



DEAD CAPITAL AND THE POOR IN EGYPT

Hernando de Soto

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FOREWORD

There is the widespread view that the benefits of economic reform programs are not shared by the majority -- especially the poorest. This skepticism also surrounds the “trickle down” approach to solving the problem of poverty and the social safety nets instituted to treat it. What should be done to counter this pessimism and generate a viable reform process?

The best solution to date seems to be the East Asian model of economic growth, characterized by labor intensive export-oriented strategies and government expenditure on primary education and health services. In this publication, Hernando De Soto advocates another. He argues that the poor in developing countries own more assets than is generally believed. But this capital is “dead” because its ownership cannot be readily traced, validated, and exchanged legally. As a result, the poor cannot use their assets in efficient and legally secured market transactions, like securing a bank loan or guaranteeing the payment of water, electricity, or other infrastructure services. De Soto asserts that a formalization process would benefit both the poor and society at large.

Is this true for Egypt? De Soto presents surprisingly large numbers: 92 percent of real estate and land in the urban sector and 87 percent in the rural sector in Egypt are informal -- over 70 percent of which belong to the poor. This is equivalent to some US\$240 billion of dead capital, suggesting that a process of formalization would do much to eradicate poverty and strengthen support of economic reforms.

De Soto’s ideas received enthusiastic support at the seminar organized for him by ECES in Cairo. But participants did question whether the approach was applicable to Egypt and whether society’s poorest would actually benefit. In spite of their doubts, they agreed that formalizing the assets of the poor in Egypt is certainly worth pursuing. This process, carried out in Peru, is now being implemented in Haiti. There is no reason why Egypt should not do the same.

Ahmed Galal
Executive Director, ECES
December 1997

تقديم

هناك شبه اتفاق على أن الغالبية العظمى من السكان وبخاصة أشدهم فقراً لا يحظون بنصيب من فوائد برامج الإصلاح الاقتصادى. كما أن هناك أيضاً تشكك حول فاعلية منهج "تسرب أو انتشار الأثار" الناشئة عن الإصلاح الاقتصادى كحل لمشاكل الفقر، وحول كفاءة شركات الأمن الاجتماعى التى تنشأ لمعالجة الفقر. والسؤال هو: ما الذى يمكن عمله لمواجهة هذا القدر من التشكك، ولضمان برنامج إصلاحى قابل للتطبيق.

يبدو أن أفضل حل حتى الآن يتمثل فى نموذج النمو الاقتصادى لمنطقة شرق آسيا، والذى يستند على كل من استراتيجية تشجيع الصادرات كثيفة العمالة والأنفاق الحكومى على التعليم الأساسى والخدمات الصحية. وفى هذا الإصدار، يعرض "هرناندو دوسوتو" وجهة نظر أخرى موداها أن الفقراء فى الدول النامية يملكون من الأصول أكثر مما يمكن تصوره عادة، إلا أن ما يملكونه من رأس المال 'ميت' **Dead Capital** أو غير مستغل اقتصادياً لأنه لا يمكن بسهولة تحديده أو تقنيته، أو تبادله بشكل قانونى. ونتيجة لما تقدم فإن الفقراء لا يمكنهم استخدام الأصول الخاصة بهم بشكل فعال من خلال عمليات تبادل مضمونة فى السوق، مثل: إمكانية الحصول على قرض مصرفى، أو ضمان دفع قيمة الاستهلاك من المياه والكهرباء وأية خدمات أساسية أخرى. وعليه فإن "دوسوتو" يؤكد على أن القيام بتحويل رأس المال غير المستغل إلى أصول مسجلة رسمياً سيكون له مردود إيجابى على كل من الفقراء والمجتمع بأسره.

ولكن، هل يصدق هذا بالنسبة لمصر؟ لقد أثار دوسوتو قدراً كبيراً من الدهشة بما قدمه من أرقام تشير إلى أن نحو ٩٢٪ من الملكية العقارية والأراضى فى القطاع الحضرى و٨٧٪ فى القطاع الريفى ما زالت غير رسمية وأن أكثر من حوالى ٧٠٪ منها مملوك للفقراء، وتعادل هذا النسبة ما قيمته حوالى ٢٤٠ مليار دولار من رأس المال "الميت". وهو ما يعنى أن إضفاء الطابع الرسمى لتلك الأصول الرأسمالية سيساعد على مواجهة الفقر ويؤدى إلى تدعيم ومساندة برامج الإصلاح الاقتصادى.

وقد لاقت أفكار دوسوتو تأييداً ملموساً فى أثناء الندوة التى نظمها المركز المصرى للدراسات الاقتصادية فى القاهرة، ولكن المشاركين أثاروا تساؤلات حول إمكانية تطبيق هذا المنهج فى مصر، وما إذا كان فعلاً سيعود بالنفع على الطبقات الأكثر فقراً. إلا أنهم على الرغم من هذه التساؤلات اتفقوا على أن عملية إضفاء الطابع الرسمى على الأصول المملوكة للفقراء، أمر جدير بالاهتمام وينبغى متابعة السير فيه. خاصة وأن هذه التجربة تم تنفيذها بنجاح فى بيرو، ويجرى حالياً تنفيذها فى هايتى، ولا نعتقد أن هناك سبباً يمنع مصر من أن تحذو حذوهما.

أحمد جلال

المدير التنفيذى

المركز المصرى للدراسات الاقتصادية

ديسمبر ١٩٩٧

HERNANDO DE SOTO

President of the Institute for Liberty and Democracy, Lima, Peru

Peruvian economist Hernando de Soto is President of the Institute for Liberty and Democracy (ILD), a non-governmental organization headquartered in Lima, Peru, and director of various mining firms. As Peruvian president Alberto Fujimori's Personal Representative and Principal Advisor, he and the ILD have been responsible for initiating and helping to pass some 400 laws and regulations that have modernized Peru's economic and political system, opening it up to greater participation by the majority.

Mr. de Soto did his post-graduate work at the Institut Universitaire de Hautes Etudes Internationales in Geneva. He has served as an economist for the General Agreement on Tariffs and Trade; as President of the Executive Committee of the Copper Exporting Countries Organization (CIPEC); as Managing Director of Universal Engineering Corporation; as a principal of the Swiss Bank Corporation Consultant Group; and as a governor of Peru's Central Reserve Bank.

Mr. de Soto is renowned for his book on economic development *The Other Path*, which became a number one best-seller in Latin America. It has been published in several languages and made the *Washington Post's* best-seller list.

PART I

DEAD CAPITAL AND THE POOR IN EGYPT¹

1. Introduction

Similar to less developed countries (LDCs) and former communist nations (FCNs), Egypt is successfully carrying out an economic reform and structural adjustment program. In Egypt, as in Latin America, a concerned number of people realize the need to ensure that the program benefits, as quickly as possible, the large majority of citizens, including the poorest. This is crucial because in countries such as Peru, most people are unable to see just how economic reforms can make a substantial difference in their lives, at least in the short and medium term.

The majority perceives a gap between what macroeconomic reforms are designed to achieve and how they will affect their economic opportunities and well-being. Therefore, for a reform program to remain politically and financially sustainable, it is imperative that, aside from mitigating the adverse effects of these reforms on the poor in the short term, ways be found to bridge this gap and to link the objectives of the program directly to the economic life of all citizens.

What follows is a proposal to create these links. It is based on the following four points:

1. The aim of the reforms is to create a market economy and, if the majority of the population is to bear the costs of these reforms and be supportive, they must also reap the benefits, and the sooner the better. Part of the solution may lie in the real assets they already own, albeit informally. Interestingly enough, few are aware that the less privileged may already possess most of the land and businesses in the country, but lack the kind of formal property rights over these assets that could raise their value and convert them into capital. Because

¹ Very much is due to the personal contributions of Mr. Ahmed Galal, Executive Director of the Egyptian Center for Economic Studies (ECES) and Mr. Sherif El Diwany, Managing Partner of Integrated Development Consultants (IDC) of Cairo, who worked with the author to structure and conform the paper to the requirements of the Distinguished Lecture Series and to suit the needs and interests of an Egyptian audience. The author is solely responsible for the views expressed in this essay.

ownership cannot be readily traced and validated, and exchanges cannot be governed by a legally recognized set of rules, their assets cannot be used in efficient and legally secured market transactions. Their property is, in effect, “dead capital.” It exists in a universe where there is too much room for misunderstanding, confusion, reversal of agreements, and faulty recollection. It is useless as collateral; it can neither secure a bank loan nor guarantee the payment of water, electricity, or other infrastructure services. As long as the majority cannot put their assets to work in the market because they are informal, they will not realize most of the benefits that should accrue from macro-reforms.

2. The informal real estate and businesses owned by the poor and many ordinary Egyptians represent a surprisingly large proportion of domestic real assets. For example, a first estimate of Egyptian real estate alone indicates that 92 percent of dwellings in the urban sector and 87 percent of holdings in the rural sector are informal. This is equivalent to some **US\$240 billion of dead capital**. This amount is: 30 times greater than the market value of the companies registered in the Cairo Stock Exchange; 55 times greater than the value of direct foreign investment in Egypt until 1996; and 116 times greater than the value of public enterprises privatized between 1992 and 1996. These figures would indicate that, by formalizing informal assets, Egyptians may be able to release more potential value that can be used for productive purposes than that value which they were able to harness by releasing the trapped water of the Aswan Dam.
3. If, after reflection, everyone agrees that there is some merit to the previous point, the problem that Egyptians will face is that most property in the informal sector cannot be documented and permanently inserted into the legal and global market economy by traditional titling, registration, surveying, mapping and privatization approaches. Available Western technology does not offer the crucial processes that Westerners went through to convert patrimony and informal possession to formal property in the last few hundred years. Moreover, there is scarce experience in converting First World experience to Third World conditions today. To complicate matters, determining ownership is not enough -- the formalization process must

also include the mechanisms required to increase the productivity of the assets of the informal sector by linking them to distinguishable end products which allow their owners to relate to government and private business.

4. This presentation broadly outlines the conceptual lags and the concrete obstacles which impede formalization, and describes the essential components required to convert the assets of most Egyptians to “live capital.” It also contains some suggestions which may assist the government’s economic reform program to further increase the number of Egyptians which could benefit from the reforms undertaken.

2. Why Is There So Much Dead Capital?

The Background: Macroeconomics Is Not Enough

Many political observers in Latin America think that the wave of change to convert LDCs and FNCs to market economies which began at the beginning of this decade has slowed down. There is a growing sentiment among Latin Americans that real improvements require approaching the subject from the people’s experience.

In Latin America, most macroeconomic stabilization and adjustment programs, by their very nature, must necessarily start and end with aggregates. The issues of poverty, which affects the majority of people in Latin America, continue to be the exclusive domain of welfare and charity agencies instead of becoming an integral part of market reform programs structured to include real opportunities for the majority of citizens. This has happened before. For example, at various times over the last 170 years, Latin Americans have had several opportunities to convert to market economies. Latin Americans failed in this task because they did not consider what their own people needed to adapt to a market system but instead focused on the aggregates of macroeconomic programs.

In effect, Latin Americans have on six occasions tried to implement macroeconomic programs directed at creating market economy systems. In the 1820s they sought to reimburse the debts incurred from purchasing weapons to fight Spain. They tried these programs again in the 1840s,

1870s, 1910s, 1930s, and in the 1960s. On each occasion, through negotiations with European and North American creditors, debts were restructured and written off, interests capitalized, and grace periods extended. On the reform front they tried to stabilize the economy by controlling inflation, liberalizing trade, privatizing (for example, by selling our railroads to the British), undertaking debt-equity swaps and overhauling the tax system. And each time, after the effort and the initial euphoria, Latin Americans swung back to populism, massive nationalization and expropriations, economic centralism and anti-market policies in general.

Though there is probably more reason for optimism today, many are not convinced that the current support for macroeconomic programs in developing nations and most former communist states is yet a reflection of a fundamental shift in attitudes about the virtue of market-economic systems and Western style democracies. Rather, it generally reflects (1) the willingness to give the market model a chance, (2) the lack of real alternatives at present, and (3) a reaction against hyperinflation, chaos and failures of past policies.

For a real shift to occur, the lives of ordinary citizens in countries embarked on economic reform programs must improve noticeably. Growth and prosperity must be viewed as a realistic alternative to the poverty and underdevelopment that is the lot of the majority today. Otherwise, the temptation to return to past policies and inflationary cures for economic ills will continue to reappear.

A Crucial Missing Ingredient: Access to Formal Property

A crucial ingredient missing in most macroeconomic programs in LDCs is the establishment of widespread, legal property rights for the assets people now hold. It is not that the majority, the poor included, in countries trying to build market economies, is without property: this majority does in fact possess land, buildings and businesses. It is that they do not have formal, legally recognized rights to use these assets in the marketplace which macroeconomic reforms are supposed to create.

The reason why open markets have produced enormous wealth in the West and not in developing countries is that the property rights of citizens of Western nations over their assets are “formalized.” What does “formalized” mean? Property rights are “formalized” when they are embodied in universally obtainable, standardized instruments of exchange that are registered and governed by legal rules, and connected to the rest of the economy through mechanisms which, additionally, can support the whole range of transactions that make a market economy work. Formalization creates the rights, obligations and end products which enable the owners to relate to government and private business. It provides the mechanisms whereby the most important assets of the informal sector — real estate and businesses — can be used to secure the provision of goods and services, especially credit and infrastructure, which are their most urgent needs. Formalization transforms its beneficiaries into individually accountable customers.

Formal property rights afford economic agents in the Western nations indisputable proof of ownership and protection from uncertainty and fraud. Property rights of Westerners can then enter the marketplace as a form of specie-backed currency adapted to the rapid and frequent transfer of resources to their highest valued use. Their markets generate growth because widespread formal property rights permit massive, low-cost exchange, thus fostering specialization and greater productivity.

In developing countries, on the contrary, real estate is difficult to use in the modern marketplace. It is estimated that as much as 75 percent of all real estate parcels do not have efficient formalized titles. Without formal property, a modern market economy simply cannot exist because most assets are commercially and financially invisible. Nobody really knows who owns what and where, who is accountable for the performance of obligations, who is responsible for losses and fraud, and what mechanisms are available to enforce payment for services and goods delivered. This is called the informal sector — that part of the non-Western world where the institutions required to provide security and allow business and government to perform efficiently are not in place. It is a universe where there is too much room for misunderstanding, confusion, reversal of agreement and faulty recollection. Where the costs of unfixity and

uncertainty are so high that credit cannot be extended on reasonable terms to most people and businesses.

The majority of informal assets are therefore **“dead capital”**: they lack value as collateral for securing the interests of creditors; they are like corporations which cannot issue stocks or bonds to obtain new investment and finance. To become **“live capital”** these assets must first be formalized so that ownership can be traced and validated, and exchanges can be governed by a legally recognizable set of rules. Formalized titles were crucial to opening the doors to credit in countries such as the United States where close to US\$4 trillion of the securities floated in the market are backed by mortgages and other guarantees which formal property permits.

Think of it this way: when you drive down most roads in the Middle East or Latin America, you can see things are being used physically: houses are used for shelter; parcels are being tilled, sowed and harvested; and merchandise is being consumed. Assets in developing countries are mostly used for these primary purposes. On the other hand, in the West, houses, land and merchandise are not only used for primary physical purposes such as shelter, agriculture, production and consumption but also to secure the interests of other parties as “collateral,” for example, to generate credit. This is because they have been formalized, their documentary representations are filed in systems governed by institutions that can enforce contracts and can link them to the rest of the economy. The result is that in the West houses, land and merchandise are not only physically useful assets, but are also capital that creates wealth. Assets in developed countries are thus “live capital” compared to most of those in the Third World which, because they cannot play this wealth generating role, are “dead capital.”

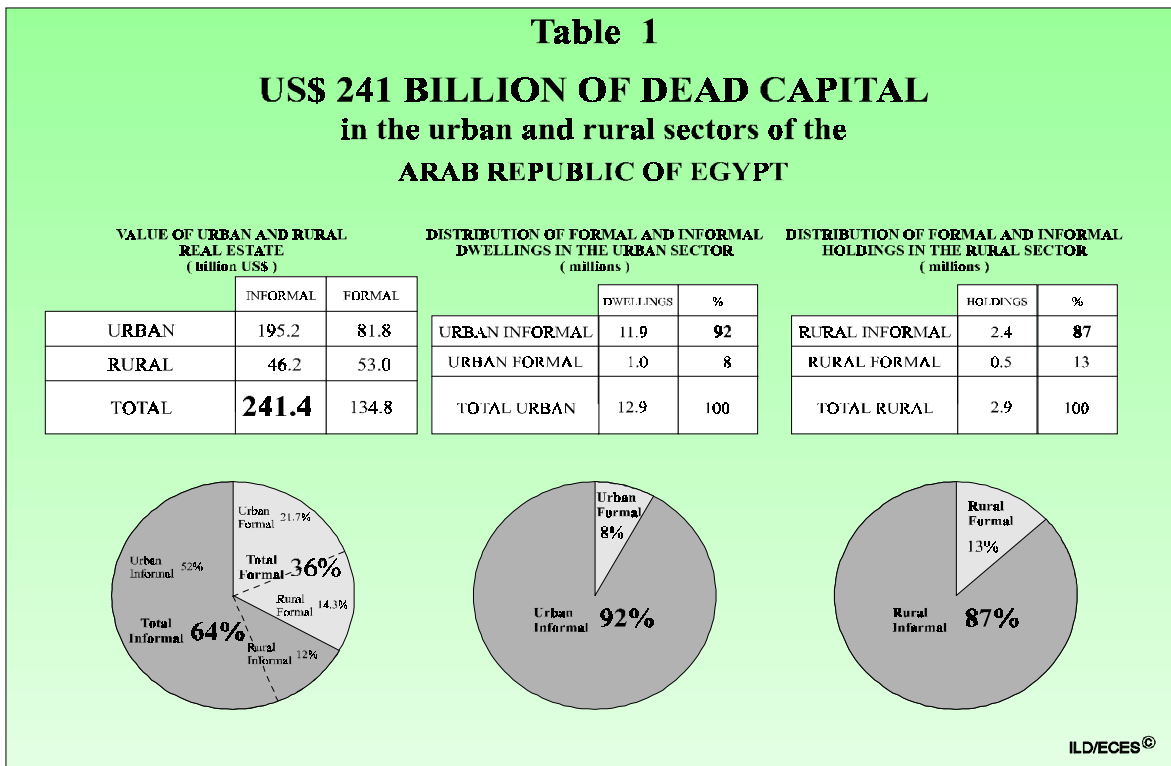
Therefore, lack of formalization condemns the majority of citizens who live in the informal sector to needless poverty. The capital value of an asset depends on the ability to enforce property rights against claims; assets in the informal sector are undervalued compared to those that are formally recognized and defensible under law. When people have formalized titles they feel that

their property is under their own legal control and they therefore have the incentive to invest their intelligence and work in improving it.

How Much Dead Capital Is There in Egypt?

How much dead capital is there in Egypt? Preliminary estimates carried out by Egyptian Center for Economic Studies (ECES) and Institute for Liberty and Democracy (ILD) indicate that informal urban and rural real estate has a value of some US\$240 billion, which represents 64 percent of total assets accumulated in Egyptian real estate. These figures are comparable to those found in Latin America (see Table 1 below)*.

What is noteworthy in addition to the value magnitude of the assets is that some 90 percent of the Egyptian population lives and works in informal urban dwellings and over 80 percent in informal rural holdings. This would seem to indicate, once these numbers have been further



*The ILD developed all the tables and graphs in this publication using multiple Egyptian sources, except for Table 2 which was developed using information from the Egyptian Ministry of Planning. The bibliography includes two publications: *The Other Path*, Harper and Row, New York, 1989, and "The Missing Ingredient," *The Economist*, London, 1993, both by Hernando de Soto.

reviewed, that even people who hold formal jobs live in informal dwellings. Therefore, a large constituency would be positively affected by a formalization program which raises the value and productivity of these assets.

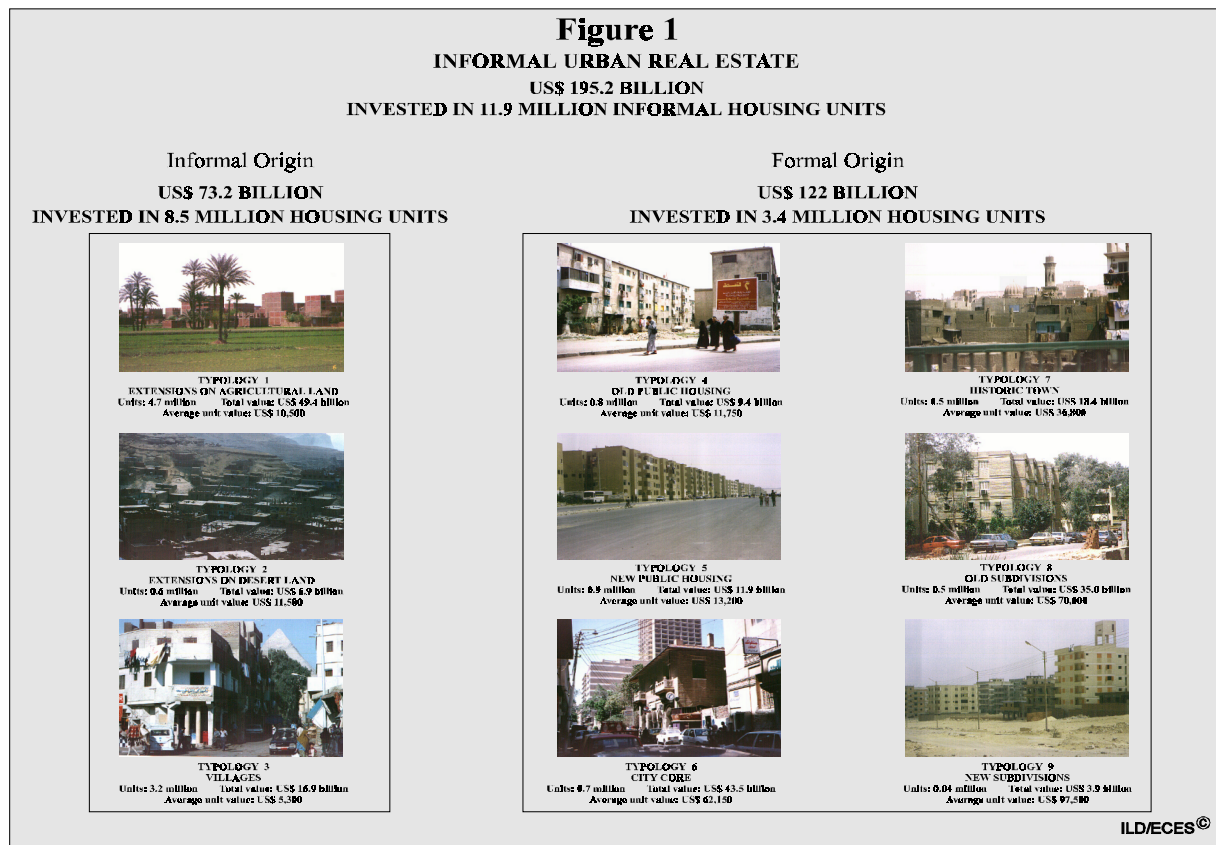
In any case, the relative importance of dead capital locked up in Egyptian real estate is enormous compared with other kinds of formal capital accumulation that exist in the country (see Table 2 below).

Dead capital in urban areas. To estimate the total value of dwellings classified as informal, which are characterized by innumerable differences in terms of type, age, state of preservation, location, and such, the existing dwellings in Greater Cairo, Alexandria and other cities in Egypt were classified into 9 distinct typologies. The value for each of these typologies was then estimated on the basis of the current replacement value of the dwellings (see Figure 1 below).

| Table 2 | | |
|---|-----------------------|---|
| | Billion US Dollars | Relative Importance of Formal Assets |
| Formal Capital versus Informal Capital in Egypt | | |
| - Investment (1989-1996) by 3,629 companies attracted by incentives of Law N°230 | 11.4 | 4.7% |
| - Market value of 746 companies listed on Cairo Stock Exchange, 1995 | 8.1 | 3.4% |
| - Investment (1979-1996) in 2,867 projects in Egypt's new urban communities | 6.4 | 2.7% |
| - Investment (1989-1996) in 650 projects in Egypt's major public free zones, 1996 | 4.1 | 1.7% |
| ● Informal Capital | 241.4 | 100.0% |
| Formal Accumulated Savings versus Informal Capital in Egypt | | |
| - Direct foreign investment, 1989-1996 | 4.4 | 1.8% |
| - Total savings and time deposits in commercial banks, 1996 | 39.2 | 16.2% |
| - Central Bank net foreign reserves, 1996 | 18.4 | 7.6% |
| - Contractual savings, 1996 | 14.9 | 6.2% |
| - Post office savings deposits, 1996 | 0.9 | 0.4% |
| ● Informal Capital | 241.4 | 100.0% |
| Privatization versus Formalization in Egypt | | |
| - Capital previously trapped in public enterprises that Egypt has freed through privatization, 1992-1996 | 2.1 | 0.9% |
| ● Capital Trapped in Informal Real Estate that Egypt could Free through a Formalization Process | 241.4 | 100.0% |
| Another way of saying this is US\$ 241 billion of informal capital is: | | |
| ● 6 times greater than total savings and time deposits in commercial banks in Egypt | | |
| ● 13 times greater than accumulated net foreign reserves up to 1996 | | |
| ● 16 times greater than accumulated investment in formal assets made by private firms attracted by incentives given by the government of Egypt through the Investment Law | | |
| ● 30 times greater than the market value of the 746 companies that registered in the Cairo Stock Exchange in response to incentives provided by the Capital Market Law | | |
| ● 55 times greater than the value of direct foreign investment in Egypt up to 1996 | | |
| ● 116 times greater than the value of the 63 public enterprises privatized between 1992 and 1996 | | |
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The next step was to apply informality coefficients to each typology, taking into account the principal characteristics associated with informality. As a last step the value of informal property for each typology was estimated and the total value of informal housing in Egypt was obtained by summing the values for each typology.

The dwellings in the first three typologies (dwellings on agricultural land, on state-owned desert land and villages on rural land) were constructed in violation of express legal prohibitions or without respecting the established legal procedures and cannot enter an expanded formal market. For these reasons they were considered informal from their origin. The other six typologies (old public housing, new public housing, city center, historic town, old subdivisions, and new subdivisions) include dwellings that were initially formal but progressively became informal and could not enter an expanded formal market. The reasons for becoming



informal were various, including: the owners violated express prohibitions; dwellings were constructed without a license and without respecting the building code or zoning regulations; the owners do not have a property title or the title has not been registered; the registry’s records on the property right have not been kept up to date.

The estimated value of all nine typologies of informal housing is US\$195.2 billion. This represents 70 percent of the overall value of all urban dwellings in Egypt.

A more detailed account of these figures and a description of the assets they represent, as well as an explanation of the methodology used to obtain the figures, are contained in Annex 1 of this presentation.

Dead capital in rural areas. To estimate the total value of agricultural land classified as informal, agricultural properties were first classified into four categories according to the size of holdings

Table 3

INFORMAL RURAL REAL ESTATE

US \$ 46.2 BILLION
INVESTED IN 2.4 MILLION INFORMAL HOLDINGS

| INFORMAL HOLDINGS WITH LESS THAN 3 FEDDANS | INFORMAL HOLDINGS WITH 3 OR MORE FEDDANS | | |
|---|--|--|---|
| <p>UNITS : 2,174,000</p> <p>TOTAL VALUE : US \$ 32.9 BILLION</p> <p>AVERAGE VALUE : US \$ 15,152</p> | <p>BETWEEN 3 AND LESS THAN 5</p> <p>UNITS : 205,000</p> <p>TOTAL VALUE : US \$ 9.2 BILLION</p> <p>AVERAGE VALUE : US \$ 44,878</p> | <p>BETWEEN 5 AND LESS THAN 15</p> <p>UNITS : 46,000</p> <p>TOTAL VALUE : US \$ 4 BILLION</p> <p>AVERAGE VALUE : US \$ 86,956</p> | <p>EQUAL TO OR GREATER THAN 15</p> <p>UNITS : 0</p> <p>TOTAL VALUE : 0</p> <p>AVERAGE VALUE : 0</p> |

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for each governorate. The property value of these agricultural areas was then estimated using the average price of agricultural products cultivated in these properties. Next, informality coefficients were applied, differentiated by the size of holding. The total value of informal rural holdings in Egypt was then obtained by adding the values for each category (see Table 3 below).

Informality in rural areas is largely due, among other things, to the following reasons: complications which arise from subdividing property as a result of inheritance processes; the high costs of the titling and registration processes; the legal impossibility to use property as collateral, reducing the incentive for small-holders to formalize; and frequent migration of small-holders because of work-related opportunities, making it difficult to formalize property rights.

According to information provided by specialists in Egypt, the citizens most affected by informality are small-holders with properties of less than 3 feddans². These land holders were grouped in the first category and it was considered reasonable to establish that all small-holdings under 3 feddans are informal.

As the size of the holding increases the land holders are better prepared and have more economic resources to solve problems related to poorly defined property rights. For this reason, for the remaining three categories (properties between 3 and 5 feddans, land holdings between 5 and 15 feddans, and holdings of greater than 15 feddans) a decreasing informality coefficient was used as the size of the holding increased. It was assumed that in the last category (holdings of greater than 15 feddans) all of the holdings were formal.

Based on this methodology, the estimated value of all agricultural property classified as informal is US\$46.2 billion. This means that 47 percent of the total value of agricultural property in Egypt is informal.

A more detailed account of these figures and a description of the assets they represent, as well as an explanation of the methodology used to obtain the figures, are contained in Annex 2 of this presentation.

² One feddan is equivalent to 0.42 hectares.

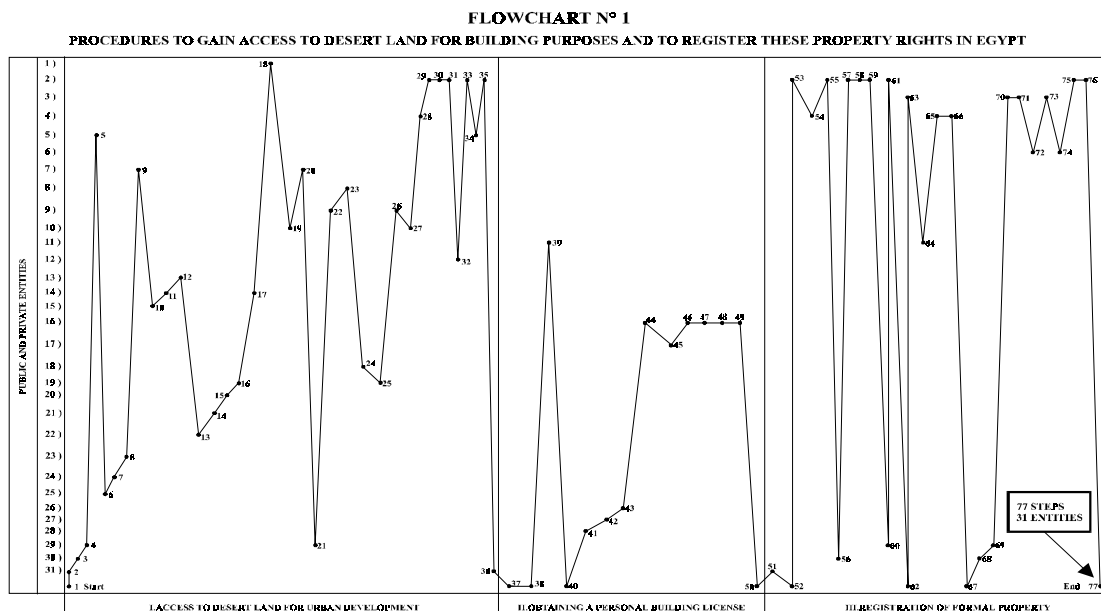
In short, the sum value of both informal urban dwellings (US\$195.2 billion) and informal rural holdings (US\$46.2 billion) is in the order of US\$241.4 billion.

Why Does Egypt Have So Much Dead Capital?

The fundamental reason why all developing countries have such unnecessarily large informal sectors — and hence dead capital — is a general lag in understanding the phenomenon. It is however doubtful that the principal causes are cultural. The real problem is the lack of knowledge there is about the nature of informality and of the enormous consequences of the structural informal-formal divide in certain countries.

This paper summarizes the results of a couple of pilot projects carried out with ECES and various Egyptian professionals in the last 4 months in Cairo which will illustrate just one way in which the informal-formal divide manifests itself.

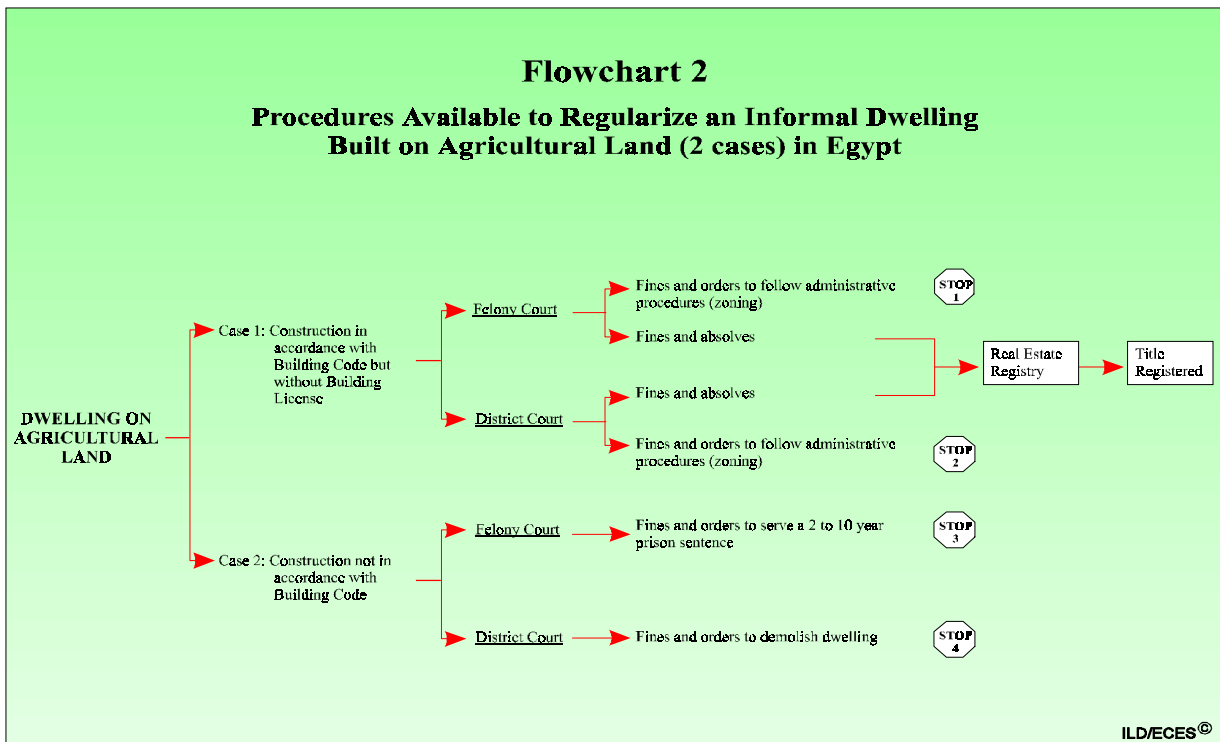
The objective of the first pilot project was to make a preliminary estimate of the cost of the procedures required by poorer Egyptians to acquire property on a formal basis. To this effect, the project simulated the case of an Egyptian citizen who wished to formally acquire a parcel on



state-owned desert land to build a dwelling unit and then register the property following legally established procedures. Flowchart 1 below summarizes the findings: it requires the individual to carry out **77 bureaucratic procedures** in some **31 different public and private offices**, all of which could take some **6 to 14 years of red tape**.

The objective of the second pilot project was to make a preliminary estimate of the procedures required to regularize informally acquired or constructed property. In other words, what must an informal sector business do to make amends and become formal? To this effect, the project simulated the case of an Egyptian citizen who had informally built a dwelling unit on agricultural land and wished to have his or her property rights formally recognized.

Flowchart 2 below summarizes the preliminary findings. In four out of six procedures that could be followed, the formal owner would have to abandon the procedures not only because they are lengthy but also because he or she runs real risks of **having the dwelling demolished, serving a prison term of 2 to 10 years, and paying steep fines**.



A more detailed account of these two pilot projects and the obstacles to formalization is presented in Annex 3.

Before attributing any particular culture with the magnitude of apparent lawlessness among the poor and the apparent disorder it brings, it is essential to examine the legal institutions and the role they play in the informal-formal divide. Therefore, creating formal property from informal possessions that can then further be converted into capital is a task that goes beyond record keeping, computers, surveying and mapping.

3. The Benefits of Formalizing the Property of the Poor

From the Standpoint of Macroeconomic Reform Programs

Economic reform programs would benefit from property formalization for three principal reasons.

First, unlike macroeconomic models, real property is an integral part of daily life and can therefore be easily understood by all. Probably some 70 percent of the assets people hold in emerging markets consist of real estate. As opposed to the poor minorities of Western countries, most of the poor majorities outside the West actually possess real property. Yet, because the poor in developing countries are hard pressed, earning a living, rearing children and surviving, they cannot be asked to understand reform programs, especially if they cannot perceive how they can benefit from them. Unless an attainable ideal is feasible, such as enhancing their possessions and their well-being as part of the economic reform policy, attracting their interest is futile.

The second reason to focus on property is because market economies are nothing more than institutions created to facilitate the exchange of legally held property. Markets do not create great wealth unless the property and transaction rights of citizens can be legally and effectively enforced. The difference between developed and underdeveloped countries, after all, is not that one has markets and the other does not. Markets are an old and universal tradition. Egyptians were taking their products to market long before Adam Smith was born; Peruvians were trading long before Columbus reached America; and Christ threw merchants out of the temple for having

degraded it into a market 2,000 years ago. The reason why so-called open market economies have not been very successful in the Middle East and Latin America in the past is not because their citizens do not like markets, but because they have never had enough formal property to make a modern market economy possible.

The third reason is that macroeconomic reforms will be politically sustainable over the long run only if the majority is given the means to create capital and access the legal market -- only if a substantial constituency is supportive. Stabilization and macroeconomic adjustment measures, that only provide opportunities for a few and do not create formal property from informal possessions that can then further be converted into capital, fly in the face of historical evidence.

The great contradiction in a reform process where formal property cannot be accessed by the majority is that it tends to concentrate capital in a few hands. Unless the majority is given the means to form capital, share in surplus-value and access expanded markets, this contradiction will likely become fertile ground for class confrontation.

Economic reform programs that successfully stabilize monetary and fiscal variables and reduce market distortions and imperfections have only just completed an initial part of the important task of putting in place a modern market economy. If they stop at that point, these reform programs will not be identified as instruments of change and will eventually be perceived -- as is increasingly the case in some Latin American countries today -- as supporting the status quo and the poverty and dissatisfaction still afflicting the majority of the people. If this association continues to grow, so too will the view that the direction begun with economic reforms only benefits those who are already rich and have capital. Those who believe in modern market reforms will only succeed if they are able to break the tradition of economic and legal apartheid which condemns the majority of Third Worlders to informality and deprives them of access to capital and expanded markets.

From the Standpoint of the Private Sector and Society in General

The fact that most assets in the developing world are informal also hampers the ability of both the private sector and the government to provide infrastructure services for those who most need them. Many of the problems that discourage the investment needed to supply electricity, water and gas outside the West — a market supposedly worth more than US\$1 trillion over the next 5 years — can be traced downstream to informality. Most of the losses of public utilities in developing countries originate in the informal sector: technical losses (due to lack of information about users) and non-technical losses (such as fraud, theft and lack of individual accountability) represent some 30 percent to 50 percent or more of total supplies, versus 8 percent in the United States and Western Europe. This is easy to understand when walking through cities, towns and farms in emerging markets and consider how difficult it is to collect debts when you do not know for certain who owns the terminal where the utilities' wire or tube ends. Moreover, because informal property holders cannot defend their assets through formal law, they have had to “massify” into defense organizations which protect their property rights collectively using political devices and pressure. Under these circumstances, it is difficult, if not impossible, for investors and entrepreneurs to identify individually accountable customers and, therefore, to supply the basic infrastructure which most citizens severely lack.

Civilized living in market economies is not simply due to greater prosperity but to the order that formalized property rights bring. Herewith follow a few examples. When poor people have confidence that land is formally theirs, their respect for other people's land also increases. Like many subversive groups in the world, Peru's Shining Path made gains among peasants by settling boundary disputes and protecting their land from threat of real or imagined expropriation. Formal title would give the poor of the Amazon basin legal alternatives to selling coca leaves to drug traffickers. As long as the farmers who grow coca remain informal, longer term cash crops for legal markets will be less interesting to grow and trafficking money will continue to be the only means to gain access to credit. Moreover, without registered property the government cannot find them, identify them or reach an enforceable crop-substitution agreement with them. Property records also give the police the possibility of acting more selectively because they can access

addresses and other property related representations which should allow them to impose order with greater possibilities for respecting human rights.

Finally, from an ecological perspective, when formal title is not there to provide security of tenure, planning horizons are shorter and so the incentives to protect land, water and forest are missing. Investments to improve soil, reduce erosion and control the accumulation of rubbish are less likely to be made; informal ownership introduces a bias against the intensive development of existing land in favor of expansion on to virgin land. When ownership is uncertain, there is a tendency to “mine” the land by maximizing its short-run production at the expense of preserving its long-term value. Crops, such as trees, whose cultivation can enhance the environment but which require many years before they turn a profit, are simply not planted.

From the Standpoint of Government in General

It is clear that formal property is more than just about ownership. It actually creates incentives and an organizational network that captures, processes and transmits information. It provides a space and a language where human productivity and endeavors can meet.

Moreover, non-Western efforts to create economically enfranchised citizens will always be handicapped so long as informality persists. It is the presence of widespread informality that is responsible for the pervasive lack of knowledge about the majority of economic activities and assets in these countries and the absence of means to deal with them.

Problems created by informal property go far in explaining: why macroeconomic stabilization and structural adjustment programs that have not been able to benefit the overwhelming majority of the population have failed to create support for sustainable market economic systems; why there is a lack of credit at reasonable cost from the formal banking system for this same majority; why the risks in financing and providing infrastructure services such as electricity, water and gas, due to huge losses resulting from theft and the inability to plan efficient distribution facilities are so high; why governments have so many difficulties in motivating private investment in areas where they are most anxious to trigger development; why fiscal authorities cannot collect taxes

efficiently, seriously handicapping the ability of governments to perform their duties adequately; why there is growing insecurity in the slums, squatter settlements and hinterland of many developing countries; and why governments are unable to maintain law and order; and, finally why many countries in spite of buying more automation hardware and software are failing to create an information revolution due to the lack of information input for computers on the majority of the population and its assets. These are just some of the problems.

People in a market economy environment, without a system that allowing them to exercise formal property rights over their assets, are helpless. Informal possessions without a widespread formal property system is like a society where people have telephones without the lines and a central switchboard that connects them to other telephones. There can be no modern governance in a sustainable market economy without formal property.

It is crucial to understand that property goes beyond possession and ownership because creating property is essentially about building institutions. Like government and money, formal property is created through human agreements for very specific utilitarian purposes. It does not require an increment to what is already known, but an understanding of the phenomenon, and the revaluation of existing perceptions. Nothing short of a revolutionary process.

4. Why Was Property Formalization Not Previously Perceived as a Crucial Missing Ingredient for Macroeconomic Reforms?

Why was the importance of the formal-informal divide not before recognized? Why was property not thought of in the formal-informal context? Why has the West been unable to teach developing countries how to create formal property from the possessions of the poor? Why have the hundreds of thousands of Third World and former communist citizens who have studied in the West not come home with the answers?

At present, my reply to these questions is — for want of a better word — **a lag**. A general lag in understanding that can be broken down into at least four parts: historical, political, cultural, and technocratic.

The Historical Lag

There is no account of the Western countries' transition from patrimony or feudalism to property in a manner that can be useful to a politician or technocrat in an emerging market nation looking for clues as to how to formalize informal property.

One reason is that Western scholars have not had enough time to determine just what their forefathers did to make property a reality. After all, contrary to popular opinion, formal property as considered here is a relatively recent phenomenon. In the West it is probably not more than 200 years old and in most Western countries it only became widespread about 100 years ago; in Japan less than 50. Since it was probably more the result of unconscious evolution than conscious planning, the implications and consequences of property creation only become apparent with time. Westerners have not been able to clarify the issue because once they finished enrolling all their assets into a formal system, formality was taken for granted and sunk into the collective unconscious. As Albert Einstein once said: "What does the fish know about the water in which it swims?"

The second reason is that just as history is usually written from the victor's viewpoint, so property is considered from the point of view of developed countries. By the time the subject was raised in the West, largely from a prospective point of view, property as a phenomenon, although far from fully developed, had already left the nursery and most commentators missed the moment of conception. To further confuse matters, this trend has continued and today's burgeoning literature on formal property either takes its genesis for granted, or attributes difficulties in generating property systems to arguable "cultural differences."

The third reason why the process of formal property creation is difficult to identify is that the transformation took place over a long period of time as the customs and norms of the peasants were slowly absorbed into formal law. It is hard to follow the thread of the story and to isolate it from other facts. In Germany, for example, the process by which property was formalized began in the 12th century, when written documents first replaced the informal oral rites used by the

peasantry, but it was not completed until 1896 when the *Grundbuch* system for recording land transactions was finally extended to the whole country.

The fourth reason why the connection between formalization and the market has largely been overlooked is that pressures by informal tenants to convert patrimonial land and political concessions into widespread formal property are often hidden beneath other unrelated historical events. The appearance of widespread property ownership in France is viewed as the triumph over feudalism rather than the beginning of a formalization process. The concessions on property extended to German peasants at the beginning of the 19th century are remembered as a tactic for enlisting their support against Napoleon and insulating them from the effects of the French Revolution, rather than as the official initiation of awarding title to common folk. The granting of formal property rights to homesteaders and squatters in North America is recounted as a political strategy for expanding territory by pushing back Indians, Mexicans and European colonists. In Japan, South Korea and Taiwan the massive campaign to formalize the property of farmers after the Second World War is fixed in memory as a policy to destroy a feudal class, contain communism and weaken local elites, rather than as one of the most important measures taken for market-economy systems to flourish.

The fifth reason is that existing literature on the history of Europe, North America and Japan was not written from the angle of the transition from informal to formal property. Therefore, few people, if any, have perceived that property rights developments, like thought patterns and social behavior, seem to come into effect at different times in each country, but at the same stage in the historical development process. In other words, the cultural differences between North and South are interesting and charming, but they in fact serve less in unraveling the mysteries of development compared with the cultural similarities of societies at the same developmental stage but at different times in world history.

Today, the problems facing emerging markets are best understood if considered from the point of view of Western countries, especially during the eighteenth and nineteenth centuries. At that time, property was being born in the West. Informal groups were fashioning rules to govern their

own relationships regarding property. These rules arose either because of the absence of relevant guidance from local and national governments, or because government imposed rules were considered ineffective. When discovering the existence of privately developed rules on property, governments finally revised, accepted and systematized those rules. Nearly all Western countries went through a stage where their officials recognized the potential benefits of informal popular rule-making, and incorporated the product of that process into national or federal law.

This is what happened in post-Second-World-War Japan at the time of US occupation when Kubakus, or village hamlet authorities, made the crucial decision to recognize the rights of the people to obtain the previously feudal land holdings. It was also the case during the Stein Hardenberg reforms at the beginning of the nineteenth century in Prussia, which were extended to all of Germany by the end of the nineteenth century. And it was definitely the case at the end of the last century and the beginning of this century with Eugen Huber's reforms in Switzerland, where local customs and decisions of private groups were brought together by the federal government to create property currency throughout the Swiss confederation. The same was true, of course, in the United States of the nineteenth century where a great deal of what is today considered stable private property had its origin in private decision making at times of great migratory movements. Their decisions were later validated by State Legislatures, the US Congress and, subsequently, the US Supreme Court, which recognized that certain rules of government regarding rights to land were framed by the "ingenuity of the American people."

The validation and systematization of informal real estate occurred all throughout the West, when the law was not able to keep up with migration or the rapid evolution of the social contract. Informal arrangements given due process have been the source of new law in all developed countries. All these processes essentially constituted a revolution, a revolution by law. Developing nations and former communist countries are now faced with this revolution. But they are missing the tools needed to avoid further unnecessary lags in changing the law to adapt itself to the reality of massive informality in our countries, especially in the last 30 or 40 years.

It is important to understand that the current fundamental problem of property in developing nations and former communist states is different from the property question in the West. In the West the argument is over the sanctity of individual property rights and the concerns of the rich for their possessions. The case of developing countries and former communist nations is different: it is principally about the lack of access to formal property by the overwhelming majority. Only when the access issue is settled will the current Western debate and issues on property take center stage.

The Political Lag

History seems to imply that the genesis of formalized property began from the bottom up -- the surfacing of informal law in some cases ran counter to official law. The transition to formalized property was essentially not premeditated, but was rather something the developed world stumbled upon not long ago. The political regimes in place today are those which recognized that property is a creation of the law justified by utilitarian considerations and the legitimate and peaceful interests of a social majority.

The West became what it is today through a close relationship between what was happening at the bottom and what occurred at the top. Grassroots economic initiatives were as relevant in creating the laws of developed countries as statutes and court decisions. Many years before the law was systematized into a distinct structure managed by professionally trained specialists, there was an informal order which gave rise to it.

For decades informality in the developing world was considered an issue of marginality, such as black markets, poverty, or unemployment in developed countries. It was something for anthropologists like Margaret Mead, and human rights heroes like Mother Teresa, to worry about. But the explosion of informal activity, the sprawling illegal cities — *favelas* in Brazil, *ranchos* in Venezuela, *barrios marginales* in Mexico, *pueblos jovenes* in Peru, *bidonvilles* in former French colonies, shantytowns in former British colonies — and massive rural squatting in the Third World over the past 50 years are nothing more than the spontaneous, unbridled

emergence of informal property: a process which will require formalization if this energy is to be channeled into organized and prosperous market economies.

Widespread informal land holding in developing countries shows that the connection between macroeconomic reforms and property issues must be made if political leaders are to grasp the full significance of informality. For if they had, they would have realized that the differences between developed and developing countries is in no small measure the difference between countries where property has been formalized and those where it has not. Third World leaders are basically facing the same challenge that politicians of Western nations dealt with 100-200 years ago: massive informality appears when governments cannot make the law coincide with the way people live and work. The difference is that today, thanks to dramatically larger populations and the communications revolution, there has been a much speedier consolidation of informal rules on property.

The problem is not that governments of developing countries are unwilling to recognize property rights. Nearly all their constitutions make the right to property fundamental, and they are parties to treaties, such as the Universal Declaration on Human Rights, which say that equal access to property rights is part of the fundamental rights of humankind.

What stands in the way of the formalization of land in developing and former communist countries is that most rights over property and ownership arrangements are defined by informal agreements, and formal authorities do not have efficient institutions and mechanisms to connect with them. The principal drama of these countries is that their political and legal systems do not have the mechanisms to pick up continually emerging consensuses, and cannot automatically correct themselves when faced with new problems.

Moreover, no single institution is responsible for formalizing property: responsibility is spread across a myriad of government departments. And the few procedures for formalizing individual parcels are expensive and time-consuming; adverse possession proceedings can take endless years of continuous paperwork. Furthermore, traditional property-registration systems are designed to manage gradual changes in land ownership and are not geared to registering a

massive number of informal properties. They are centralized and cannot reach remote places nor process information with the ease and speed required for a market economy.

To complicate matters, in regions such as Latin America the system is obsessively concerned with bureaucratic paperwork and details of authenticity and verification. Well within colonial traditions — even after 170 years of independence from Spain — Latin America jurists have been taught to create law through the exegetic adaptation of foreign legal texts. What is missing are techniques that involve citizens: participation, accountability, transparency or grassroots practices. As a consequence what Latin America lawyers are really good at is adapting law to documents, not adapting law to people. They know much about how land is bought and sold, but little or nothing on how to generate formal property rights and connect them to the market.

The Cultural Lag

One of the main problems today is that economists and policy makers do not fully realize that property exists in a social and not a physical space. The principal source of obscurity today comes from the fact that most people view property as a measurement endeavor generally confined to the domain of cadastral cartographers, surveyors and engineers. This view fails to appreciate that though a property may be illustrated in its physical appearance it is the product of a social and institutional construct and is therefore a crucial underpinning of society that helps bring all sorts of things together.

Think of it this way: when property changes hands, nothing about it changes. By looking at something, a parcel of land, a llama or a camel, there is no way of knowing whose property it really is. A stolen camel looks exactly like any other. If this is the case then to focus on the physical thing misses much of the point. What does change, for example when something is transferred, is the way in which people behave in relation to it and its owner, and this change is mediated by the minds of citizens. What this boils down to is that property is a concept rather than a thing in itself.

The strength of formal property creation is that it detaches the perception of things from their physical space to a mental space where people can more easily envision alternative uses of things and deploy the full powers of their imagination. What Western formal property representation systems did was increase the range of conceivable uses and operations of assets. Formal property titles, when constructed correctly, act like a beam which focuses the light of a greater consensus into a more coherent beam. It illuminates the land projecting it into relief and revealing all of its potential uses.

The development of formal property could therefore be considered one of the most remarkable achievements of the West. It made it possible to enter the network of switches and connections needed for a market economy. The formalization of real estate provides agents with the means to perceive the bundle of possibilities as their disposal to be used in a variety of conditions and from different points of view. Formal property thus changes the cognitive environment of human beings and should be an important part of any adjustment process.

The Technocratic Lag

Property, like all institutions, is built by human agreement for specific purposes. There have not been enough resources channeled into efforts to understand how it is created, its social underpinnings and their implications. Whatever resources are spent in this direction are mainly dedicated to technological devices and services which did not even exist when the West created formal property.

In this context, some enlightened technicians are becoming increasingly conscious of the fact that while they may be getting better surveys, maps, and computer equipment to manage information, they are not converting informal into formal property. There is a growing awareness that existing land titling projects are not dealing with problems of formalization. Rather, they are dealing only with *property documentation* services which focus on *surveying and mapping* and the *modernization of registries*. Surveying and mapping efforts are indispensable for defining physical location, but they reveal nothing about who has rights over what land, and they

contribute even less to the fundamental challenge of converting informal to formal property in the first place.

The automation of information in property registries made possible by computer technology has revolutionized the storage and retrieval of information but has been of little value in creating formal property. Rights and obligations in the informal sector are not embodied in standardized instruments that computers can accept and process or in formats that databases can store.

Most top experts in the West who run registry systems acknowledge that they are not equipped to design and implement the institutional infrastructure required to bring informal assets into a sustainable market economy. While it is true that the legal status of the assets recorded rests partly on rules that govern the registries, most of it derives from an institutional framework that exists outside their range of responsibilities. In many cases, existing registries constitute the last stage of an incremental process that has evolved over hundreds of years to give security to property, but they lack the awareness of the genesis of property and its connections to growth and governance.

Since many emerging markets do not have formal and easily accessible property infrastructure, surveying and mapping, information technology, and registration, expertise from developed countries is mainly useful to improve the documentation on property already formalized. But this expertise has generally not been helpful when it comes to resolving the problems of informal ownership. In developed nations, property has already been formalized as a result of a slow process that lasted hundreds of years and is now embedded in socially and legally accepted norms. Assets are already part of a regulatory framework that allows property rights to guarantee the performance of obligations and protect holders and third parties from uncertainty and fraud.

This is why, with a couple of exceptions, the land titling projects carried out since World War II have bogged down or been abandoned. These projects have generally failed to produce economic growth, facilitate credit, or provide the massive benefits that should come with the creation of formal property. The reason for this is that they have dealt principally with property

documentation, and not with the obstacles that block formalization efforts. They focus on the tasks required to document property which is already a part of the formal market economy. As a result they have generated an abundance of mapping, surveying and state of the art computer registries that have produced, at best, limited and short-lived real estate inventories. Owners, after subsequent transactions, slip out of the registries, making them simple “snapshot” books — useful for historical purposes only. They remain, therefore, quite disconnected from the economic and social aims that formal property is supposed to achieve. None of them properly address the challenge of how to systematically and massively bring informal property into the formal market so that it can be adequately documented.

Experience to date seems to demonstrate that existing titling in LDCs and FCNs, or the transposition of Western titling and registration systems to those countries, do not generate additional value that converts these assets into capital. Therefore, the recognition of individual or collective property rights over assets in LDCs and FCNs using traditional methods does not raise their productivity at all or even significantly.

5. How to Convert the Assets of the Poor into Live Capital?

The basic problems which must be resolved if formalization of real estate and business in LDCs and LDFCNs is to be successful can be grouped into **three** categories:

Most property is in the informal sector and it cannot be documented or inserted into the legal and global market economy by traditional titling, registration, mapping and privatization approaches, among other reasons, because:

- most property is in the informal sector and cannot be documented by traditional mapping and registration approaches;
- informal property is complex and diverse and defined by institutional arrangements that cannot be picked up through traditional titling and record keeping schemes;
- informal proofs of ownership are not accepted by formal law;

- jurisdictions and boundaries of informal communities are difficult to identify within the context of formal law;
- informal property boundaries are difficult to integrate on to official maps;
- owners of informal property rights are difficult to identify on a massive scale; and
- disputes between competing claims, formal and informal, are difficult to resolve within the context of formal law.

Existing formal organizations and institutions are not designed to deal with widespread informality, among other reasons, because:

- registries and other property-related institutions cannot manage massive change;
- overlapping functions and responsibilities;
- bureaucratic infighting and resistance;
- legal monopolies and other restrictive practices;
- complex, expensive, and time-consuming procedures;
- documents are difficult to retrieve (poor indexing);
- conflicting records (many titles issued for the same property);
- conflicting legal maps (overlapping boundaries);
- faulty titles (mistakes, missing information);
- titles do not satisfy collateral requirements; and
- property registration is rapidly outdated since existing procedures cause subsequent transfers to be carried out informally.

Ownership is only one segment of the larger formalization process that converts “property” into “capital.” Traditional approaches to titling and registration of assets do not include the mechanisms required to make the assets of the informal sector even more productive by linking them to the legal and economic network of modern market societies.

All the elements assembled together reveal that successful formalization throughout the history of developed and developing countries requires a process which solves all the above problems and which is rightly called “formalization.” Formalization is a highly integrated, purposeful process which brings together complex interrelationships and arrangements among individuals in the informal sector to hold and manage assets. It leads to clearly distinguishable end-products which enable owners to relate to government and private business. It provides the mechanisms whereby the most important assets of the informal sector — real estate and businesses — can be used to secure the provision of goods and services, especially credit and infrastructure, which are their most urgent needs. Formalization transforms its beneficiaries into individually accountable customers.

The ILD, with USAID financial, intellectual and moral support, have demonstrated this in two pilot projects in Peru:

- *A real estate property creation system (Proform) that transforms informal property to recorded formal property on a massive scale, many times faster than, and at less than one percent of the cost of any other system in the world.* From 1990 to 1993, Proform formalized 300,000 properties in Peru and El Salvador. Significant increases in production (40 percent), income (100 percent) and asset values (200 percent), as well as access to credit (340 percent), followed.
- *A business registry system for corporations (Businessform) that enables massive formalization of enterprises that worked outside the law, and the creation of new enterprises that otherwise would not have existed, or that would have been created inside the informal sector.* From 1991 to 1994, some 275,000 informal enterprises were formalized and 105,000 new firms that otherwise would not exist were created, adding more than 550,000 new jobs, saving US\$690 million in administrative expenses, and raising tax revenues by US\$1.2 billion.

The creation of formalized property in emerging markets requires — just like a train — a pre-existing system of tracks and switches to link one destination with another. The challenge is to lay a system of tracks that can efficiently link the rights to formalized property with agents in the formal marketplace. Just like railroad tracks, the blueprints for formalization must be adapted to the landscape. This is basically what, unwittingly, all developed countries have done. It is the invisible framework, deeply imbedded in their collective subconscious, within which they operate.

These would be the main components.

- A) Determine magnitude and causes of informal property and extralegal norms which govern it.**
1. Detect and decode the innumerable ways in which property rights are held and exercised by the different informal communities in the nation. Identify and document the distinct risks, real and potential, which informal owners and their would-be trading partners in the formal commercial sector confront in each of these different collectives.
 2. Discover the informal methods for reducing risk which are effective and are compatible with existing legal provisions and identify those utilized in the formal sector. Include in the property formalization process those elements that can be used as mechanisms to reduce risks.
 3. Determine points where the extra-legal norms coincide with the law in order to facilitate the incorporation of informal property into the legal system.
 4. Determine points within the law which would facilitate the incorporation of informal property into the formal order without compromising the level of security the formal order provides for property already covered.
 5. Identify and modify those laws and regulations which cause informality.

6. Develop, for each of the distinct risks identified, mechanisms which reduce or eliminate them.

B) Develop institutional reform.

7. Identify and connect with the formalization process the different institutions and organizations that presently govern property rights.

8. Develop institutions and procedures which permit, within the bounds of the law and respecting existing and effective property rights, economies of scale in all the activities which constitute the process of formalization.

9. Design, obtain approval for, and put into operation agencies which will be able to execute the formalization process.

10. Establish institutions and organizations which will permit the rapid introduction of changes in the diverse approval processes required for formalization, as well as changes appropriate to each informal community, and eliminate those norms or procedures which hinder formalization.

11. Develop and propose a comprehensive program of formalization which, besides including procedures and institutions responsible for formalization, incorporates the political priorities of the government and reflects a consensus within society.

12. Consolidate into manageable packages the laws and procedures which will govern the formalization process.

13. Formalize property in ways that increase its value and permit its true owners, uses and location to be identified with certainty. This will furnish the state with new sources of information, investments, and ways of collecting taxes, and it will facilitate as well the extension of basic public services to areas which still do not have them.

14. Establish procedures which ensure that the costs of remaining formal remain below those of informality.

C) Collect proofs of ownership.

15. Design mechanisms to obtain the massive participation of the members of informal settlements for the purpose of reducing the costs of formalization.

16. Develop manuals which explain to authorities of informal settlements the ways in which they can participate in the selection and collection of proofs of ownership.

17. Write explanatory manuals and design training courses for the organization of formalization brigades which reflect the types of informality they will find. Include in the manuals instructions on how to prepare maps which show the location and dimensions of each plot and ascertain that the documentation reflects what is actually present on the ground.

18. Devise procedures which will facilitate the use of lawyers and engineers as verifiers certifying the validity of the information, both textual and graphic, furnished by the organizations in each settlement. This will permit the establishment of individual rights to each parcel.

D) Devise and implement a communications strategy.

19. Design the means of communicating to society in general the benefits of formalization, emphasizing the reduction in risks and making it clear that formalization will neither affect existing property rights nor compromise the rights of third parties.

20. Devise methods of communication appropriate for each informal community that facilitates the participation of each.

21. Identify the particular language of and the permanent channels of communication to each settlement and to relevant business sectors. To reinforce the advantages of remaining formal, stress the benefits which formalization offers and provide information about the access to new services which it will permit.

E) Adapt conventional registry, surveying and mapping technologies to the formalization program.

22. Devise specifications for the development of a comprehensive system of mapping and surveying that takes maximum advantage of the information supplied by the informal communities. Such a system must be able to determine when new mapping is required and at what level of precision. It should also be able to determine when, after appropriate modification, existing maps are sufficient to define the boundaries of parcels before making them a part of official maps.

23. Re-engineer the existing registry system so that it adapt -- during a national program of formalization -- to new types of informality and to the requirements of dealing with new risks as they are discovered. This assumes the restructuring of the organization and its internal work flows, simplifying the registration processes, establishing specifications for automating information, designing and implementing a quality control system, selecting and training personnel, and establishing procedures and control mechanisms to ensure that overtime the registry maintains its quality and efficiency and that the cost of its services are not so great that its users slip back into informality.

24. Devise the procedures and systems which will allow the transfer of registry information from the traditional registry to the new registry system. These procedures and systems should allow the transfer of not only the antecedents required for formalization, but also the titles of those owners of formal property interested in the benefits of the new system.

25. Issue official titles that indisputably certify the rights of each owner to his or her parcel as well as the rights any third parties may have. This will prevent litigation over the rights, ensure that the title reflects the acceptance of all within the community and contains all information and other elements needed for it to be traded in an expanded market with a minimum of risk.

F) Integrate informal stock into market economy.

26. Design and implement the mechanisms required for formalized parcels to increase in value substantially thus allowing them to be used as collateral.

27. Establish the macro and micro infrastructure in such a way that the rights and responsibilities of suppliers and users of utility services can be demassified and the risk of repayment reduced. This will allow those contemplating financing or investing in new or expanding infrastructure — rather than taking over existing infrastructure (such as the generation, transmission, and distribution of electric power, water works) — to see that the risks of supplying those who do not have these services are substantially reduced when their property rights have been formalized.

28. Establish institutions that will allow the private sector to design and sell products that will diminish risks for the recently formalized. This would include non payment risks; the protection of property owners from litigation over the validity of their titles; protection for lenders and suppliers from the risks of repayment for infrastructure services; and the reduction of risks for developers, suppliers and other investors in real estate or related markets.

29. Devise mechanisms that show the owners of formalized property that their assets are protected by the same institutional framework that protects the rights of private investors, both domestic and foreign. This will give these owners a reason to respect contracts governed by the formal legal order.

30. Create mechanisms that will reduce the political and operational risks associated with private investment in an emerging market. These risks would include: the termination of agreements with private companies as a result of what is usually perceived of as political pressure; the lack of credibility of the titles to the lands where foreign investors wish to install their machinery and equipment; the risks of massive non-payment for services rendered; and ineffective remedies to enforce payment obligations.
31. Formalize property in a manner that will permit the private sector to organize systems for assessments, securitization, and rediscounting in secondary markets, especially international markets, so that credit needed by the owners of formalized assets will be available.
32. Create an alternative to squatting so that citizens can obtain property under law. When illegal invasions continue to occur in an emerging market, they raise the level of uncertainty for investors and thus cast a pall over the investment climate.

Needless to say, those nations that were successful were those that put property rights at the top of their agendas. Integrating the marginalized assets and people of a nation is, after all, a highly political task, the most noble of them all. Such an exercise can not be successful if the highest political authorities and the head of state are not thoroughly committed.

6. Conclusions: the Unfinished Agenda

Economic reform programs are trying to change macroeconomic national administrations in such a manner that people can adapt from a life organized on the basis of small, impoverished and encapsulated markets to one of global interdependence that should lead to prosperity. For thousands of years people lived in self-contained communities. But with the industrial revolution, the coming of market economics and the information revolution, civilization is offering a new way of life where people and communities are less autonomous and more interdependent.

The problem is that all citizens do not have the same ability to use their assets within the market economic system. The implicit assumption has been that there are no legal privileges and that everyone has the opportunity to have their assets paperized according to law and adapted to transactions in the wider marketplace.

The task of converting a nation into a market economy requires, in addition to successful stabilization and adjustment programs, the formalization of their informal sector. It is essential to take into account that the majority of the assets in developing nations and former communist countries are in the informal sector and simply cannot be exchanged on a large scale, not even within the national market. It is important to ask whether existing law is adapted to the needs of the majority of the people; whether it actually helps the poor use their assets efficiently in the market, and if not, what must be done to reform it.

Everyone who believes in market economic systems must also realize that carrying out successful macroeconomic transformations, like those taking place in Egypt today, does not mean that a full blast market economy revolution has taken place.

For this to happen, society must ensure that the benefits of macroeconomic achievements are correspondingly made available to the poor, otherwise the intellectual leadership won over the last decade will be lost and all the arguments for market systems will be sterile. Governmental and societal leaders will be perceived as nothing else than self-satisfied defenders of the interests of the dominant classes and foreign investors. The path to prosperity will be blocked, simply because the “lost in history” issue of property and whether the poor have any fruitful way of using it were forgotten.

It is important to understand the relevance of the informal-formal divide, as well as comprehend what is required for the assets of the majority of citizens in developing and former communist nations to be protected by law and used in the marketplace to generate wealth and a civilized society. This includes a leadership that understands the role that the assets of most citizens in developing countries and former communist nations can play in an expanded economy if they are adequately formalized.

The greatest challenge facing developing and former communist countries is to complete the reform agenda. This means not only continuing successful macroeconomic reform programs, but also bridging the informal-formal divide, overcoming the institutional apartheid that impedes the majority, especially the poorest, from increasing the value and productivity of their assets. The fundamental task is to show that this can be done.

PART II: DISCUSSION

DEAD CAPITAL AND THE POOR IN EGYPT

Participants in the discussion following Hernando de Soto's presentation included Tarek Hatem of the Management Department of Cairo University; Abdel Aziz M. Hegazy, former Egyptian prime minister; Adel Bishai of the Economics Department of the American University in Cairo; Mervat El Tallawy Minister of Insurance and Social Affairs; Laila I. Kamel of Community and Institutional Development; and Faika El Refaei of the Central Bank of Egypt. The following is a summary of the discussion.

Participant: You have outlined the problems and explained the need to move dead capital. But how is this done? For example, you tell us that the poor must be more involved – how do we get them involved?

Speaker: The bridge which I presented in the paper illustrates the different steps one must take in the process. It is first essential to understand that there is no lack of law in your country. It is simply that you may have more laws than you think and you must find out what they are, and decode them. This is something for which we have technology. The problem, as many of you know, is that there is a clear demarcation between the informal sector and formal sectors. These are all part of that gray area everybody must deal with in our countries called the informal sector.

It is like achieving economic integration among developed countries – you have to integrate legislation until everybody understands the same common denominators. You then need to calculate your transaction costs. In other words, if people decide to have their property protected through informal rather than formal arrangements, it essentially means that informal arrangements are cheaper. In the end you have to assure that your formal arrangements become just as cheap as the informal ones.

Some feel this means not paying taxes. But it is surprising what you find when you investigate the conditions in the informal sector. You will find that there are costs that exceed taxation. For

example, if you have an informal business in Peru, inflation tax is paid in cash since other non-cash forms of payments are impossible. The cost of keeping large cash balances on the streets is extremely high. The cost of buying off police and public officials is extremely high. The cost of only being able to sell in small quantities is extremely high. The cost of not being able to do long-term, but only short-term and over-the-counter transactions is extremely high.

It is not high taxes that keep the informal sector away, but in most cases a system that is legally hostile to them. You essentially have to fix listening devices in informal level neighborhoods to find out what the real costs of law is to the majority of citizens. It is not a complicated or even an expensive task. It requires a certain degree of technology and the belief that people do follow orders. But the orders may be quite different once you have grasped the different pieces of the puzzle. You must then create an institutional order which allows all the existing registry systems to handle massive formalization. You also need to have an information system which makes sure that everybody is aware so that they voluntarily cross the line. And last but not least, you have to consult with all the different authorities interested, whether private or informal businesses, tax authorities, and government authorities at different levels, to assure that the documentation produced from the new property system actually has capital value when it reaches them.

So there is no quick and easy reply. It is as if you ask me how to prepare “crepe suzette” in France. I have given you a small recipe that requires eggs and sugar. But the real recipe is in the paper. It means accepting that you have within your own midst a large part of society which has decided to break up the legal system into various parts and another which is completely detached. You have to bring the two sides together. It is no different than when you bring the legislation of various nations together.

Think of the privatization process as an example. Privatizing requires creating an infrastructure that is safe for foreign investment and local investment. You create a special kind of legislation -- you hire Schroder’s Bank or Rothchild’s or foreign legal advisers who tell you

what they need to survive in a private atmosphere. Now, instead of talking to the rich abroad, talk to the poor at home. It is really not that difficult once you have decided to talk to the poor.

Participant: I very much enjoyed listening to you because I am deeply interested in the poor in Egypt. But I would first like to ask you to define what you mean by “poor,” because you seem to depend much on the poor who own something -- a physical asset. But what about the poorest of the poor?

The poor are definitely classified into categories. You seem to have concentrated on one particular class of poor. Second, I think you have made the assumption that the poor can use a physical asset as collateral for creating work and lift themselves out of poverty. But usually the poor cannot present any sort of collateral to a banking system or financial institution. This is why professor Yunis in Bangladesh created the non-collateral investment program for the poor. They can go to the bank and obtain money without presenting anything, but there is some sort of credibility because of the grouping of these poor to invest in smaller business.

I would like to enlarge the classes of the poor to include the poorest of the poor who have nothing, as well as others with a little piece of land in a village, a flat or maybe some machinery, but whose income can not satisfy their needs, or even what I call the “sufficiency” level. Is your theory applied to all classes and groups of the poor or to only one? If so, what should be done with the others?

Speaker: Thank you for your very interesting and constructive questions. Regarding the first you are absolutely right. Speaking of the poor is like speaking of formality, one is dealing with generalizations. It is true that not all the poor have assets. But it is interesting when you begin analyzing basic statistics. For example, in my country about 85 percent of the poor have some assets in land. And since they do not pay rent they are basically landowners.

In Switzerland, interestingly enough, one of the wealthiest industrial countries in the world, only 30 percent own households. This does not mean that they are not poor but that they do not wish to hold their assets in their homes. They prefer to keep them in stocks, shares or bonds. Of

course, you will find that there are differing degrees of poverty and many poor feel trapped in a cul-de-sac.

If you provide the poor the opportunity to accumulate wealth, how many of them will actually succeed? And even then will society and the market system be able to take care of everyone simply through competition. More and more economists are coming to the conclusion that economics alone does not suffice. The state needs to play a direct or indirect role in taking care of the poorest of the poor. Of course, the less poor in the upper sectors you have, the easier it will be to find the sources of wealth with which to take care of them, whether in the smallest or biggest families of Peru and Latin America. As families take care of their poorest family members so it is natural that a nation should wish to do the same outside the world of economics and inside the world of politics.

With regard to physical assets, it is not only a question of credit and collateral. Trying to obtain credit without an address does not exist in the United States or Europe. In Peru and Latin America only 20 percent of the people have addresses you can trust. Identifying yourself necessarily comes before any talk of collateral. The only collateral that is truly immobile is land. Therefore you must be able to trace collateral to an individual even if that collateral is a machine.

Certain forms of exchange are possible only if you have property because there are other functions such as those related to infrastructure -- which is not collateral. The point is simple: whoever provides the service should know who is accountable. Also, once you know who lives where, you can calculate your risks much better. Every daily transaction becomes much easier when you deal with immobile assets. A society constructed on systematic consensus provides a solid basis on which to build. It is obvious that there are many consensus in our countries that escape the general legal order. By bringing them inside you introduce a quality of securities to transactions. This is achieved by accumulating additional information which incorporates the small more local and impoverished consensus working outside the law. It is therefore not only collateral but goes much further.

The third point is on the Mohamed Yunis type of credit in the Graming Bank without collateral, which is fantastic and should be encouraged. Today in Peru there are many individuals trying to imitate the Graming Bank. We have been trying to do that for about 12 years and the state has spent much money because in many cases the Graming Bank has worked even without the support of the state and probably even against the state. But throughout Latin America we have calculated how much people such as Mohamed Yunis cover in credit to the poor. In Peru it never even reaches 1 percent, so it is a double-edged sword.

On many occasions in my country, when bankers encourage us to imitate Mohamed Yunis it is because they want everybody to use foreign money to give credit to the 1 percent while they keep the 99 percent to themselves. So the answer is this, you can do much for the poorest of the poor when there is no collateral and all ingenuity is deserved. But this should not divert us from the fact that the majority of savings and collateral in your country, which amounts to US\$241 billion of invisible buildings, is undoubtedly much more money than Mohamed Yunis ever dreamt of. So I am not advising you to disregard the poorest of the poor but there are other very important actions you can take aside from helping the bottom shelf. Though the bottom shelf is great stuff.

Participant: Thank you for an extremely informative and exciting speech. I am one of the people in Egypt who since the 1980s has been writing about Egyptian small-scale industries and the formal sector. Your discussion is fitting because the informal sector is one of this country's main forces, but many of my colleagues, intellectuals and even economists are not aware of the extent of small business contribution in Egypt. Small businesses of 10 people or less employ more than 50 percent of the Egyptian industrial labor force. So your talk is very appropriate and full of ideas. I just have two points to raise.

I am not very much intrigued by the figure US\$204 billion or US\$190 billion that you mentioned. It is catchy but in a sense confuses the difference between stock and flow. Would it make a difference if it were US\$199 billion. What if there is US\$190 billion? Are we more interested at that stage in fixed capital or in circulating capital? It is like wealth and income, stock and flow. It matters little if one of Egypt's 99 pyramids is worth US\$10 billion. What

matters is the flow. Second, you mentioned towards the end of your speech, and I agree with you, that we have been privatizing a bit too fast without building the institutions for it. Private property is the buzz word.

You mentioned that generally speaking unless property rights exist, the value of things may go down. The strange phenomenon happening in Egypt at the moment, which is a challenge for the Egyptian government and for us all, is that without well-defined property rights, desert land is open to massive speculation and profits in billions. It is a problem to make this money on speculating without the legal background for it. What should be done? Finally, I would like to make a point made by Prime Minister Hegazi on the informal sector. The governorate of Domiette in Egypt has 0 percent unemployment and is based entirely on small-scale industry. But in the formal sector, collateral may mean reputation without papers, without any land. The collateral can itself be informal.

Speaker: Thank you for your questions. I am glad you were not thrilled by the \$241bln. In fact these are not surprising numbers. You spoke about something I discussed with Ahmed Galal -- the differences between stock and flow. The question is what is flow without stock? If you take a modern economics book, by say Paul Samuelson or Rudigar Dornbush, when you speak of capital and financial flows, property is an immediate ingredient. Because, if it is really a question of money, Latin Americans produce a lot more of it than North Americans. There is great flow but it is inflationary.

So the point is this: you are able to produce in as much as your production is represented. In other words, the amount of transaction costs you incur when your property is not directly represented means that your flow is only so much less. Your stock helps create your flow. There is an automatic assumption that capital is money. If capital were only money then all we would have to do is create more money and then we would have more flows. The reason for such little capital for investment in many of our countries is because there is nothing which allows you to fix and realize whatever value you create.

When Adams Smith wrote about 250 years ago, he used to say that you must not confuse money with real wealth. He said money is like a great highway. It is a circulating mechanism which allows us to lubricate the system and to provide common denominator values, but it is not capital and not wealth. What I am saying is that \$241 billion is completely unimpressive unless it can become flow. When you are actually able to enter this sum into your system, it can be converted from a stock into a flow and then monetized accordingly. But until then it will remain stock which is what I call “dead capital.” I think this is as far as I can go now.

The next thing you mentioned was that transactions do take place at the informal sector. I do not know if I understood correctly. That people have transactions and use collateral at the informal level is absolutely true. Market economies have always existed at the informal level even 3,000 years ago in the Babylonian times. As a matter of fact, world capital actually came from that part of the world. The whole idea of capital comes from the Medieval Latin term “capitals” which refers to head. Capital referred to cattle because one could measure them by heads and because they created surplus value. One cow and one bull always equals little calves -- so capital begets capital. However, when capital is informal the transaction size is extremely limited. It is similar to the enormous market activity in our countries. Collateral systems do exist as do market transactions, but they are extremely reduced in size, extremely reduced in time and extremely insecure. As it is outside the economy it is at very high risk, and therefore depends on an enormous amount of investment and who you know.

Let me give you an idea of how most transactions in a country such as Peru are really done. I may use some strong metaphors, but I do not know how else to bring this point across because our system of records on ownership and rights are so absolutely poor and unreliable. It not only affects the poor, but everybody. The poor and informal economy input is essential. It is not possible to depend solely on the formal economy. Latin Americans dedicate an enormous amount of time cultivating personal relationships because the only recipe to security in transactions is who you know, how you know them and what reputation they have. You can break and make

someone through their reputation. The result is that at least 60 to 70 percent of a Peruvian entrepreneur's time is spent networking and cultivating relationships.

You will usually find that entrepreneurs in Western industrialized countries are less used to this. They have very focused energies because they usually dedicate all their time to doing business, because their documentation is secure and because they can deal in large volumes with low transaction costs. The informal sector wastes an enormous amount of human energy establishing relationships which can easily be done through a fax or a code number in the West. So I am not saying that there are no market economies in the informal sector, but that they depend on who you know and on public relations, which in the end keep most of our people very poor instead of making them participate in real production.

Participant: I would like to thank Mr. de Soto for a very enlightening lecture. It allows us to view the poor and poverty from a different angle and reflects similar studies we prepared a couple of years ago on the role of women and the informal sector. To our surprise, the role and productivity of these invisible men and women in the informal sector are tremendous though never reflected properly in formal statistics.

However, on a large scale, the point is not property -- what they own or not -- but capability, what they can produce and what services they offer. Unless this is registered and planned for, then economic policy will not properly reflect the facts. The informal sector is needed for its capabilities, which should be reflected in formal statistics and decision making. It will allow us to take the right course in bringing about sustainable development. Mr. Yunis's idea for Bangladesh is actually already employed in Egypt in remote rural areas. Women have created their own banking system in which money exchange is performed. It is a local banking system that the poor use to survive, which proves that they have potential and ideas. And they know exactly what they need. It is therefore important for us to listen to them more closely. They will be able to put us on the right track.

Speaker: I find your comments very interesting. One thing we did in Peru as part of the formalization process was formalizing marriages. We found that in many cases the title of homes, especially when informal, depends on the husband. And one reason why wives were not able to share the property was because the amount of time lost on bureaucratic procedures before marriage was equivalent to 155 days. So we cut it down to 15 days and thereby increased the amount of legal marriages in Peru and the rights of women on assets.

Formalization really means integrating the excluded into society, which in turn means taking into consideration the gender issue. Integration has actually allowed us to bring so many people into the formal sector because it not only facilitated their entry into the formal sector but also gave them real estate assets. It also meant the creation of contracts, including those for individuals: family and women rights laws. This made women very powerful in Peru. So in the end what counts is not so much the \$241 billion but the amount of potential which has not yet been used. That can not be used unless you create mechanisms of appropriation and in that context it is indeed of interest to the private sector.

One of the reasons I have come to Egypt, apart from being extremely fascinated by this marvelous nation, was of course because I was invited by an organization whose board members were mainly composed of people from the private sector. It was interesting to me because I think it is crucial that people from the private sector realize that a lot of the so-called people in the informal sector are their most supportive constituency -- provided you can find a system of identification. They are both really in business and business will gain if entrepreneurs who are marginalized actually partake in the system.

One interesting thing that we discovered about Peru when we began our reforms with president Fujimori was that it was important to eliminate the word "private" from the political vocabulary. When we conducted a study inquiring about the meaning of the word "private" to the 80 or 90 percent of the Peruvian population represented by key people assembled in a large room, their answer was interesting. Some 60 or 70 percent of the Peruvian population said, "I'm not a member of the private sector." We then asked a second question, "Are you a member of the

public sector?” and the reply was “No, of course not, the public sector is the government.” Then we asked, “Who is in the private sector?” The reply was *los de arriba* or “those up there.”

So the first thing we learned is that the word “private” is bad. In fact, it was very hard to get through a privatization program because people viewed privatization as taking from the nation and giving to the rich. But if you give the poor property, they will understand the difference between sovereignty and property. I, for example, have property in Peru and I have absolutely no problem seeing Americans, Chinese or Chileans come in and take the electrical company as a private company because I know we are not giving them sovereignty. They are getting property, just like I have property. But for somebody who does not have legal property, that is a hard distinction to make. Property is perceived as something so subtle and representative, abstract and conceptual that you must actually feel it before you can distinguish it from the idea of sovereignty. So you can even begin interesting privatization and become a more efficient country and make it politically viable if people distinguish between sovereignty and property. But that can only happen if everyone has access to property.

Participant: I am from the NGO sector. I work with the informal sector all the time, and in this city alone 9,000 tons of garbage are generated everyday. The informal sector handles 3,000 tons and we have established that every 3,000 tons handled by the informal sector creates at least 15,000 jobs. Yet all the advice and strategies from policy makers to solve the garbage problem of Cairo is simply to import huge trucks and do away with all this dirt. When we proposed to formalize informal sector solutions, they were not quite convinced. Most of these informal sector people are forced to live on the edge of the city in informal settlements. They are excluded because they keep moving outside the neighborhoods they service. What did you do in Peru? What mechanism did you use to convince policy makers?

Speaker: The system we used to convince policy makers to put these rules into place was first of all to show them voting trends. You suddenly realize that different people are motivated by different quantities. An entrepreneur has to make an internal rate of return which he can be

denominated in money. But a politician has to think in terms of his electorate, and in terms of his constituency. So once you have clearly illustrated or been able to establish how many people actually work in the informal sector, what it means for the economy, your policy makers will automatically turn towards it. The first thing to do is continue finding out how many tons of garbage are being moved and how many people are being served. When you add it up, it may come out to 70 percent of Egyptians. I do not think there will be a politician in town who will not react.

Second, in Peru we scared them, by showing how many of these changes came about in western Europe, and how the history of the world can be written in terms of informal sectors that are ignored. Take for instance the Boston Tea Party of the American colonists who were not willing to pay taxes. Their actions were obviously a part of the informal sector and made the United Kingdom lose their colonies very fast and early on. I am sure Britain would have liked to hold on to them for at least as long as it held on to Hong Kong. So if you ignore your informal sector and have a terrorist movement the way we did in Peru which was enough to alert people, things can change quickly. It is also interesting to look at how nations change. For example, the events leading up to the French Revolution are revealing. The British had found a way of weaving textiles inspired by the Indians which they called cotton textiles or “calicos.” It was so efficient that small informal entrepreneurs in France began to use it.

This is of course before the word “informal” existed, so nobody called them informal entrepreneurs. They were just simply illegal bandits, disloyal competition, or small business. It was such a threat to the existing private industry which was protected by the king that the death penalty was established for whoever would import “calicos” from outside France or whoever would manufacture “calicos” within France. About 30 years ago they began collecting all the certificates of public executions carried out in France against the illegal manufacture of calicos, either by hanging or by summary executions on the beaches if they were smugglers. They totaled 16,000 death certificates in less than 10 years.

On many occasions, especially since the Industrial Revolution, people suddenly realized that there existed a large working class functioning invisibly and which was very productive. If it were a violent class it could be doing many negative things. But from what I see in most of our countries, they are actually being very productive, for example, in dealing with garbage. The sooner we are able to incorporate them into society and recognize their role -- by paying statistical attention to them, by telling ourselves they are an important part of society and that the formal sector is actually the true marginal sector -- the sooner we will create a bigger and better society.

Participant: I listened to your lecture with interest and I have 2 comments. First, I have understood that the lecture is about formalization of property: to convert it from dead to live capital. To do this from the practical point of view we have to assume that whoever owns the property should be an entrepreneur in order to convert it into productive capacity after formalization and to contribute to economic development. I think the study needs to be completed to investigate this. Of the LE 241 billion of property, how much of it can actually be converted into productive capacity through the business sector.

Second, in Egypt neither land nor houses are considered appropriate collateral for bank credit since land is not accepted as collateral, because if the borrower is not able to pay back his loan, you will not be able to sell the land. In the present rent law, although the market value of the houses might change if you choose to sell, you will sell it at zero price because you cannot ask the tenants to leave and rent is very low. Houses and land are not considered appropriate collateral against loans. How can this be solved?

Speaker: I think I have understood at least part of your 2 questions. First, the idea that it is done only for entrepreneurs is general. I used the real estate because it was easy to get figures. It is available, as opposed to business which is mainly underground. It is easier to calculate. But, in effect, we are talking about all forms of capital. You are correct when you say that not all stock of goods or real assets will necessarily become capital, in the sense of becoming a means of

production. Not all of it will be used as a means of production. Of the LE 241 billion probably only a fraction will be used.

But, on the other hand, if it can be on the market, if it can be something that can be exchanged for whatever transaction, at least what we've been able to see in Peru is that the value of things in about 2 or 3 years doubles, in about 6 years triples and then quadruples and also has a higher value, a higher market value of whatever assets you have. The amount of capital used as a means of production will therefore also accordingly increase. Not everybody used their home directly as collateral, including the agricultural sector.

This does not mean, for example, as in many parts of Peru that people wish to use their land as collateral. They sometimes wish to use their crops as collateral but you can not even use your crops as collateral until you know who owns the land on which the crop is grown. Also, it does not necessarily mean that you want everything to be able to sell or mortgage foreclosed. That is a political decision that your government and your people will have to decide. The only important thing that we are trying get across is that when things are adequately represented, you will see that they have more functions than those who are only apparent at a physical level. How many of those functions can property actually accomplish is something that is a Egyptian political decision. It is not a decision for a foreigner and it is not a decision for an outsider.

Your next question is very tricky. I know very little about the Egyptian market concerning the possibility of foreclosures and your system of rent control. In Peru, for example, there are many cases where rent control had the practical effects of converting rent-payers into the real owners. So you may want to decide first of all who really owns what before you decide who is going to get what and how you are going to let people have things. I am not saying that there is a quick and easy solution. What I indicated is that when you look at physical things beyond their physical status and you realize the potential they have, you may reach different conclusions. From then on, there are sovereign political decisions which only Egyptians will be able to make.

List of Attendees

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Former Prime Minister, Abdel Aziz Hegazi & Co., Accounting and Management Consultants

Abda Al-Mahdi

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Abdel Aziz El Aguizy

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Abdel Hamid El Kosheiry

General Manager, Club d'Affaires Franco-Egyptien

Ahmed El Maghraby

Chairman, Accor Hotels and Member, ECES

Ahmed Esmat Mahdy

Deputy Head of Economic Section, Al Ahram Newspaper

Ahmed Ihab Gamal El Din

Second Secretary, Ministry of Foreign Affairs

Ahmed Lotfy

Information Specialist, Embassy of the United States of America

Ahmed Shawki

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Aida Rezkalla

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Ali Al Korey

Chairman, Futaimisr Trading Co.

Ali El Din Hilal

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Ali Shalaby

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First Undersecretary, Ministry of International Cooperation

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Ann Marie Harrison

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Anwar El Mofty

President & General Manager, Budget Rent A Car

Ashraf El Leithy

Journalist, Middle East News Agency

Ashraf Mahmoud

Senior Vice President & General Manager, Al Ahly for Development & Investment (ADI)

Assaad S. Assaad

Chief Executive & Partner, Financial & Investment Studies Office and Member, ECES

Ayman Helmy

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Attorney at Law, Ibrashy & Dermarkar Co.

Ben Faulks

Cairo Correspondent, Bloomberg News

Carol Kalin

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Charles Malak

Managing Director, Multifood Company

Christian Falkowski

Ambassador, European Union Delegation

Dahlia Khalifa

Vice Chairman, Office for Studies & Finance (OSAF)

Dalia Wahba

Communications & Development Manager, CID

David Dunford

Coordinator, MENA Bank

David Jessee

Leader, Growth Through Globalization Team, USAID Cairo Mission

David Watson

Country Corporate Head, Citibank N.A.-Cairo

Dayna Samra

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Edmund Saums

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