constant attention needed from the leaders and managers of a country and their international partners to mobilize the necessary resources is often underestimated. The gap in time between the promised benefits and the actual delivery of such benefits is particularly important.*
- E. Participation of the poor. The participation of the poor is an essential factor for sustainability. But if they are to be convinced that their participation is worthwhile, the poor must see visible benefits from their engagements. The sequence of the programs must, therefore, be carefully thought through to ensure credibility.*
- F. Dealing with existing reality. The poor hold their assets through a complex*

range of relations and mechanisms. As legal empowerment can result in conflicting claims over assets whose value is likely to rise significantly, there is a clear need for enabling mechanisms to secure consensus and to resolve disputes.

There is a fragile global consensus that liberal democracy and the market economy are the best organizational forms for the polity and economy respectively. In terms of politics, communist, fascist, and most authoritarian regimes have failed to create legitimate political orders that can transform their subjects into loyal citizens. In terms of economics, these regimes have failed to create firm systems of property rights that can transform the citizens into stakeholders in the state. By contrast, liberal democratic countries that embraced the market economy have succeeded in creating broad-based middle classes that have been critical to social stability, political legitimacy and economic dynamism.

The consensus, however, is fragile, since it is perhaps more rooted in the failure of the alternative systems than the genuine embrace of liberal democracy and the capitalist economy as institutional models. Historical events – ranging from the onset of democratization in southern Europe, to the crisis of the authoritarian regimes in Latin America, the implosion of the Soviet Union, and the collapse of African dictatorships – seemed to leave liberal democracy as the only genuine alternative. After a decade and a half, however, the consensus looks more fragile than seemed evident in the moment of global enthusiasm that greeted the velvet revolutions and the collapse of the Soviet Union. Russia is becoming distinctly more authoritarian, and Latin American regimes may be entering into a new cycle of legitimacy crises. The consolidation of democracy in southern Europe, by contrast, is directly linked to the participation of these countries in European economic institutions, opening up the prospects of joining the European middle class for their citizens.

The success in southern Europe is marked by the dual transformations in the polity and economy. Meanwhile, developing countries and former Soviet republics seem to be suffering from a dual failure to construct polities and economies bound by rule of law and firm property rights. If the wealth creation potential of the market is to be unleashed at the global level and harnessed to the task of the empowerment of the poor, then we must address the issue of transforming property into a bundle of rights and obligations. The Legal Empowerment has been formed at a critical juncture of history; and one hopes that it will begin the process of generating a global consensus on turning the world's poor and excluded children, women, and men into stakeholders in the rule of law.