



THE OTHER PATH

The Economic Answer to Terrorism

Report on the conference sponsored by



El Diario, the tabloid of the Shining Path, terrorist organization in Peru, accusing Hernando de Soto, President of the Institute for Liberty and Democracy (ILD), of being responsible for reducing support for terrorism due to the ideas in his book "The Other Path."



"I'm glad to come and let the world know that I certainly support - this administration certainly supports - the Institute for Liberty and Democracy's (ILD) ideas around the world."

Hon. Donald L. Evans
Secretary, U.S. Department of Commerce



"...the most promising anti-poverty initiative in the world is the one being advanced by the ILD."

Hon. Madeleine K. Albright
Chairman of the National Democratic Institute and former U.S. Secretary of State



Between 1982 and 1996, ILD programs, with an investment of \$17 million from USAID and \$1.2 million from CIPE, allowed Peru's poor to acquire \$9.4 billion in net benefits. This is equivalent to an average annual return of 142%.

ILD programs have:

- Allowed 6.3 million of Peru's poor to gain legal title to their homes and property. As a result, the value of their homes has increased by \$2.2 billion and their income by \$3.2 billion.
- Allowed newly formalized owners to obtain \$300 million in capital loans and saved them \$254 million in reduced red tape costs.
- Reduced child labor among newly formalized property owners by 28%.
- Provided a winning strategy that allowed the army to build closer relationships with informal farmers which helped combat terrorism on the ground.

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Franklin D. Raines
Chairman, Fannie Mae

David de Ferranti
Vice President for Latin America, World Bank

Ali Jalali
Minister of the Interior of Afghanistan

Sally Bowen
Correspondent for Financial Times of London and Reuters in Peru

Francisco Bertrand
Former Minister of Interior of El Salvador

Henri Guillén
Commission for the Formalization of Informal Property, COFOPRI, Peru



Hernando de Soto

The Institute for Liberty and Democracy (ILD) is a private, non-profit organization headquartered in Lima, Peru. The mission of the Institute is to assist developing and former Soviet nations in the transition to a modern market economy that gives those who have been locked out of the system - more than 70 percent of the world's population - a stake in the economy. To accomplish this, the ILD works with heads of state to implement institutional reforms that give the poor access to formal property rights for their real estate holdings and businesses along with the tools to release the capital locked up in those assets.

The ILD does not only design strategies and projects - it implements them. Over the past 15 years, the Institute created and managed legal property systems that have moved hundreds of thousands of businesses and real estate holdings from the underground economy into the economic mainstream.

The Economist listed the ILD as one of the two most important think tanks in the world; according to the Telegraph of London, the ILD has created one of the four big ideas in modern times for improving the lot of the world's poor. Time magazine named the ILD as one of the five most important innovators of the twentieth century in Latin America. Ronald Coase, winner of the Nobel Prize in economics, has called the ILD's work "powerful and completely convincing." Francis Fukuyama, author of *The End of History*, has said that the ILD's methodology "constitutes one of the few new and genuinely promising approaches to overcoming poverty to come along in a very long time."

The ILD is now working in 5 countries and is dealing with some 15 new requests in Africa, Asia, Latin America, the Middle East, and the former Soviet Union.

On February 13 2003, the Center for International Private Enterprise (CIPE) and the National Democratic Institute (NDI) hosted a conference at the Hall of Flags at the US Chamber of Commerce to hear different independent accounts of the Institute for Liberty and Democracy's (ILD) experience in peacefully fighting for development and against terrorism.

The ILD was created in Peru in 1982 in the midst of deadly attacks by a home-grown terrorist group known as the "Shining Path." To achieve development and counter the terrorist extensive efforts to recruit among Peru's poor, the ILD designed and implemented various institutional reform programs to integrate the poor into the market economy and make the rule of law accessible to all.

Most of these programs were successful. According to the Shining Path's official newspaper, the ILD's measures crippled their recruitment efforts. The terrorists were dealt other damaging blows when grassroots associations, coca growers, farmer militias and unions adopted the ILD's programs and ideas. These Peruvians as well as representatives of international financial institutions, foreign correspondents, foreign affairs officers and distinguished military who supported or observed the ILD's efforts explained how ILD's non-violent institutional and economic reforms can effectively help to defeat terrorism.

Over the past two decades, the ILD has been successful both as an intellectual force for change and on the ground, moving millions of businesses and homes from the underground economy into the economic mainstream. More than 20 heads of state in developing and former Soviet nations have called on the ILD to help them implement the model of reform that they have created.

That is why CIPE and NDI organized this conference. Extracts and summaries of the speeches follow in this report.



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About NDI

The National Democratic Institute for International Affairs (NDI) is a nonprofit organization working to strengthen and expand democracy worldwide. NDI works with democrats in every region of the world to build political and civic organizations, to safeguard elections, and to promote citizen participation, openness, and accountability in government.

About CIPE

The Center for International Private Enterprise is an affiliate of the U.S. Chamber of Commerce, established in 1983 to promote private enterprise and market-oriented reform worldwide. As a principal participant in the National Endowment for Democracy, CIPE supports strategies and techniques that address market-based democratic development. CIPE also receives support from the U.S. Agency for International Development (USAID), as well as private corporations and foundations. Since its inception, CIPE has funded more than 700 projects in 80 countries and has conducted business association management training programs in Africa, Asia, Central and Eastern Europe, Eurasia, Latin America, and the Middle East.

The proceedings of the full conference were broadcast live on CIPE's Electronic Roundtables website and are archived and available for viewing at

www.cipe.org

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Picture by N.Zachmanoglou

**The Honorable Donald L. Evans,
Secretary, U.S. Department of Commerce**

The ILD message provides the answer to leading this world towards peace. The ILD offers us another way to dramatically change the status quo. The ILD makes capitalism work through the reform of the legal system and the award of property rights. With accessible and transparent property rights, the poor can leverage their property into capital, and that means new jobs.

I'm glad to come and let the world know that I certainly support - this administration certainly supports - the ILD's ideas around the world, because their ideas are the ideas of renewing hope for the billions of fellow human beings that we have to lift out of despair and poverty.



Picture by N.Zachmanoglou

**The Honorable Madeleine K. Albright,
Chairman of the National Democratic
Institute
and former U.S. Secretary of State**

The ILD has accomplished a great deal in helping to create free, fair, and market-based systems, and it was really with very good reason that President Clinton stated that the most promising anti-poverty initiative in the world is the one being advanced by the ILD.

**David de Ferranti,
Vice President for Latin America, World
Bank,
represented by Ronald Myers,
Sector Manager, Public Sector, World Bank**

Our \$38 million loan for the Peruvian urban formalization project was approved in August 1998. It has disbursed over \$27 million.

The success of this project reflects the concepts developed by ILD. We basically inherited a well conceived program from the ILD and the Government of Peru and scaled it up for national coverage. I think the genius of the ILD concept is that it focuses on institutional issues, scoping out in detail the organizational barriers that impede the poor from increasing their economic activity, listening to the poor, involving them, leveraging their aspirations for property, recognizing the critical importance of property rights for economic advancement, both individual and national.

What has been achieved so far? Total number of properties formalized, over 1.5 million. Total number of titles issued, over 1.2 million. Gender breakdown in titles issued—33% male and 67% female. Subsequent transactions registered



—about 110,000. This is affecting seven million individuals out of ten living just at, above, or below the poverty line. This is the largest urban titling exercise for squatters of the world.

There are some additional indications of impact beyond these numbers. A recent study by a Princeton University economist estimated that for the average Peruvian squatter family, granting of a property title meant there was less need to stay at home to protect the property. This in turn has led to:

- A substantial increase in labor hours: newly titled households are increasing paid labor by 45 hours per week, resulting in additional family monthly income of \$118.
- A 28% reduction in the probability of child labor, as it is substituted by adult labor. This means children will have more hours per day to devote to school or study, improving their skills and potential for better employment.

Others have estimated that so far the program has brought close to \$6 billion in assets of the poor into the market. And these assets have increased already in value by about \$1.7 billion. This would represent a 28% average increase in the wealth of an average property owner.

We are also perceiving a lessening in conflict over property, both in terms of judicial actions and physical confrontations, with undoubted economic, social, and personal benefits. World Bank President Wolfensohn has been quite clear in saying that poverty itself does not lead to terrorism, but the despair, hopelessness, and anger at perpetual poverty can only aid the terrorists.

This is an exciting project for the Bank. We expect this type of program to expand to other countries inside and outside the region.

**Henri Guillén,
Commission for the Formalization of
Informal Property, COFOPRI, Peru**

The Peruvian titling experience initiated by the ILD is evolving. We are now seeing that newly titled buildings originally assessed at a value of \$2,000, increase their average value to \$5,000 once they are accepted by the economic agents as collateral. Moreover, in the last two years, the number of mortgages has tripled and the amount of credit given has more than doubled.



Picture by N.Zachmanoglou

**Guido Lombardi,
Peruvian TV anchorman and journalist**

I am a personal witness to what happened in the coca growing valleys of Peru. When I visited them for the first time, at the end of the 1960s, these were areas where farmers grew fruits and vegetables. When I returned in the 1980s, most of these farmers were now growing the coca leaf—they were persecuted by the police and encroached upon by the Shining Path terrorists and the drug trafficking cartels.

In the 1990s I saw how the ILD entered these valleys, identified the coca organizations and their leadership with precision and built a bridge between them and government. The President was invited and did visit the valleys, and all the coca leaders returned the visit by meeting with him and top authorities in the Lima Presidential Palace. Peaceful negotiations led to a new legal framework, the decriminalization of the farmers and their spontaneous desire to identify both the terrorists and the drug-trafficking outposts.



Picture by N.Zachmanoglou

I was a witness to how appealing the prospect of enjoying property rights and the protection of the law was for them. And how, in a short time, as general Jaime Salinas Sedó said previously, once inside the law, mobilizing their customary defense organization, some 30,000 to 50,000 strong, they defeated the Shining Path on the battle field and drove the survivors to hide in the cities where the police captured their leaders after a short while. It wasn't easy: many lives were lost, including that of Walter Tocas, the main interlocutor of the ILD at the Huallaga valley. But we did learn a fundamental truth: the victory against terrorism,

and ultimately against poverty, depends on our ability to build institutions that reflect the tradition and the practices of the poorest sectors of society and on our ability to make them the leaders of their own fate.

Jaime Salinas Sedó,
Peruvian Army General formerly responsible for the planning and implementation of anti subversive activities

By studying the ILD's work, including *The Other Path*, we in the military acquired an economic and sociological insight into our national reality that was very different from the one we had before. The ILD's teachings and activities allowed us to understand that the aspirations of the people

whose support we had to win over if we were to vanquish terrorism. They had an enormous desire for personal improvement, gave huge importance to property rights, and felt excluded by an obsolete legal system.



Picture by N.Zachmanoglou

This led us to radically revise our military strategy so as to get that support from the Peruvian population at large. We not only wanted more emphasis on human rights, but we also wanted the poor to achieve their economic aspirations using legal means. This not only meant supporting programs to include those who worked outside the law, but also implementing mechanisms to legalize informal peasant organizations who had been fighting against the Shining Path and who were those who finally allowed us to beat back subversion.

What the ILD and de Soto's book *The Other Path* did was to confront the Shining Path intellectually. This was disastrous for the terrorists. It substantially decreased their ability to recruit young people who now understood that they could achieve their goals within the law. We always knew that poverty was fertile ground for violence. Now we know that the real danger comes from trying to enforce discriminatory legal systems that exclude people and prevent them from enjoying their rights as citizens.

Hugo Huilca,
General coordinator of the self-defense militias of Ayacucho which defeated the Shining Path in central Peru



We, the informal farmers of Peru's central highlands, were able to defeat the Shining Path when the government began listening to us and

helping us solve our problems. This was possible because the ILD put us in contact with the Peruvian government and our political leaders and insisted that Peru's informal sector be formalized. The idea of owning our land and having our rules and customs respected gave us hope and the will to fight. You cannot win a war against terrorism if you do not involve the people who understand the problems. And our problem was that we were very isolated and alienated.

José Ugaz,
Special State Attorney of Peru for Prosecuting Fujimori and Montesinos



Picture by N.Zachmanoglou

The ILD's project was begun in 1990 when 75% of all people locked away in Peruvian prisons, nearly 14,000, had been imprisoned without having been tried and had been there for periods that

exceeded the penalties that would have been imposed on them had they been found guilty. This gave the Shining Path the possibility of recruiting among all of these prisoners who, together with their families, were resentful and irritated because they had been deprived of liberty for so long without a sentence. The terrorists used this resentment to recruit members within the jails themselves. The fact is that criminal trials can last up to three years and that conditions in Peruvian prisons are inhumane. For example, Lurigancho, the most important prison in the country, was built to shelter 1,500 inmates, but in 1990 had over 7,000. The ILD then created for government the mechanism which allowed the granting of amnesty under certain conditions, which thereby quickly freed those who had been unjustly locked up.

The ILD system and the modifications it brought about in the law liberated between 3 and 4 thousand prisoners in the first year of its enactment. Many thousands more have benefited from it because the ILD system is now contained in the Constitution and in the Code of Criminal Procedures and until today helps prevent that prisons become the source of resentment and terrorism.

Sally Bowen,
Correspondent for Financial Times of London and Reuters in Peru

The ILD is a think tank of amazing creativity. It went to the heart of the problem. It talked to the people. It initiated debate. It went out and asked people: What are your problems? How can you solve them? How do you solve them?

No less important, I think, were the political initiatives. It seemed like a small revolution when the ILD campaigned for the pre-publication of

draft legal norms, and when it designed and set up Peru's first ombudsman's office. All these things took time. It required long educational campaigns to bring Peruvians around to seeing the importance of citizen participation and accountability.

Yet today, the mechanisms which the ILD finally put in place —such as the referendum, the electoral district system and the access to public information— are accepted without question by Peruvians.

What the ILD discovered —listening to the urban and rural poor, the peasants and the coca growers — and which most politicians and intellectuals, interestingly, completely failed to grasp, is that these people who were caught up in this terrible war didn't want it at all. On the contrary, what they wanted was peace, to grow their legal crops, to mind their farms, not to be hassled, to build their small businesses and bring up their families. They wanted to be part of society, to be included, and yet consistently they found themselves excluded. And exclusion was Sendero Luminoso's strongest ally.



Picture by N.Zachmanoglou

What the institute did so eloquently was to offer *The Other Path*, Hernando's book and recipes for inclusion; they threw down a gauntlet to Sendero Luminoso and to its leader, Abimael Guzman.

Often in the clandestine copies of Sendero's newspaper, *El Diario*, that we as journalists would acquire to find out what this strange and barbaric group were thinking, I read many vicious attacks on the ILD and on Hernando. Guzman knew that this was an organization that was a threat, that were the ILD recipes to succeed, his limited support would wither away altogether. This is why he bombed and bloodied them.

I think Peru has a considerable unpaid debt of gratitude to the ILD, and I very much hope that other countries and governments can take full advantage of the valuable experience gained on the ground in Peru.

Hernán Chang,
Former President of the Peru Drivers Federation

The ILD planted the intellectual seeds that allowed Peru to win its struggle against terrorism. It helped us to understand that we drivers, all 300,000 of us, were entrepreneurs and that property



Picture by N.Zachmanoglou

rights were important. It gave us the conviction and the resolve that allowed us to stand up against terrorists and stop them from taking control over Peru's transport system, which they needed if they were to choke the productive system and make the economy come to a halt.

Matthew Bishop,
Business Editor, The Economist

Like many people, I was exhilarated when I read "The Mystery of Capital". The idea that the large numbers of poor people in the world are mostly evidence not of the failure of capitalism, but rather of the failure to include them in capitalism, was both a profound relief and an inspiration to action. But the journalist in me asked, isn't this too good to be true?

Last August [2002], we traveled into the Amazon, into the heart of one of Peru's main coca growing regions, where I spoke with many of the community leaders and some of the governmental and NGO workers there.

What is indisputable, just as Hernando says, is that the farmers are clearly entrepreneurial at heart and would clearly prefer to be earning their living from something other than coca. Time and again they told me they do not want to live at the mercy of the ruthless drug gangs that buy the coca or of the government, that might suddenly decide to destroy it. They have developed a taste for civic society, for living within the law, just as Hernando said they would. Although much of the publicity about Hernando's writing focuses on his advocacy of efficient property rights for the poor, the real heart of his message, I believe, is the importance of including the poor and excluded within the capitalist legal system. Legalizing the militias and of coca farming sent a powerful message of support to the farmers, whose bravery and cooperation with the national army clearly played a huge part in the defeat of the Shining Path.



I left the Amazon certain that great progress had been made, but also fearful that much remains to be done. Yet my conversations there left me with absolutely no doubt that by actively engaging with the poor and excluded, by treating them as normal people who want the chance of a better life, and by demonstrating that the full apparatus of the state, from its army to its legal system, is on their side as they seek that better life, buys a phenomenal amount of goodwill. And that goodwill is perhaps the most effective weapon against terrorism that there can be.

Ali Jalali,
Minister of the Interior of Afghanistan

The ILD has said that if war against terrorism is to succeed, we have to talk to the excluded, the people. We believe this is right: with community and economic development, we will be able to fight more effectively against terrorism and to legitimize trade in our country.

Francisco Bertrand,
Former Minister of Interior of El Salvador

El Salvador had a long and painful war. At the end of the conflict, we, together with the ILD, designed a property system that allowed us to incorporate marginal human settlements that produced something almost magical. It not only allowed us to bring the poor inside the rule of law, but it also allowed us to identify those properties where former wartime combatants and poor people who fled violence could be relocated and given a peaceful alternative to waging war.



Picture by N.Zachmanoglou

Just before coming to this conference, when I was talking to the U.S. Ambassador in El Salvador, Mrs. Rose Lincoln, I informed her that one of the principal tools that had allowed us to rebuild El Salvador in two

years after 60% of the homes had been destroyed by two tremendous earthquakes, was the property registry system, which allowed us to quickly define rights and make land available to those who were homeless. Property set the foundations for peace after war and after a national disaster.

This system is now at the source of over \$800 million of credit backed by mortgages which carry interest rates of 6% and have maturities of up to 30 years because the property system is simple and clear. There are no useless legal tangles, and the mortgages recovery rate is rapid, safe, and reliable. As Secretary Donald Evans said, terrorism is not based on poverty: it is based on the perception citizens have of their future and of the opportunities that legal life can offer them.

Hisham Fahmy,
Executive Director of AmCham Egypt

The strength of ILD's program is not only in reforming the property rights system but in the process of this reform as well. It is this process that is allowing us here in Egypt to unravel the problems with each piece of legislation and regulation, as well as the conditions of the informal sector, which represents 25 to 35 percent of our economy. The bureaucratic obstacles that drive businesses into the informal economy are exactly the same that hurt investment in Egypt. The ILD process identifies every step and every obstacle the private sector faces and has

helped us work with the government to address each one. The outcome of this process not only helps the poor but large industries and investors as well. The new mortgage law recently enacted could not succeed without a stable property rights system. This law will help create jobs and give our poor and young people hope in the market economy and make them constituents for reform by bringing them the benefits of this system. ILD's program is wonderful, and I thank Hernando de Soto for bringing it here.



Ahmed Galal,
Director of the Egyptian Center of Economic Studies

I am completely convinced of the value of the work we are doing with ILD in Egypt on informality, a very large problem here. We are working with the government to reform institutions and make sure that they are working for everyone in our society. This is a key aspect of our efforts with ILD. We are developing a blueprint jointly with the government and finding that policy-makers in Egypt are very keen on this project, especially in how the property rights reform process is inclusive and will benefit all segments of society.



Franklin D. Raines,
Chairman, Fannie Mae

I think that the power of the ILD's insights and ideas is not easily going to be exhausted. We are nearly at the end of the beginning of the discussions of these ideas.

The connection between formal property systems and the creation of wealth is something that the rich nations of the West take for granted. That is why I am most interested to find out how the ILD's concepts can be applied to the challenges that we face here in the United States. Here we have succeeded in using access to property ownership



Picture by N.Zachmanoglou

to advance our economy and society in ways that make us the envy of the world. But we haven't succeeded for everyone. All over America - in central cities, older suburbs, small towns, and in rural areas - there are millions of people who still do not have full access to our legal, financial, and property systems. That's why you see so many of what we call check-cashing stores and payday lenders and pawnshops in decaying neighborhoods, and that's also why many consumers here will overpay for credit or turn to predatory lenders, the bottom feeders of our system, all of which keeps these consumers from ever getting a foothold in the mainstream system.

The challenge in the United States is to bring all of our people into our highly advanced formal property and financial system. Homeownership is the fundamental way that we obtain property and generate wealth in this country for the average person. Just look at what has occurred over the past three years. Even as Americans lost \$5.5 trillion in the stock market, homeowners gained \$2.3 trillion in home equity wealth.

We need to leverage the power of property in the United States even more. What we need to do now in the United States is to take the concepts that Hernando de Soto is talking about and ask: How do we derive our advantages to those who have not benefited yet from our system, especially those that have systematically been denied access to our legal, financial, and property system, even as it was developing?

In the United States, homeownership is our version of *The Other Path*, and as we work to make our formal property system more inclusive, we will be better equipped to share our experience with other nations as they harness the mystery of capital to better their societies.

Francis Fukuyama,
Dean of Faculty, John Hopkins University

The ILD has really brought about a major conceptual revolution in the way we think about questions of poverty and problems in the world that really stretch from poverty to terrorism.

The absence of the institutional capacity to determine property rights is at the center of many of the problems we face today. The ILD was the first to highlight, document, and develop a strategy



Picture by N.Zachmanoglou

for dealing with this issue. The solutions to these problems are not anything that's ever going to be designed here in Washington or by a bunch of academics sitting in universities. They really have to be developed by people on the ground. The interesting aspect of this is - though each country is a particular case, they all share a common set of problems that the ILD has a system to deal with.

Brian Atwood,
Former Administrator, USAID

If we are going to deal effectively with terrorism, we can't just use our military, we can't just use our diplomats. We have to use creative ideas in development assistance such as the one of the ILD.



Picture by N.Zachmanoglou

When the ILD uses that phrase "dead capital," it speaks volumes to me and to other people who are in the development business. We have seen it. The poor are sitting on it, but it isn't working. It isn't able to be used as collateral and the like. This is really revolutionary thinking. I have seen it. You can't imagine the impact on leaders when they are told that their country is worth billions more than what the IMF says, because of all of that dead capital that exists.

To create capital and incentives, you need a legal framework rooted in property. That is what the ILD's work is all about. I think one of the reasons that USAID is a strategic asset to this country is because it has been exposed, more than any other American group, to the work of the ILD.

I'm very proud that USAID was able to play a role in helping to internationalize the ILD and that its message has been spread around the world as part of a revolution to which we now need to give more impetus.

Alan Larson,
Under Secretary for Economic Affairs, US Department of State,
represented by Shaun Donnelly,
Principal Deputy Assistant Secretary for Economic Affairs

The MCA, Millennium Challenge Account, that we now have before the Congress, also reflects the ILD's influence on enterprise directly by asking how much time it takes someone to start a business in a poor country. That's one of the explicit criteria that we're going to establish in selecting countries for eligibility under the MCA when it's enacted by the Congress.

John D. Sullivan,
Executive Director, Center for International Private Enterprise

When CIPE ranked all of the 700 projects that it funded since 1983, after a really intensive evaluation, it awarded the ILD Project the first position because it had so much more of an impact than any other one. It was and continues to be the most successful program that we have supported.



Picture by N.Zachmanoglou

What the ILD has done is change the debate on development. It is no longer about the Washington consensus, culture, or neoliberalism. The debate is about how can you get the poor into the market economy, because when they do get in they can be as successful as anybody else, whether they are Africans or Peruvians.

John Sanbrailo,
Executive Director, Pan American Development Foundation and former USAID Mission Director in Peru.

From the very beginning, USAID saw the ILD's work as a conceptual revolution, a revolution in thinking about development, about how to address the issues of poverty, how to address the large population that felt excluded from market economies, and how to come up with and support ideas that were particularly unique and innovative in addressing some of these issues.



Picture by N.Zachmanoglou

Go back to the early 1980s and think about the development agenda that existed at that time. There was no reference to the rule of law and property rights. If in 2003 it is on the agenda, it is due to the work of the ILD.

ILD PROGRAMS: PRACTICAL ACHIEVEMENTS

Between 1982 and 1996, with an investment of \$17 million by USAID and \$1.2 from CIPE, the ILD created a program to bring the poor majority in Peru and El Salvador from the extralegal economy, where they were susceptible to recruitment by terrorist organizations, into the formal economy. As a result, the poor of Peru have obtained \$9.4 billion in net benefits between 1991 and 2002 (see items 1 - 7 below). This is equivalent to an average annual return of 142%, or a benefit-cost ratio of \$2.42 for each \$1.00 that USAID and CIPE invested in ILD. Items 8 to 14 refer to those additional benefits that are not economically quantifiable.

The itemized results of the program that ILD designed and initiated/operated with the \$18.2 million are:

1. **6.3 million Peruvians** below the poverty line now legally own their real estate assets. (COFOPRI)
2. The value of these formalized real estate assets has increased by **\$2.2 billion**. (World Bank)
3. The income of formalized real estate owners has increased by **\$3.2 billion**. (Princeton University)
4. Formalized real estate owners have obtained **\$300 million** in additional loans. (COFOPRI)
5. Formalized owners have saved some **\$254 million** in red tape costs. (COFOPRI and ILD estimates)
6. **380,000 business enterprises** belonging mainly to the poor were formalized. (ILD)
7. These new businesses generated **560,000 additional legal jobs** and increased tax revenue by **\$300 million** a year. (ILD)



The classic street peddler



Clandestine shoe factory



First steps...



Signs of urban planning...



Urbanized



Previously extralegal settlement



Registering a title



Woman receiving a title to her home at the public ceremony



New market

8. Child labor has been reduced by **28%** among formalized property owners. (Princeton University)
9. Land-related conflict in formalized areas has been reduced from **5% to 0.006%**. (RPU/ILD estimates)
10. The macroeconomic policies and 200 other institutional reforms initiated by ILD raised Peru's growth rate to nearly **14%** by 1994 and brought down inflation from **7,650%** in 1990 to **10%** in 1995. (IMF and ILD estimates)
11. Recruitment efforts of Shining Path terrorists were severely decreased by ILD intellectual offensive. (El Diario: official Shining Path newspaper)
12. ILD provided the military with a winning strategy that allowed the army to come closer to informal farmers so as to beat terrorism on the ground. (General Jaime Salinas Sedó, Commander in Chief of Anti Subversive Operations)
13. ILD helped farmers reduce coca production, formalized their militias, and thus helped them defeat terrorists in rural areas. (Hugo Huillca, General Coordinator of Self Defense Militias in Ayacucho)
14. By the end of 2003, the real estate formalization system designed by ILD for El Salvador will have brought **1 million poor people** under the rule of law. The program helped to peacefully settle former wartime combatants and refugees on productive land, reducing incentives to violence. (Ministers of Justice and Interior) The system has been crucial to resettle victims of the latest earthquakes and the registry is now recording over **\$800 million of credit** backed by mortgages at interest rates of 60% with maturities of up to 30 years whose property procedures are now simple and clear. (Centro Nacional de Registro)
15. Additional international acceptance: In addition to Peru and El Salvador, ILD is now working in **Egypt, Haiti, Honduras, Mexico, and the Philippines**. Since mid-2002, the following 14 countries have invited the ILD to work with them: **Afghanistan, Algeria, Colombia, Georgia, Ghana, Kazakhstan, Mozambique, Nigeria, Palestine, Russia, Sri Lanka, Tanzania, Thailand, and Venezuela**.

ABOUT THE INSTITUTE FOR LIBERTY AND DEMOCRACY

The ILD addresses the most pressing economic and social problems that governments of developing and former Soviet nations face: the failure of current market-oriented reforms to benefit the majority of the population.

By studying the capitalist transformation of the West and Japan during the 19th and 20th centuries and from 17 years of work in the field, the ILD has found that the principal reason for the failure of free enterprise policies to gain a stable foothold in most of the developing world is that nations have tried to modernize their economies without putting into place the foundation stone of a market economy—a comprehensive and inclusive property system. The overwhelming majority of the citizens of developing and former Soviet nations wish to participate in a free enterprise system, but they cannot access the existing property law and are therefore forced to hold their assets and operate their businesses *outside* the legal property system.

Property law is what makes the market economy work. It is property law that provides the framework of rules that organizes the market, the titles and records that identify economic agents, the contractual mechanisms that allow people to exchange goods and services in the expanded market. It is property law that provides the means to enforce rules and contracts along with the procedures that allow citizens to transform their assets into leverageable capital. Therefore, those who are excluded from the legal system, mainly the poor, are also excluded from the legal market economy.

Yet, over the past 50 years, developing nations—and now former Soviet countries—eager to embrace a market-oriented economy have rarely budgeted for property reform programs. The few titling and small business promotion programs that have been carried out were born with three major defects:

1. They have conceived of property as an ownership issue.
2. They presume that poor people who live and work outside the law do not have their own local property rights systems.
3. They have framed reform as a technical issue and not a political one.

The ILD addresses these three problems head-on:

1. Understanding that the Institution of Property is the Hidden Architecture of Capital

For the ILD, property is much more than ownership: the legal property system is in fact the hidden architecture

that organizes the market in *every* Western nation—and the missing link for ensuring the rise of widespread legal entrepreneurship in *every* developing nation.

The ILD creates property systems in each country by representing assets in standardized and universally accepted records that allow owners to use their assets, whether they be businesses or real estate, to guarantee credit and contracts, and to be divided and represented in shares that investors can buy. ILD makes sure that beneficiaries of property programs are also in a position to access the instruments that store and transfer the value of their assets, such as shares of corporate stock, patent rights, promissory notes, bills of exchange, and bonds. The ILD designs the property system so that addresses can be systematically verified, assets described according to standard business practices, people can be made to pay their debts, and authors of fraud and losses can be easily identified in an expanded market.

The ILD is, so far, in fact, the only organization with a comprehensive program for reforming property and related institutions in developing nations with the aim of opening them up to the majority of the population, thus solving the underlying causes of transition failures and the rise of extralegal markets.

2. Bringing the Poor and their Customs into Center Stage

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

By the ILD's calculation, only the value of real estate held by the poor in developing countries and former Soviet nations is at least \$9.3 trillion, which is 93 times as much as all development assistance from all advanced countries to the Third World in the past three decades, or the total value of all the companies listed on the main stock exchanges of the world's most developed countries.

The ILD has discovered, through practice, how to build a property system that is rooted in these extralegal social contracts. As a result, they now have the experience in building a legal and political structure, a bridge, so well anchored in poor people's own extralegal arrangements that they will gladly walk across it to enter a new, all encompassing property law

that will connect them to the market economy and to capital.

3. Making the Head of State the Champion of Market Reforms

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

The principal objective of the ILD property program is the establishment of the rule of law. For the ILD, the route to an enduring pluralistic market economy is bringing the poor and their assets inside the formal economy, thereby reducing poverty, corruption and black markets—while increasing government revenues. Experience has taught the ILD that in order for any government to commit to a decision as far-reaching as creating a market-based system by reforming their property institutions is a giant political undertaking that requires the unflinching support of the head of state.

That is why in each country that it works, the ILD partners with the head of state. Otherwise, major reform would be doomed at the outset. *Only* the head of state and his immediate entourage can command the attention of resistant elites and garner the overwhelming political support required to wipe out the willful inertia of the *status quo*. Also, it is only the head of state who has the power to prevent the bureaucratic infighting that inevitably paralyzes legal reform. Clearly, a decision as far-reaching as creating a market-based system by reforming the legal property system, which will in turn redistribute a nation's wealth and emancipate the poor, is essentially political and should be put in the hands of the head of state right from the start.

The ILD program for the transition to the rule of law and inclusive capitalism consists of five stages:

1. Awareness
2. Diagnosis
3. Reform design
4. Implementation
5. Capital formation and good governance

It is conceptually explained in "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else" by Hernando de Soto and technically outlined on the ILD's website: <http://www.ild.org.pe>

