CHAPTER THREE

YOU CAN'T PLAN A MARKET

The nature of man is intricate;
the objects of society are of the greatest complexity:
and therefore no simple disposition
or direction of power can be suitable
either to man's nature
or to the quality of his affairs.

EDMUND BURKE, "REFLECTIONS ON THE REVOLUTION IN FRANCE," 179.[1]

THE FAILURE OF THE Big Push led to some soul-searching among foreign aid agencies, beginning in the 1980s. Maybe the failure was due to poor countries' interference with free markets. After all, if one of the secrets of Western prosperity was the feedback and accountability of free markets, the most obvious thing the West could do to transform the Rest was to introduce free markets.

The next step in escalation of the White Man's Burden was to condition aid on the Rest's adopting a rapid transition to markets. There is usually a sharp division between those who favor free markets and those who don't, with each camp fearful of ceding any ground to the other. This book arrives at a paradoxical finding: free markets work, but free-market reforms often don't.

To explain this paradox, this chapter will discuss how introducing free markets from the top down is not so simple. It overlooks the long sequence of choices, institutions, and innovations that have allowed free markets to develop in the rich Western economies. It also overlooks the bottom-up perspective on how markets often *don't* function well in the low-income societies of Africa, Latin America, Asia, and the former Communist bloc. Markets everywhere emerge in an unplanned, spontaneous way, adapting to local traditions and circumstances, and not through reforms designed by outsiders. The free market depends on the bottom-up emergence of complex institutions and social norms that are difficult for outsiders to understand, much less change.

Paradoxically, the West tried to *plan* how to achieve a *market.* Even after evidence accumulated that these outsider-imposed free markets were not working, unfortunately, the interests of the poor did not have enough weight to force a change in Western policy. Planners underestimated how difficult it is to get markets working in a socially beneficial way. People everywhere have to explore with

piecemeal, experimental steps how to move toward free markets.

Russian Nights

Russia became a free-market economy on January 1, 1992. At least that's what the West told the Russians they were becoming when the Russians removed controls on prices and soon after privatized state enterprises, with advice from us hubris-laden Western experts. Western economists wrote a prominent article in 1992 promising Russians that "enormous scope exists for increases in average living standards within a few years.[2] The same economists said in December 1991 that the Russian "shock therapy" plan (the top-down imposition of markets) contained "all the essential elements necessary for rapid transition to the market.[3]

Russia received thirteen structural adjustment loans in the 1990s alone. Thousands of percent inflation and a decade of production collapse later, we outside experts had to admit that the market had not created "enormous scope…for increases in average living standards within a few years." Overnight transformation to a market economy had joined the list of failed utopian schemes.

Economists like me were slow on the uptake, in that it took us a decade of failure to convince us that top-down imposition of markets did not work. With the World Bank, I was intermittently working on Russia in 1990–1995, and I confess I believed in shock therapy. Like many other Western economists flooding Moscow at the time, I had only the most superficial knowledge of Russian institutions and history. Economists more familiar with the pre-reform Soviet Union were much more prescient. University of Maryland economist Peter Murrell—a longtime student of centrally planned economies—wrote a series of articles in 1991–1993 arguing against shock therapy as utopian social engineering. At the time, he lost the argument. He wrote to me recently that to try to convince other economists of his views was itself a "utopian" project, and he turned his attention to other subjects after 1993. History vindicated Murrell's scathing description of shock therapy: "There is complete disdain for all that exists…. History, society, and the economics of present institutions are all minor issues in choosing a reform program…. Establishment of a market economy is seen as mostly involving destruction…shock therapists assume that technocratic solutions are fairly easy to implement…. One must reject all existing arrangements.[4]

Murrell was quick to realize the relevance of Burke and Popper for events in Russia. His quote of Popper in 1992 is a perfect prediction of how Russian reform would fail: "It is not reasonable to assume that a complete reconstruction of our social system would lead at once to a workable system.[5]

Economists Clifford Gaddy and Barry Ickes, also longtime Soviet experts, closely followed the response of the old Soviet enterprises to the new environment of markets. Shock therapy predicted that those enterprises that were most competitive at the new market–determined prices would expand, while inefficient dinosaurs would go extinct. That is not what happened, according to Gaddy and Ickes. The Soviet plant managers had had a network of relationships with state bureaucrats and other plant managers that enabled the managers to survive. Using the barter and delivery of goods to offset tax liabilities, they managed to keep producing goods nobody wanted in a "virtual economy" that had no resemblance to the fantasies of shock therapists. The share of Russian enterprises that were running losses actually increased in the early years of shock therapy, to 40 percent, and has since remained stable.[6]

In one illustrative example, the Middle Volga Chemicals Plant in Samara Oblast managed to find a "market" for ten tons of toxic chemicals. It passed these along to the Samara Oblast government in

lieu of obligations to pay into the unemployment fund. The Samara government in turn used these chemicals to satisfy its obligation as a relatively rich region to make transfer payments to poor regions. It did so by agreeing with the Russian Ministry of Labor that Samara would ship goods to the unemployment compensation fund in the poor republic of Mari-El. So the ten tons of toxic chemicals wound up in Yoshkar-Ola, the capital of Mari-El. What the unemployed workers in Mari-El did with ten tons of toxic chemicals is not known.[7]

As this example suggests, some Soviet enterprises were surviving even though they were using up valuable inputs to produce worthless outputs. They got subsidized electricity and gas from the state electricity and gas monopolies. The latter, Gazprom, was sitting on huge deposits of natural gas, and was one of the few sources of genuine value creation in the economy. Many other enterprises were actually destroying value rather than creating it. They could sustain the demand for their worthless output by using their Soviet-era relationships with other worthless firms. For example, enterprise A could produce some crap that enterprise B would accept as an input to produce its own crap, which B in turn would pass along to enterprise C, who would close the loop by selling its crap as an input back to enterprise A. Meanwhile, A, B, and C were all using up valuable gas and electricity. The Soviet-trained plant managers at the bottom outwitted the shock therapists at the top. The local and often the federal authorities went along with the game because they did not want to face large-scale unemployment.

As far as companies that were actually producing value were concerned, they were the target more of private looting than of private entrepreneurial activity. The Russian "free-market reforms" included privatization of former state enterprises. The reforms followed the disastrous sequence of free markets and privatization without first creating the rules that make profit-seeking behavior beneficial to society. Searchers in markets need rules or else they become opportunists who benefit at others' expense. In 1995, in return for support of the "pro-market reformer" Boris Yeltsin, for example, Russian tycoons snatched up the valuable firms at bargain-basement prices. At the auction of the prize oil company Yukos, the Yeltsin government excluded bids from foreign buyers, eliminating most deep-pocket competitors. The Yeltsin government also allowed the banks running the auction to bid on the properties they themselves were auctioning. So Mikhail Khodorkovsky could bid on the auction of Yukos, even though he owned the bank running the auction, Menatep. Russian privatization chief Alfred Kokh alleged that Khodorkovsky used the money of Yukos itself to bid for Yukos, perhaps by pledging future oil deliveries in return for loans. He managed to buy 77 percent of Yukos shares for $309 million in December 1995.[8] This was a pretty good deal for a company that by 2003 reached a market valuation of $30 billion.[9] Khodorkovsky joined the top ranks on *Forbes* 's annual billionaires list.

Thirteen years after the official crusade to remake Russia in the image of the United States began, the patient is ailing. This is not just a metaphor: the Russians are dying at alarming rates. After the collapse of communism, the Russian suicide rate increased by 50 percent. Life expectancy increased almost everywhere else except for AIDS-crisis countries, but it declined in Russia especially for men (see figure 3). This trend began in the latter decades of the Soviet Union, and has continued in post-Soviet Russia.[10]

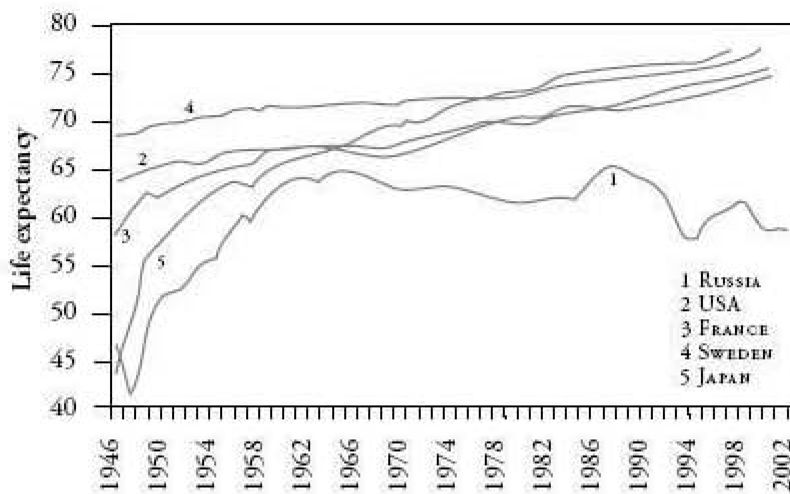

Fig. 3. Life Expectancy for Men in Russia and Developed Countries, from UNDP Russia Human Development Report

After the Western illusion of supporting "democratic reformers" such as Yeltsin, Yeltsin's anointed successor, Vladimir Putin, stamped out much of the little democracy Yeltsin had left behind. In 2004, Freedom House downgraded Russia from "partly free" to "not free." Putin went afte Mikhail Khodorkovsky for alleged nonpayment of taxes (a crime that would apply to most of the Russian population). A court convicted Khodorkovsky in May 2005 and sentenced him to nine years in prison.

The Russian economy has registered strong growth since the crisis of 1998, but this is only partial recovery from a deep trough. Russian per capita income in 2004 was still 17 percent below the Soviet peak in 1989. The public is underwhelmed: in a survey in December 2004, 41 percent o the population viewed the economy's performance as "poor," while a more sanguine 46 percent described it as "mediocre." After seven years of "transition," 70 percent of the Russian population in 1999 thought the country was headed in the "wrong direction." After partial economic recovery, Russians cheered up enough that only 56 percent thought it was still going in the wrong direction in January 2005.[11]

The Flight of Icarus

Shock therapy was the application to Russia of what the World Bank and the IMF called "structura adjustment," which in turn was heir to the Big Push. Structural adjustment loans were the brainchild of World Bank president Robert McNamara and his deputy, Ernest Stern, who sketched out the idea on a flight the two took together to the World Bank/IMF Annual Meeting in Belgrade in late September 1979. Structural adjustment loans were given to finance imports, and were conditional upon countries adopting free markets. The IMF, which had already been doing conditional loans for a long time, signed on to the new idea. What was the inspiration for what turned out to be a historic World Bank mistake of financing comprehensive reforms instead of financing piecemeal improvements? The idea was that developing countries needed the big reforms in order for individual projects to be productive, hence the escalation of World Bank intervention.

This reasoning was appealing. I used to believe in shock therapy and structural adjustment. We

proponents of such comprehensive reforms convinced ourselves at the time that partial reform would not work unless all of the complementary reforms happened quickly and simultaneously. Sometimes we clinched the argument with a metaphor like "You can't cross a chasm in two leaps." It seemed plausible that the returns on small interventions would be low if the whole economic and political system was messed up—hence the attempt to remake the system in one fell swoop.

What we shock therapists didn't realize was that *all* reforms are partial; it is impossible to do everything at once, and no policymaker has enough information even to know what "everything" is. The choice is between large-scale partial reforms (which shock therapy mislabels as comprehensive reforms) and small-scale partial reforms. Either large-scale or small-scale partial reforms could backfire, but it is much easier to correct the small mistakes than the large mistakes. The "unintended consequences" problem is greater with a large-scale reform than with a smaller one. The attempted changes at the top are out of touch with the complexity at the bottom, as we will see in this chapter. To make a long story short, the shock therapy often ran afoul of poor institutions that failed to prevent public corruption and private looting. The overambitious reforms of shock therapy and structural adjustment were the flight of Icarus for the World Bank and the IMF. Aiming for the sun, they instead descended into a sea of failure.

TABLE 2. STRUCTURAL ADJUSTMENT LOANS, GROWTH, AND INFLATION IN POOR COUNTRIES WITH MOST STRUCTURAL ADJUSTMENT LOANS RECEIVED

	Number of IMF and World Bank adjustment loans 1980–1999	*Annual per capita growth rate from the date of first structural adjustment loan (%)*	*Annual inflation rate from first adjustment loan to 1999 (%)*
African Countries That Were in the World's Top Twenty of Structural Adjustment Loans Received 1980–1999			
Niger	14	-2.30	2
Zambia	18	-2.10	58
Madagascar	17	-1.80	17
Togo	15	-1.60	5
Côte d'Ivoire	26	-1.40	6
Malawi	18	-0.20	23
Mali	15	-0.10	4
Mauritania	16	0.10	7
Senegal	21	0.10	5
Kenya	19	0.10	14
Ghana	26	1.20	32
Uganda	20	2.30	50
Top Ten Recipients of Structural Adjustment Loans over 1990–1999 Among Ex-Communist Countries (Growth and Inflation Measured from First Adjustment Loan to 1999)			
Ukraine	10	-8.4	215
Russian Federation	13	-5.7	141
Kyrgyz Republic	10	-4.4	25
Kazakhstan	9	-3.1	117
Bulgaria	13	-2.2	124
Romania	11	-1.2	114
Hungary	14	1.0	16
Poland	9	3.4	52
Albania	8	4.4	40
Georgia	7	6.4	37

The World Bank and the IMF gave Côte d'Ivoire twenty-six structural adjustment loans in th 1980s and 1990s. Per capita income in the country plunged throughout the period in one of the worst and longest depressions in economic history. Today, Côte d'Ivoire is mired in civil war. Indeed, it's a little unnerving that almost all recent cases of collapses into anarchy were preceded by heavy World Bank and IMF involvement. Although I don't think the IMF and the World Bank caused th Ivorian collapse into anarchy, it would be hard to argue that their involvement in the country had a *positive* long-run effect.

I have picked out the African countries that were in the top twenty worldwide in the number of structural adjustment loans received from the World Bank and the IMF. Most African countries that received intensive treatment from structural adjustment have had negative or zero growth. I have also listed the top ten recipients of structural adjustment loans in the ex-Communist countries. Most ex-Communist countries that received shock therapy and many structural adjustment loans have had sharply negative growth and high inflation (see table 2).

On balance, the outcomes associated with frequent structural adjustment lending are poor. Using the methods of evaluation mentioned earlier, one finds that, first, things were so bad in so many countries that were recipients of structural adjustment loans that it stretches belief that the loans had a strong *positive* effect. Second, since structural adjustment loans were repeated year after year, one wonders why the patient did not improve after repeated doses of the medicine. Finally, formal statistical methods to control for possible reverse causality from crisis to treatment still found that structural adjustment lending has had a zero or negative effect on economic growth.[12] Another influential recent study by Adam Przeworski of New York University and James Vreeland of Yale found that the effect of IMF programs on growth was negative, even when the study controlled for the adverse-selection effect. Another piece of evidence: as we see in a later chapter, African countries (even the "success stories") couldn't pay back zero-interest structural adjustment loans, and the World Bank and IMF had to forgive the debts. The White Man's Burden was deployed in other ex Communist countries of Eastern Europe and the former Soviet Union besides Russia. These countrie themselves technically had white people, but the Western whites were convinced they had missionary gifts for their Eastern counterparts. Unfortunately, the attempted leap across the chasm fell a little short of the other side, as shown in figure 4, aside from the Polish success story. It's hard to know how to attribute blame for this disaster, but clearly the high expectations of the Western reformers were not realized.

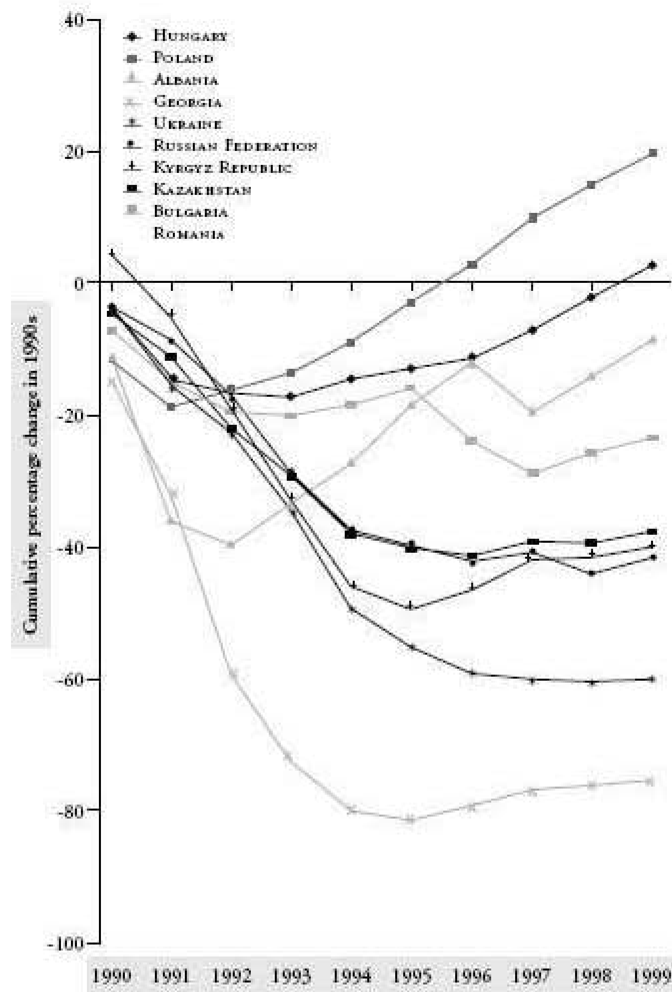

Fig. 4. Growth Trajectory in 1990s of Intensive Structural-Adjustment-Lending Ex-Communist Cases

Another region where there was great hope for comprehensive reform was Latin America, which had followed a regime of state intervention and restrictions on free trade from the 1950s through the 1970s. After the debt crisis of the early 1980s, in which Latin American countries were cut off from access to new loans from international private banks, the countries started moving toward free markets. As usual, structural adjustment loans from the World Bank and IMF supported these comprehensive reforms. One widely used index shows increasing economic freedom from 1985 to 2000 on average in Latin America (see figure 5).

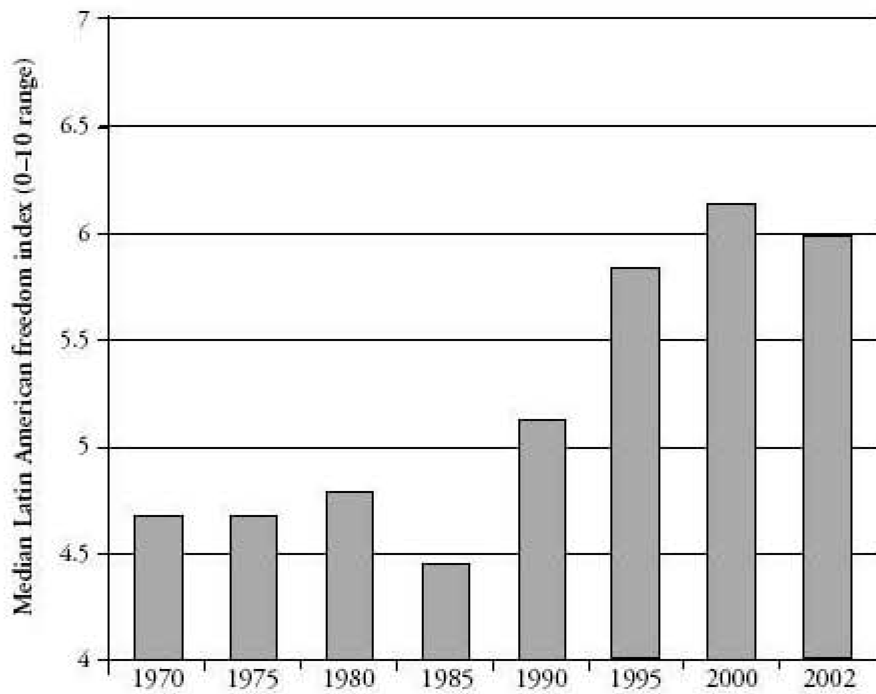

Fig. 5. Economic Freedom Index in Latin America

Unfortunately, the comprehensive reform in Latin America has not been accompanied by economic growth. Ironically for structural adjustment proponents, the best period for Latin American growth was in the period of state intervention, 1950–1980. If that growth had continued, income in Latin America would now be three times higher than it was in 1950. Instead, in 2003, income there was barely twice the level of a half century earlier, with little progress made over 1980–2003 (see figure 6). The backlash against free markets is unfortunately now gaining strength in Latin America, with free markets tarnished by the utopian expectations of structural adjustment.

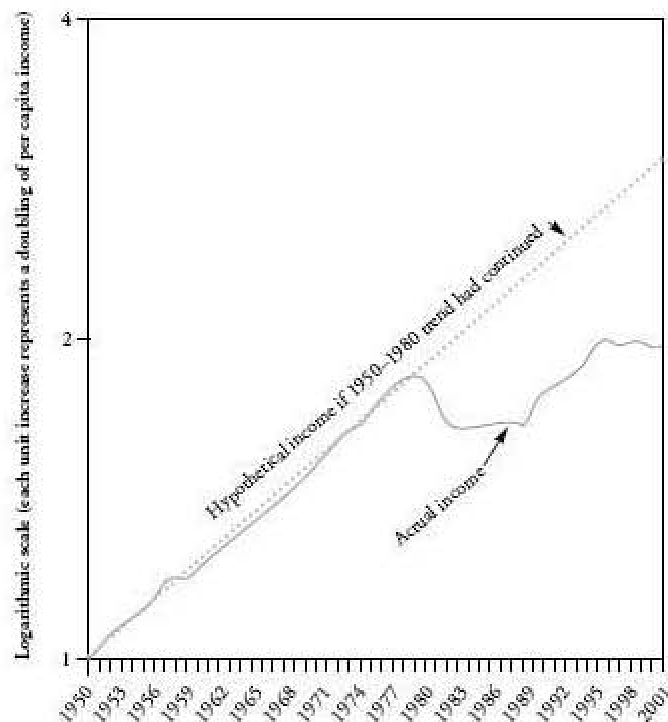

Fig. 6. Per Capita Income Index in Latin America (Log Base 2 Scale,* 1950 = 1): Actual and Trend, 1950–2003

So we have three regions where there were great hopes for structural adjustment and shock therapy—Africa, the former Communist countries, and Latin America—and three regions where those hopes were dashed. What was the West's response?

The response to failure was to do more of the same. The IMF and World Bank kept on giving out structural adjustment loans for more than two decades, despite their record of failure. Today, they are still doing those loans; they have just changed their name to "poverty reduction loans." This is the fixation-on-a-big-goal characteristic of Planners, despite repeated failures to reach the goal.

I'm Hungry—Let's Invent Free Markets

The free market *is* a universally useful system. Economic freedom is one of mankind's most underrated inventions, much less publicized than its cousin political freedom. Economic freedom just means unrestricted rights to produce, buy, and sell. Each of us can choose the things we want and not have somebody else decide what is best for us. We can also freely choose what we are going to sell and what occupation to choose, based on our inside knowledge of what we are best at and most like doing.

This freedom of choice and of personal knowledge makes possible the great gains that come from specialization. If I were limited to my consuming only what I could make or do myself, the results would not be pretty. My cooking skills are limited, for example, as my kids will attest. Rachel, Caleb, and Grace long ago got tired of my staple menu items of boiled spaghetti, macaroni and cheese, and rice and beans. Hence, we rely on the historic market innovation of takeout, which opens up to us a wonderful world of bagels, pizza, and rich cuisines from cultures such as China, Ethiopia, Japan, Thailand, Vietnam, and Tex-Mexico. Even when we are stuck with my cooking repertoire, this still depends on my purchasing pasta, cheese, rice, and beans from supermarkets. Without markets, I would be forced to grow the wheat, beans, and rice myself, milk the cow, process the grains and beans into edible form, and make the cheese and pasta. (I have no clue how to do any of the above.) Instead, I trade on the free market my economist services (which inexplicably find some buyers at New York University) and get money in return. I use this money to select home cooking items and to order takeout.

Adam Smith celebrated specialization in *The Wealth of Nations* in 1776. Each of us has some innate advantages in doing some things and innate disadvantages in doing others. Market exchange makes it possible for us to determine what we are good at, to specialize in producing it, and to trade it for other things produced by people good at producing those things. This applies to nations as well as individuals, which is part of the intellectual case for free trade. As an old joke has it, heaven is where the chefs are French, the police are British, the lovers are Italian, and the car mechanics are German—and it is all organized by the Swiss. Hell is where the chefs are British, the police are German, the lovers are Swiss, and the car mechanics are French—and it is all organized by the Italians.

Specialization doesn't necessarily involve innate abilities. This awful joke became an awful joke because we see some national differences (although I can't necessarily verify the ones implied above), but don't really believe these differences are innate. The French don't have any gene that

makes them wonderful cooks or lousy car mechanics; but they have refined their culinary tradition from one generation to the next. This also applies to individuals. You learn by doing. As each person does a task repeatedly, practice makes perfect, no matter whether that task is playing Mozart sonatas or nailing shingles to a roof. As each of us specializes and then trades our final products with one another, we all become better off.

The other great accomplishment of markets is that they reconcile the choices people make for themselves with the choices other people are making. Back at the dinner table we find that no Planner is necessary to process the enormous amount of information required to decide how much pasta, rice, cheese, and takeout cuisines of various cultures to supply to the people of New York. This great achievement of markets is achieved through Searchers. The suppliers search for customers, the customers search for suppliers, and the price adjusts up or down to equate supply and demand. So the market determines prices and quantities to reconcile the needs and abilities of suppliers and consumers. The price reflects both the additional cost that the supplier incurs to supply an additional item and the additional benefit that the consumer gets from purchasing one more of each item. Hence, the market matches the additional cost to society of producing each item to the additional benefit to society of consuming that item. The market comes up with a basket of commodities produced at the lowest possible price for the highest possible benefit. Economists have mathematical proofs that show that, under certain conditions, free markets lead to the best possible allocation of the economy's resources for everyone—given each person's initial stock of possessions. (Of course, it is disturbing that some people have tinier endowments than others; I will get to that later.) Adam Smith celebrated the social good achieved in this system, even though each of us is operating out of self-interest.

The West often awards itself credit for having invented the market. This is nonsense. Any visit to an outdoor market in Africa, Asia, the Middle East, or Latin America will quickly convince you that markets are vibrant in poor countries. Historical anecdotes suggest that these markets predated Western contact.

And market instincts are hardwired into human nature. As any parent knows, children understand the concept of gains from trade early on. The first thing that Rachel, Caleb, and Grace did after the neighborhood Easter egg hunt when they were young was empty out their candy and start trading—Rachel likes dark chocolate, Grace likes milk chocolate, and Caleb likes peanut butter cups. When Tom Sawyer traded Huck Finn a pinch bug for a tooth, he was acting out of instinct, not MBA training.[13]

For some goods, the price the suppliers want is too high relative to what the consumers are willing to pay, and therefore suppliers don't produce. There is no takeout market in New York for the Jell-O mixed with fruit cocktail and topped with marshmallows that my mother made when I was growing up in Bowling Green, Ohio. Unlike bagels, Jell-O doesn't meet the market test that consumers are willing to pay a high enough price to cover the suppliers' costs, and so we have bagel shops and no Jell-O shops.

Markets have potential for mutually beneficial trades. If an Ohioan has more bagels than he wants, and a New Yorker has more Jell-O than he wants, they are both better off if they trade bagels for Jell-O. The intensities of their desire for bagels and Jell-O and their holdings of bagels and Jell-O determined the terms of trade. Many critics of free markets miss this point—that any voluntary exchange makes *both* parties better off, although not necessarily to the same degree. Our sense of fairness is offended if the price seems too high for one party or the other—if a New Yorker has a lot of unwanted Jell-O and a high demand for bagels, then an Ohioan can drive what will look like a great bargain in getting a lot of Jell-O for his bagels. Still, even if the Ohioan benefits more than the

New Yorker, they are both better off making the trade.

Consumer Searchers are always on the lookout for beneficial trades. Supplier Searchers are or the lookout for profitable products to supply. The market has no use for the Millennium Jell-O Plan.

Financial Markets Are Good, Too

How does the financial market come in to all this? Financial markets refute the common perceptior that what you can invest in the future is limited to your own funds. You can borrow to buy land or start a small business (this works less often than it should, but much more often than if financial markets didn't exist). The beauty of financial markets is that they make high return investments available to everyone. This idea motivates the enthusiasm for microcredit schemes that reach destitute people, such as that of the Grameen Bank in Bangladesh.

Given that everyone can enter, financial markets equalize the returns (i.e., the percentage you get over and above repaying the cost of the original investment) to various types of investments across the economy. Anyone can enter any industry. If bagel stores have a high return, then many people will enter bagel retailing until they drive down the returns to normal levels. Any economy in which people do not equalize returns across all types of activities (getting an education, buying land, starting a small business, etc.) is not a free-market economy. It is also not making the most out of its stock of savings. You can see this by asking what would happen if you took money out of a low-return activity (Jell-O stores) and put it in a high-return activity (bagel stores). The value of output would go dowr by less in the Jell-O takeout industry than it would go up in bagels, and so the economy would produce more out of the same stock of savings. Anytime returns are unequal, such free gains in output are possible. Wall Street wizards, entrepreneurs, or Bill Gates search out any unusually high-returr activities, and by investing in them, drive down their returns, while ruthlessly taking capital away from low-return activities. Again, no central bureau is in charge of investments—just myriad Searchers such as financial firms. Planners would do an awful job allocating money across sectors ir the financial markets because they have no way of getting information on which sectors have high payoffs. There are many savers and investors, and financial firms play middlemen between the two.

So the bottom line is that financial markets (1) are a great source of free-market efficiency, and (2) create opportunities for anyone to get rich by borrowing and investing.

If we combine the virtues of goods markets and financial markets, we get a positive-feedback loop for any successful search to meet the needs of our fellow citizens. If we supply a product in high demand, we will reap high profits. Profits induce us to expand production, pulling workers and raw materials away from other products in less demand to produce the high-demand product. Outside investors want to share in the high returns, giving us more financing to expand our scale even more. An equally powerful incentive exists to *invent* a brand-new product to meet consumer needs. The positive-feedback loop to searching for solutions to customers' problems has made the market the greatest bottom-up system in history for meeting people's needs. (If only foreign aid could work like this!)

Not only that, but the common thread in the success stories of the last few decades—Hong Kong Korea, Singapore, Taiwan, China, India, Chile, Botswana, etc.—is that the Searchers for success ii each of these countries (which were often far from laissez-faire market economies) subjected their efforts to a market test, often through international markets. Would private foreign investors invest? Would the rest of the world buy what they were producing? The answer was yes, which gave the

Searchers feedback to move in the direction of prosperity, although their paths toward market successes varied from the simplistic visions of shock therapy.

Bottom-up Problems with Markets

With this paean to the glories of the market, the question becomes why markets don't make all societies rich. This book is *not* suggesting a simple recipe for national success; the point of this chapter is the opposite: no recipe exists, only a confusing welter of bottom-up social institutions and norms essential for markets. These evolve slowly on their own from the actions of many agents; the Western outsiders and Planners don't have a clue how to create these norms and institutions.

Nor are markets of much help to those who are now very poor—after all, the poor have no money to motivate any market Searchers to meet their needs. The hope for the poor depends on the same dual forces this book emphasizes throughout: (1) homegrown, market-based development that will lift up both rich and poor (which this chapter further argues is way too complex a task for Western assistance); and (2) Western assistance for meeting the most desperate needs of the poor until homegrown market-based development reaches them. (Western assistance could also borrow some ideas from markets, such as eliciting feedback from customers.)

The quest for helping the poor gets more complex the more you study it, but please don't give up! There is hope once you give up the Planner's ambition of universally imposing a free market from the top down. I point out in this chapter some of the universal problems with markets for poor countries, but the solutions are as varied as the countries and their complex histories.

The problem with praise of markets is that it overlooked all the bottom-up searches necessary to make markets work well. One of the main things that social institutions and norms must do is find ways to prevent market participants from "opportunistic behavior," more commonly known as "cheating." While the theory of the invisible hand celebrates self-interest as socially beneficial, this is true only if there are norms that make possible mutually beneficial transactions between parties. Lack of checks and balances on greed can prevent economic development just as a lack of markets can.

One type of cheating occurs when you cannot observe the quality of the good I am offering you. I could cheat you by running a taquería in Mexico City and selling you tacos made under unsanitary conditions. (I will spare you the details—let's just say I don't wash my hands frequently.) When you later get sick, you realize you paid more than you would have had you known how unsanitary the tacos were. The quality problem is ubiquitous, and even the simplest kind of exchange has problems. If you had known the tacos might be unsanitary, you would have offered a lower price. If I adopted costly but safe food handling methods and sold you healthy tacos, but you couldn't observe my safe handling and still offered the low price, then I would be the one who lost out in the exchange. So I would not bother with safe food handling, selling you the lousy tacos you expected. I could even keep all the best taco ingredients and safest procedures for tacos consumed by my own family, and sell you the tacos made with shoddy ingredients and food safety procedures. So the market does not supply healthy tacos! The economist George Akerlof of Berkeley won the Nobel Prize for this kind of insight, applied to sales of used cars.[14] Even slightly used cars sell for far less than new cars because buyers have no information on the cars' quality (and used car sellers have a tendency to sell lemons).

Many other types of cheating exist. For many transactions, payment at the time we get the service is not efficient. Either the service comes first, or the payment comes first. So, whoever acts second

can renege on the contract—by not paying or by not delivering the service. I can arrange to have fresh meat, tomatoes, chilies, cilantro, and onions delivered to my taquería by farmers. It has to be worth the trip for them to deliver the produce, so they will demand payment in advance. Now they might not show up, disappearing with my advance payment. Credit markets have this problem in spades—the borrower has no incentive to pay back the loan unless the lender can enforce repayment.

Another trick by the supplier could be to appear before the lunchtime peak and demand extra payment above what I have already paid, knowing he has me in a tight spot—it being too late for me to find another supplier. This is the "hold-up" problem—often at a point in a transaction, one party has a stranglehold on the other and can extort additional payment. A contemporary of Julius Caesar's, Crassus, made a fortune in early Rome with a private fire company that would negotiate a price for extinguishing a fire as it was raging.[15]

Can I Trust You?

There are solutions to cheating on market transactions. Maybe you and I are very honest, and we don't cheat each other. Some honesty and fairness seems biologically hardwired into us as Homo sapiens, which makes possible more trade than pure self-interest would predict.[16] Over and above this biological minimum, there are variations in trust across people and groups. Some who emphasize culture say some ethnic groups have evolved norms of honesty. Others argue that political, social, and economic incentives determine honesty.

Different societies have different amounts of "social capital" or "trust," that is, how much people follow rules without any coercion. Trust measures the confidence we have in perfect strangers. If each of us trusts the other, even a stranger, then the cheating problem does not arise. World Bank economists Steve Knack and Phil Keefer examined the effects of trust by using the results of surveys that asked people from different nations, "Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people?" Knack and Keefer measured "trust" as the percentage of people who chose the first answer. They found that low-income societies have less trust than rich societies, and societies with less trust have less rapid economic growth.[17] Figure 7 shows the strong positive association between trust and income. If we order the survey sample into four equal size groups, going from low trust to high trust, per capita income is a lot higher in the high-trust group than in the low-trust group. In rich Denmark, where trust is so high that mothers leave babies unattended on the street while they shop, 58 percent say they can trust people. In the poor Philippines, only 5 percent are trusting.

Note that what is important here is whether you trust *strangers*. Almost every society has cooperative relationships between kinfolk. What is important is the radius of trust. Do you trust only the members of your immediate family? Or does the circle widen to include your extended family, or your clan, or your village, or your ethnic group, or all the way to strangers? In a low-trust society, you trust your friends and family, but nobody else. As a Filipino businessman lamented, "We have no institutional loyalty, only personal loyalty.[18]

Trust is also associated with unforced good behavior toward strangers. *Reader's Digest* did a survey of American and European cities in which wallets containing money were randomly dropped on the street. The survey then counted how many wallets were returned with the money intact. The percentage of returned wallets is strongly associated with the percentage answering yes to the trust survey question. Denmark performed well on returned wallets (almost *all* of them were returned), just

as it did on trusting strangers. Casual observation suggests that trust is higher in small towns than in impersonal cities. In Bowling Green, Ohio, you buy a movie ticket from a girl in the window out in front of the cinema. You then walk into the cinema lobby, through an entrance anyone could enter, without anyone's checking to see whether you've bought a ticket!

The larger the radius of trust, the less you worry about cheating in business transactions. A low-trust society such as Mexico features a strong insider/outsider mentality. The slang term for your buddies is *cuates* (your twins). You would do anything for your *cuates,* but ripping off a stranger is okay. You are amazingly courteous to a social acquaintance, but anonymous interactions tend to be rude. So you leap to hold the door open for a lady in a social situation, but later shove some ladies aside to get into a subway car.

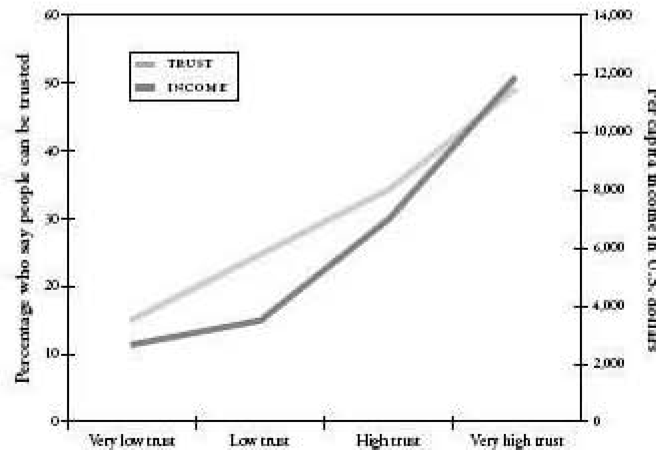

Fig. 7. Trust and Per Capita Income

Trust affects virtually every dimension of doing business. Malagasy grain traders carry out inspections of each lot of grain in person because they don't trust employees. One third of the traders say they don't hire more workers because of fear of theft by them. This limits the grain traders' firm size, cutting short a trader's potential success.[19] In many countries, companies tend to be family enterprises because family members are the only ones felt trustworthy. So the size of the company is then limited by the size of the family.

Other Solutions for Cheaters

Even if we don't trust one another, there are other bottom-up solutions to opportunism. As far as not delivering products or not repaying debts, there are credit reporting agencies and Better Business Bureaus that can handle these problems. Warranties protect the consumer against product defects.

A poor country cannot use these solutions as much as a rich one. The transactions are not large enough, and communications are too costly for credit reporting agencies or Better Business Bureaus. The supplier can abscond by not honoring a warranty just as it can default on a debt.

Don't jump to the conclusion that courts are a simple answer. The costs of legal action are not worth it with tiny transactions. One study found that African manufacturers seldom used courts to settle disputes. As predicted, the use of courts was less likely the smaller the size of the firm.[20] Institutions such as courts are usually not reliable in poor countries anyway. They are more corruptible—the richer or stronger party will pay bribes or intimidate the judge into seeing things

their way.

Credit reporting agencies also work less well in poor societies—tracking down con artists is hard because they leave no paper trail. You don't have too many driver's licenses if few people drive. Formal addresses are seldom clear in shantytowns. You don't have phone numbers if you don't have phones. The lack of formal or private institutions to prevent cheating means that quality will be low (e.g., food establishments sell poor and unhealthy food). Most transactions in poor countries will be anonymous cash-and-carry transactions trading poor-quality goods for money. The closest approximation in the rich countries might be flea markets or garage sales. The economist Marcel Fafchamps (on whose work this chapter bases some of its exposition) quips that Africa has a flea-market economy rather than a free-market economy.

It's Whom You Know…

Nevertheless, poor people are inventive in searching for solutions to cheating. In West Africa, the age group is an association of all men in a tribe who come of age at the same time. In Nigeria, according to the district head of Owokwu, "Age-groups are…generally self-development oriented. They…act as thrift and credit associations, procure farms for their members…. People of the same age have to qualify to be members of the group by being upright members of the community. They also have to be hardworking, of sane mind, and not convicted of any crime.[21] The age group prevents opportunistic behavior by its members.

Another solution is to have an ongoing relationship of trading, so one of us will not cheat the other and risk losing all future trade. Potential business partners stay on probation for a while until you trust them. Marcel Fafchamps reports that Malagasy grain traders don't grant a client trade credit until after they have done about ten cash transactions with him. African manufacturers report that they require six to twelve months of repeated interaction with a client until they grant trade credits.[22] Once businessmen form a trusting relationship, they continue it to save on the costs of starting up a new one. One survey found that the average business relationship in Africa lasted seven years.

We could also belong to a multimember network of businesses that sanctioned our behavior and issued referrals to third parties—other taquería owners could form a business association that shared information on who were the reliable suppliers. A supplier cheating one taquería would risk losing the whole market.

These networks form at lowest cost among people who interact for other reasons. Economic historians Nathan Rosenberg and L. E. Birdzell relate how many financiers and entrepreneurs behind America's nineteenth- century industrialization learned to trust one another by serving together in the Civil War.[23] A more common setting for social interaction is the family or ethnic group, whose members develop trust in one another through encounters such as those at weddings, funerals, birthday parties, and ethnic festivals. A web forms of socially linked businessmen who trust one another enough to extend credit, to recommend suppliers or buyers, and to not engage in hold-ups. One ethnic group is usually prominent in business in a poor society. In pre-industrial Europe, it was the Jews. In East Africa, it's the Indians. (Indians own almost all businesses in Kenya, although they make up only 1 percent of the population.) In West Africa, it is the Lebanese. In southern Africa, it is whites and Indians. Among indigenous African groups, often one dominates trading—the Bamileke in Cameroon, the Luba in the Democratic Republic of the Congo, the Hausa in West Africa, the Igbo in Nigeria, and the Serahule in the Gambia. In Southeast Asia, the overseas Chinese (the "bamboo network") play

this role. Often there are subgroups—for example, the overseas Chinese came largely from the coastal enclaves stretching from Canton to Fuzhou (the same region leads the boom in China itself today).[24]

These ethnic networks solve many of the cheating problems. As one observer of the "bamboo network" noted, if a Chinese businessman reneges on an agreement, he goes on the blacklist. Since the overseas Chinese straddle many international boundaries, they promote international and domestic benefits from trade. The economist James Rauch found that international trade is unusually high between any two countries that both have large minorities of overseas Chinese.

Other ethnic networks have evolved other strategies to enforce good behavior. The Hausa in Ibadan, Nigeria, both own houses and broker long-distance trade in cattle and kola nuts. If the brokers cheat their business partners and then disappear from Ibadan, their problem is that they leave behind valuable houses as hostages. The chief of the Hausa quarter will prevent these cheaters from selling their houses when they go on the lam.

The economist Avner Greif describes a "multilateral punishment strategy" that keeps agents from cheating a network of merchants. He argues that the higher the probability that merchants will hire an agent again even after he cheats, the more likely he is to cheat. If an individual merchant blacklists an agent who cheated him, other merchants could hire the agent—so bilateral punishment doesn't work as well as multilateral punishment. If everybody in the network agrees that they will never hire an agent who has ever cheated any of them, that destroys the employment prospects of a cheating agent. The network consists of merchants who interact frequently enough to convey information about cheating agents. Hence, with multilateral punishment, merchants can trust agents not to cheat. Greif applied this idea to the eleventh-century Maghribi traders (Jewish merchants based in Cairo), who operated around the Mediterranean using agents, even in the absence of any courts.[25]

The ethnic networks also work as referral services for finding new business. The bamboo network gathers information on who needs what supply components, subassembly plants, financing, and so on. The people involved know one another, and can pass this information on to third parties in the network who do not know their potential business partner. The network expels anyone who misbehaves, who then loses all access to information.[26]

The Market Net

I am in Addis Ababa's city market, the largest open-air market in Africa. No shortage of markets here. I go to buy handicrafts and gifts for the kids. The taxi driver recommends a particular shop, and I make a number of purchases there. Afterward, the shop owner takes me to see other shops in the market. We talk as we stride along, and he tells me he is a Gurage, Ethiopia's entrepreneurial minority. The Gurage make up only 4 percent of Addis Ababa's labor force but own 34 percent of the businesses. He takes me to other Gurage businesses in the market, where he bargains on my behalf (getting me better bargains than I got in his shop). His referrals to other Gurage shops created the opportunity for their owners and me to do deals.

These ethnic specializations can become self-perpetuating. The Luo tribes-people in Kenya, who live next to Lake Victoria, are fish traders. Such is their reputation for fish trading that the Luo entered the business of fish trading in Mombasa, far from Lake Victoria, on the coast of the Indian Ocean. If Kenyans think of the Luo as having a network that ensures high-quality fish, then they will prefer to buy fish from Luo traders rather than from other ethnic groups. The Luo will drive other ethnic groups

out of the fish-trading business, but the other groups may find another niche—for example, the Indians, with their network of retail businesses in Nairobi. Kenyans now would not buy retail products from a Luo retail shop in Nairobi, just as they would not buy fish from an Indian fish trader. The next generation of Luo will find it more rewarding to become fish traders than shop owners, just as the next generation of Indians will make the reverse decision.

Ethnic specialization is widespread. Even in market-rich New York City, there are ethnic concentrations by occupation. Hasidic Jews famously dominate the diamond trade on Forty-seventh Street in Manhattan. Studies find that a remarkably high share of all nail salons in many American cities are Vietnamese owned and operated. These patterns may reflect the same ethnic "brand-name" effects as in Kenya. Fafchamps speculates that the caste system in India, with its rigidity of hereditary occupations by caste, may be the result of such a process. Since some occupations are more rewarding or high skilled than others, this is a recipe for persistent ethnic (or caste) income inequality.

However, ethnic specialization is not as ubiquitous in rich countries as in poor countries because there is an impersonal solution in rich countries to establishing a reputation for quality and fair dealing: creating a large corporation. The corporation spends a large upfront amount to create a brand-name reputation and has a lot to lose if it cheats. The size of transactions is too small in poor countries to make the corporate solution work.

The ethnic differentials also persist because the networks freeze out the outsiders. In Zimbabwe, whites and Asians own most of the business firms, which seldom deal with indigenous African-owned firms.[27] Refusing to deal with outsiders limits entry into particular sectors, limiting competition and giving above-normal profits to the established well-connected firms. Those in the networks also may have a competitive advantage over outsiders because they share technical knowledge with one another. Economists Tim Conley and Chris Udry found that Ghanaian farmers shared technical knowledge within their social network about a new opportunity to grow pineapples for export to Europe, such as how much fertilizer to use.

However, networks are far from a perfect solution to making markets work. The networks exclude as well as include, missing many entrepreneurs and suppliers when they limit trade to a minority. The gains from trade through personalized exchange are much less than through the impersonal exchange made possible by formal institutions.[28]

Also, if business networks form among minority ethnic groups, this situation can breed ethnic hostility to markets among the majority population. Resistance to market reform in Russia is bound up with anti-Semitism and other prejudices, because some perceive that Jews, ethnic groups from the Caucasus, and other ethnic minorities have disproportionately benefited from free markets.

The well-connected people advance rather than the well qualified. Firms in poor countries are very often family firms. As a trading friend says, the firm does better to hire the family idiot rather than the village genius—the former at least can be trusted not to cheat them. When formal institutions establish the rules of the game, the market finds the village genius and uses him according to his merits. The social networks may retard formal institutions, as network members will out-compete the formal institutions until the latter reach some critical mass.

Old-school networks do connect businessmen in rich countries. However, because formal institutions work better in rich countries, these networks recruit their members more according to merit than in poor countries—the old-school ties will be valuable only if it was a good school.

Feeling confused? You are not yet confused enough. How can top-down Planners make markets work when it requires understanding not just free markets but also the bottom-up search for the social

norms, producer and consumer networks, and kin relationships that facilitate exchange? Whether you and I can become better off through markets depends now on more than our individual choices. All in a society must develop the informal social ties that make our individual market choices possible. The chances are low that the international jet set will understand us enough to make markets work for us. The quest to help the poor has put far too little effort into learning about their informal social arrangements.

Showdown at Predators' Pass

Another problem society must solve is protection of property and person. High-value property magnifies the need for protection. Without rules to protect us, you and I play a disastrous game of threat and self-protection. Suppose each of us has the same amount of money but only two choices as to what to do with it—devote all our funds to producing new goods, thus increasing our funds, or spend some of our resources on guns, which enable us to protect our own property and also seize our neighbors' property at gunpoint. If you buy a gun and I don't, then you get my money and your original money less the cost of the gun, and I end up with nothing. If I buy a gun and you don't, then the opposite is true. If we both buy guns, then we have a predators' equilibrium, neither of us produces anything, and we each just keep our original money.

We would both be better off by not buying guns and just producing. Yet in a lawless world, that would never occur. Each one of us can always do better by buying a gun, whatever the other one does. If you don't buy a gun, I can seize your property and increase my funds more than by production. If you do buy a gun, I can at least defend my property against you. So buying a gun is always my best move; the same holds for you, and so we both wind up with less money than if we had both been peaceful. In terms of game theory, this game is the classic prisoner's dilemma.

This assumes that buying guns is legal. In the United States, where you can buy assault weapons on the airport highway but where airport security scrutinizes your nail clippers, this may be a good assumption. One way to avoid the predators' equilibrium is to allow only honest policemen to have guns.

But predation doesn't happen as often as this theory predicts, even without a policeman looking over your shoulder. Many opportunities for pilfering go unrealized. The social norm that stealing is disgraceful is a sanction against predation. Most kinds of social conflict resolution don't involve armed coercion. Academic seminars can be intellectually violent, but, fortunately, professors don't pack semiautomatic weapons.

These social norms are more effective in communities with face-to-face interactions as opposed to situations with anonymous social interactions—one reason why small towns have less crime per capita than the big cities. Social norms also seem to be stronger among rich people than among poor people, as a rich person loses more economic opportunities and income from social disgrace. This is why you can usually be sure an executive in a suit will not mug you.

Social norms against predation don't work so well in many poor communities today. In a Brazilian urban slum, young men and women said it was every person for himself: "People are like a dog…only protect their house…if outside the house someone is robbed or dead…nobody cares.[29] In the slums of Dhaka and Chittagong in Bangladesh, "musclemen" kidnap and rape young girls. They demand protection money from slum dwellers on the threat of burning down their houses.[30] A formerly prosperous woman named Nasibeko of Kuphera village, Malawi, reports, "Our life was fine

until one day when our cattle were stolen. After that, our lives became miserable." Farmers in Mtamba, Malawi, say, "We can't grow cassava these days to support us when the maize is finished because thieves will come to steal it.[31]

Responding to ineffective social norms, poor communities often form their own self-protection groups. In their more benign form, such groups provide community safety. In some villages in Tanzania, self-protection groups called *sungusungu* deter cattle theft. The young men of the community take turns participating, and the women provide food for them as implicit payment. Nigerian age groups also help provide law and order in local communities. And in Phwetekere, Malawi, villagers started a neighborhood watch to discourage crime.

Unfortunately, self-protection groups can get out of hand. In a less benign form, vigilante bands capriciously respond to rumor and innuendo, playing the role of judge, jury, and executioner. A villager in Phwetekere, Malawi, reported to an interviewer that the village had burned a thief to death the week before the interview.[32] I once witnessed a mob in Nairobi, Kenya, strip an accused thief naked and haul him down the street in a cart, while beating him.

An even less savory possibility for controlling predation (as well as cheating) is a Mafia-like organization. The Chinese in Southeast Asia are famous not only for trade but also for triads, Mafia-like gangs. If someone cheats a triad member, he has a violent way to persuade the cheater to pay. Although any such information is speculative, one study of Hong Kong businesses estimated that 40 percent of them had triad members on their boards of directors.[33]

Drug lords dispense justice in slums in Jamaica.[34] The Mafia was omnipresent in Russia after the Soviet collapse Even a murderous Mafia can meet a genuine social need when law and order collapses (as it did in Russia, or earlier in Sicily in the nineteenth century). The Mafia can prevent anyone from robbing anybody else in their territory with just the threat of violence to deter the robber. The problem is that there is no good way to exit from the Mafia's protection, which means the organization almost always over-stays its welcome.[35]

Elsewhere around the world, warlords, clan leaders, semi-feudal land-holders, tribal chiefs, and village headmen often dispense justice in many poor societies. Villagers in Malawi report high satisfaction with dispute resolution by village headmen.[36] Mafia dons, warlords, and feudal landlords probably do not achieve as much client satisfaction. These examples show that bottom-up solutions don't always lead to attractive outcomes. Yet the Western world evolved gradually through such bottom-up mechanisms, some combination of benevolent social norms, self-protection societies, and local strong men. Perhaps the story of the Western state is just that warlords sorted themselves out, as the strongest warlord put down the rest and gradually evolved into a more benevolent, accountable government. Some scholars have speculated that the benevolent outcome came about in part because Europeans could often simply move from a bad jurisdiction to a better one.

This is of course a vast oversimplification. Western social scientists don't begin to comprehend fully the complex process of state formation and rule of law in the West, so they shouldn't be too quick to predict how it will work anywhere else.

Property Rights

Property rights also determine whether markets work. Do I have title to the land, building, and equipment making up my taco stand? Hernando de Soto noted in his great book *The Mystery of Capital* that the majority of land occupied by the poor urban majorities in the developing world does

not have legal title—*nobody* owns it. Only if I felt secure that I would keep my taco stand would I invest in more sanitary food-processing equipment. I can borrow from a bank to purchase such equipment only if I have title to the property to put down as collateral. Only then will the bank feel secure that I will not abscond with the loan. Even then, the loans will be available only if the laws allow the bank to take my taquería if I default on the loan. Property rights are also critical if I opt for incorporation. Lenders and shareholders need to feel secure that they really do have a claim on corporate property.

Property rights are an incentive to accumulate assets over time and across generations, which is often necessary to have the productive capacity to meet consumer needs. When I sacrifice consumption to buy land, factories, or other assets, I don't want someone else seizing the assets. For example, a man in Isla Trinitaria, Ecuador, cut back even on food and clothing to save enough to build up a small shellfish business. But he lost it all when the mayor seized the land.[37]

What determines property rights? Alas, property rights are more complicated than the state enforcing them from the top down (and the state itself may be a thief, as the next chapter discusses). Property arises from a decentralized searching for solutions, just like the other complexities of markets. Your right to your property is only as strong as those around you are willing to acknowledge.

Stronger ethnic groups often seize land from weaker ones. In India, Hindu settlers push the tribal Adivasi population into the degraded forests and eroded hill slopes, scrubland, and rocky soil.[38] (White people are not the only ones to push others around.)

Even countries with strong property rights today had those rights emerge gradually from the bottom up. American property rights did not spring full-blown from the minds of the Founding Fathers, and even then the rights applied differently to different groups.

George Washington Slept Here

Those of you unwise enough to have read my first book have already met my disreputable frontier ancestor, Thomas Cresap. Dragging my relatives in at every opportunity, let me tell you about his son, Michael. In 1774, Michael (my great-great-great-great-great grandfather) was in the Ohio River country near today's Wheeling, West Virginia. Michael Cresap was interested in the Ohio River area downstream from Wheeling, since he claimed some riverfront land there. Two tracts of choice river bottomland he claimed were "Cresap's Bottom" and "Round Bottom." Michael's methods of establishing title to the land were relaxed.

One who disputed his methods was Mr. Founding Father himself. George Washington was speculating in Ohio River land to supplement his army and plantation income. Both Michael and George claimed the piece of land called the Round Bottom. George Washington, in a rare burst of humor, said that Michael's "claim to the round bottom & other lands on the Ohio River for 30 miles is equally well founded." That is, George said, Michael founded his claims on nothing. Michael's method, George derided, was claiming "every good bottom upon the river; building a cabbin thereon to keep off others; & then selling them, and going on to possess other lands in the same manner."

Other title methods on the American frontier made Michael's methods look like a formal court hearing. Another technique was to slash trees along the boundary line of the land you were claiming. Squatters' right to land is an old tradition. Congress later willy-nilly appropriated some of the same frontier land for Revolutionary War veterans. Many pieces of land on the frontier thus came to have multiple claimants. The only thing the whites, who squabbled about one another's land rights, could

agree upon was that the real owners of the land—the Native Americans—had no rights at all.

The federal government after 1790 tried to sort out the land chaos for the whites, if not for the natives. More than twenty acts of Congress addressed the land issue between 1799 and 1830, along with numerous state-by-state legislative acts. The tug of war between squatters' rights and more formal legal titling continued. Lax enforcement made for inconsistency on the ground. A "preemption" right was finally recognized by Congress in 1830 (and made permanent in 1841), essentially legalizing squatters' rights.[39] The Homestead Act during the Civil War formalized acquiring legal title by settlement on federally owned land.

Michael Cresap died in 1775 fighting under Washington in the Revolutionary War, leaving his heirs to litigate about land titles. The Round Bottom dispute between the Cresaps and the Washingtons that dated back to 1773 was finally settled in a Richmond, Virginia, courthouse in 1834, in favor of the Washingtons (big surprise).

Michael's claim to Cresap's Bottom, on the other hand, endured. His son, Michael, Jr., farmed the fertile land. My grandmother told me about her childhood visits to the old Ohio River homestead where her mother, Hannah Cresap, grew up. The land remained in the Cresap family until the twentieth century, when the family sold it to coal companies at a handsome profit. Today a huge power plant and a coal mine occupy Cresap's Bottom, whose owners would quickly chase away squatters with court orders. When Hannah Cresap died, my mother bought a lime green couch with the proceeds from her inheritance. I grew up reading books on a lime green couch financed by the property rights established over two centuries ago on Cresap's Bottom.

To Title or Not to Title?

Legal title is not worthwhile when the assets are not valuable. It is not worth it with a rustic cabin. The costs of litigating over title to property can be more than the value of the property itself (as my ex-wife and I found out through our divorce lawyers' bills). Top-down titling of land requires a substantial investment in surveying, mapping, defining boundaries, and maintaining land records. Titling requires a long-standing written tradition. Then you can search court records for any other (perhaps long-forgotten) party with a legal claim to the property.[40] The large fixed cost is not worth it unless the value of the asset is high.[41] It *is* worth it today in Cresap's Bottom to protect a power plant.

Property law in the United States, as with many other kinds of law, evolved as piecemeal solutions to deal with particular problems as they arose. California miners during the 1849 gold rush agreed among themselves to the division of mining claims, enforced by a committee elected in each mining camp. The miners had no advance information about which claims would strike it rich, and it was in all of their interests to avoid a violent free-for-all. Hence they just agreed beforehand to split up the land, and then let each miner keep whatever he found on his land. California state law later retroactively recognized the informal claims the miners had devised themselves.[42] The collection of past practical solutions gradually determines a legal norm.

Custom and Law

We see the same process in developing societies. Titling is even more complicated if the land is used for different purposes by different parties (for example, for grazing by pastoralists and for growing

crops by farmers). Poorer societies define land ownership more by oral tradition, customary arrangements, or informal community agreement than by formal titles. An expensive system of land titling under such circumstances is senseless (the Planners don't investigate local custom enough to get this, as when aid agencies recommend computerized databases of land titles).

Customary arrangements can also deal with property owned by the community, like common pastureland on which all can graze their cows. Common property is subject to the "tragedy of the commons" problem, in which each herdsman overgrazes the pasture because the costs are borne by the community rather than by the herdsman. (I want my cow to eat the grass before your cow does.) However, if population density is low and land abundant, the tragedy of the commons does not arise, and community ownership works fine. Even when pressure on the land tightens up, informal community arrangements can still control overgrazing (say the village elders decide that you and I may let our cows into the pasture on alternating days).

NYU professor Leonard Wantchekon offered this account of how his village in Benin managed a common property resource, the fishing pond (overfishing is a classic example used for the tragedy of the commons), when he was growing up: To open the fishing season, elders performed ritual tests at Amlé, a lake fifteen kilometers from the village. If the fish were large enough, fishing was allowed for two or three days. If they were too small, all fishing was forbidden, and anyone who secretly fished the lake at this time was outcast, excluded from the formal and informal groups that formed the village's social structure. Those who committed this breach of trust were often shunned by the whole community; no one would speak to the offender, or even acknowledge his existence for a year or more.

When the value of the land increases, formal titles are worth the transaction costs—in return for greater ownership security. Now loose customary arrangements will not hold up; ignoring custom pays too well. Hence, a growing economy moves from customary law to formal law, but outsiders cannot know enough to engineer such a transition.

One example of how *not* to do it is having Western lawyers and accountants rewrite the legal code overnight from the top down, as the West tried in Eastern Europe after 1990. In Eastern Europe chief recipients of foreign aid were the Big Six accounting firms in the West.[43] who drafted new laws for Eastern Europe and trained thousands of locals in Western law. Eastern European legislatures passed the Western-drafted laws, satisfying aid conditions for the West, but the new laws on paper had little effect on actual rules of conduct. At the behest of donors, Albania dutifully passed a bankruptcy law in 1994, one of the elements of property rights. Only one bankruptcy case ever made it to the Albanian courts, even after a national pyramid scheme in the mid 1990s led to losses for investors amounting to 60 percent of the GDP.[44]

As legal practitioner Wade Channell summarized the legal reform experience of Eastern Europe after 1990: "It is hard to imagine any rule of law aid specialist pursuing law reform in his or her own country in this fashion. If I assembled half a dozen recognized European or U.S. specialists to redraft the U.S. Code of Judicial Ethics and then tried to get it passed by the U.S. Congress with little or no input on the proposed draft from congressional committees, the judiciary, the bar, business interests, law schools, or other stakeholders, I would be looking for a new career rather quickly. Based on many current practices, however, that career could easily be found abroad 'helping' transition countries with the same process.[45]

Titling Toward Confusion in Kenya

Lord Lugard, the architect of British colonial rule in Africa, said land tenure follows "a steady evolution, side by side with the evolution of social progress." This "natural evolution" leads to "individual ownership." The Native Land Tenure Rules of 1956 privatized land in Kenya, advertising it as "a normal step in the evolution of a country," under which "energetic or rich Africans will be able to acquire more land."

The anthropologist Parker Shipton, one of the few outsiders who bothered studying the region in detail, looked at the consequences of land titling for the Luo tribe in western Kenya in the early 1980s.[46] The traditional system among the Luo was a complicated maze of swapping plots among kin and seasonal exchanges of land for labor and livestock. There were both individual and family rights in cultivated fields and free-grazing rights for the community after the harvest. Each household's claim to land included many plots of different soils and terrains, on which many different crops grew —not a bad system with which to diversify risk in an uncertain climate. The traditional land patron (*weg lowo*) would often give temporary land rights to the client (*jodak*). There were seasonal exchanges of plows and draft animals for land, or land for labor.

Land titling brought many uncertainties into this complex system. Would the government give the titles to the *weg lowo* or to the *jodak*? The system inclined toward the latter, fostering bitter conflict between the two groups. Sometimes the former *weg lowo* would wind up as the *jodak* of his former *jodak*. An unpaid adjudication committee, who expected both parties to provide a feast for them, made the decisions. The system favored whoever could bring more goats to the feast. Often claimants would not bother with adjudication as the costs of the feast exceeded the value of the property.

Although land sales increased after formal registration, neither the buyers nor the sellers wanted the high fees or red tape associated with registering the sales. The system of formal titles thus gradually lost correspondence with those who the locals knew owned the land. An increasing number of formal titleholders resided in the local graveyard.

The opportunistic behavior that bedevils market transactions also plagued land sales in Kenya. Sellers who had earlier pledged their land as collateral for a loan would fail to inform the buyer of this claim on the land. Banks found it politically difficult to auction off the collateral land after loan default, since land owned by kin of the defaulter surrounded it. Some sellers sold to several buyers at once, using different elders as witnesses.

The adjudication committees required that sellers retain enough land for the subsistence of their own families. Sellers sometimes exploited this rule by selling "too much" land, gambling that the land-control board would give back some of their land while the buyers would not recover the purchase price.

Ocholla Ogweng of Kanyamkago got a loan of thirty thousand Kenyan shillings from Barclay's Bank in 1979. To raise collateral, he asked the help of his wife's father, Ogwok Nyayal. Mr. Nyayal arranged with his sister's husband, Mr. Alloyce Ohero, to pledge his land as collateral for Mr. Ogweng's loan. Alloyce Ohero then sold part of his land to two strangers, without informing them of the Barclay's Bank lien, and they settled on the land. Mr. Ohero died in 1981, and Mr. Ogweng defaulted on his loan. The two sons of Alloyce Ohero expected to inherit the unsold part of his land, equally unaware of the Barclay's Bank claim. By 1982, a court broker prepared to auction off all of Mr. Ohero's former land on behalf of Barclay's, to the consternation of everyone involved. The two strangers blamed Mr. Ohero's sons, who blamed their uncle Ogwok Nyayal, who blamed Alloyce Ohero, who, if he had been alive, would have blamed Ocholla Ogweng. Here was a deal with nothing

for everyone.

What looks like opportunistic behavior could be the mingling of private property with traditional values, which place obligations to kin above those to strangers or banks. By imposing land titling on such complex social customs, "private property rights" may actually increase the insecurity of land tenure rather than decrease it.

Perhaps chastened by these experiences, formal land law in Kenya is now moving back toward recognizing customary rights. The government is allowing the paper titles to lapse.[47] Reformers who want to increase the security of property rights have to search for what works in each locality. A more likely way forward for formal law would be building on the customary law rather than contradicting it.

Bottom-up Legal Evolution

Researchers have accumulated evidence that the bottom-up approach to law has proven to be superior for economic development to more top-down approaches. A series of studies compare development outcomes in countries with a common-law tradition to those with a civil-law tradition. The common-law tradition originated in England and spread to British colonies. In this tradition, judges are independent professionals who make rulings on cases based on precedents from similar cases. The principles of the law evolve in response to practical realities, and can be adapted to new situations as they arise. As the great American jurist Oliver Wendell Holmes said, "It is the merit of the common law that it decides the case first and determines the principles afterwards.[48]

The modern civil-law tradition originated under Napoleon, in France, and spread to French and Spanish colonies. (Spain was under the control of Napoleon at the time.) In this tradition, laws are written from the top down by the legislature to cover every possible situation. Judges are glorified clerks just applying the written law. This system of law lacks bottom-up feedback of the common law that comes from having cases determine law. As a result, the law is less well adapted to reality on the ground and has trouble adapting to new situations as technology and society change. Ironically, France itself proved more flexible in applying the civil law than French or Spanish colonies, who have followed a judicial formalism that was slow as well as poorly adapted to changing circumstances.

The differences show up in institutions. Systems that rely on case law have a positive-feedback loop between the law and the arrangements that economic actors need to facilitate markets. Case law countries thus wind up with a wider variety of formal institutions more supportive of prosperity—property rights, contract enforcement, rule of law, and even corporate accountability—than do civil-law countries. Australia, Canada, New Zealand, Pakistan, Uganda, and the United States are examples of former British colonies that have well-developed property rights protection for their level of income. Algeria, Colombia, Haiti, and Nicaragua are examples of former French or Spanish colonies that have poor property rights protection for their level of income.

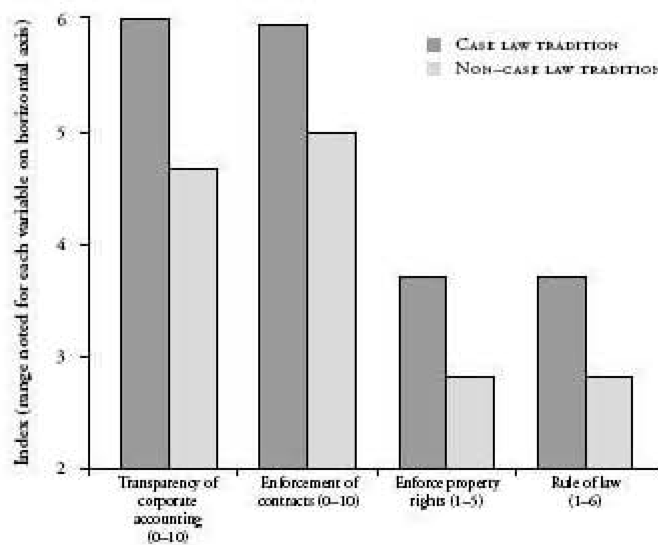

Fig. 8. Institutional Outcomes and Legal Traditions
***Source*: Beck and Levine 2004[49]**

The search process of the common law was particularly important in supporting financial markets. Finance requires more complicated arrangements, such as legal protection of shareholders in companies and bankruptcy proceedings to give creditors their money. Indeed, it turns out that countries with British legal origins have better legal protections for shareholders and creditors than countries with French legal origins. The result is that case law countries have much more developed financial markets, as measured by indicators such as the share of private credit in GDP, and stock market capitalization and liquidity.

Finance Without Good Laws

Mexico is a civil-law state that has failed to evolve good financial laws. Take the example of privatization of Mexican state banks beginning in 1991. Privatization is one of the staples of free-market reform urged by the World Bank and the IMF. But in the case of Mexico, things did not go according to plan. The problem began with the privatization program itself, in which buyers of the banks could use loans from the banks they were buying to purchase the banks. One buyer covered 75 percent of the purchase price with this trick. Normally, savers would not want to deposit in banks with such shaky financing, but savers had deposit insurance from the Mexican government. The newly privatized banks thus expanded credit rapidly, with little regard for risk. Lax banking regulations allowed them to roll over loans that borrowers did not repay without even having to declare the loans in default. Bank credit grew by more than 20 percent per year in real terms from 1991 to 1994, while past-due loans grew by more than 40 percent per year.[50] If the banks did try to collect from borrowers, they ran into Mexico's torturous (civil-law) bankruptcy laws, in which it took between three and seven years for banks to recover collateral from borrowers. The reckless credit expansion contributed to the collapse of the peso beginning in December 1994, in which the currency lost half of its value, and Mexico had a severe recession.

In the aftermath of the peso crisis, the government designed a bailout of the banking system's bad

loans. Unfortunately, the government (with World Bank and IMF acquiescence) dragged its feet on the bailout. With an anticipated bailout, the banks' owners had incentives to lend to themselves and then default. During 1995–1998, the banks gave 20 percent of large loans to individuals on their own boards of directors. The looting of the banks raised the cost of the bailout to the government, which in the end amounted to 15 percent of the Mexican GDP.

Since 1998, regulation of banks has been much tougher, and the government has allowed foreign banks to enter in order to put competitive pressure on Mexican banks. The bad loan problem has finally been solved, but mainly because banks lend less to the private sector. Because of the still-shaky bankruptcy laws, banks are now extremely cautious about private borrowers—the share of private loans in bank assets declined from 49 percent in 1997 to 30 percent in 2003. Mexico has still not solved the problem of making financial markets work because of the difficulty in getting the bottom-up rules and incentives right.[51] This story may give some insight into why the payoff to Latin America's "free-market" reforms was disappointing.

Top-down Dreams

So the West cannot design a comprehensive reform for a poor country that creates benevolent laws and good institutions to make markets work. We have seen that the rules that make markets work reflect a complex bottom-up search for social norms, networks of relationships, and formal laws and institutions that have the most payoff. To make things worse, these norms, networks, and institutions change in response to changed circumstances and their own past history. Political philosophers such as Burke, Popper, and Hayek had the key insight that this social interplay was so complex that a top-down reform that tried to change all the rules at once could make things worse rather than better.

Economic theorist Avinash Dixit has a more recent example of why top-down reform may have unintended consequences. Suppose a society is facilitating market transactions mainly through networks. We have seen that such networks are self-enforcing in that any cheater can be expelled from the network and thus lose all future business opportunities. Now suppose that the World Bank twists the arm of a government to set up a system with formal rules overseen by courts. Suppose such a parallel system is at least partially effective, making some business opportunities possible through the formal rules. Some of the participants in the informal networks can cheat their partners, exit the network, and begin operating in the formal system. A society could get caught in a disastrous in-between situation in which the networks break down, disrupting the previous trades, but the formal system still operates imperfectly, limiting the scope for new trades. Having two sets of rules is often worse than having only one. A reform where the gradual introduction of formal rules *reinforced* the existing networks would work better than one that tried to replace them. A plausible story for the evolution of institutions in the West is that informal relationships and norms in networks gradually hardened into formal rules (which are still supported by informal relationships and norms).[52]

This is armchair speculation, but Dixit's story may help explain why the transition from communism to capitalism in the former Soviet Union was such a disaster, and why market reforms in Latin America and Africa were disappointing. Even with severely distorted markets, the participants had formed networks of mutual trades and obligations that made the system functional at some level. Trying to change the rules all at once with the rapid introduction of free markets disrupted the old ties, while the new formal institutions were still too weak to make free markets work well. Gradual movement to freer markets would have given the participants more time to adjust their relationships

and trades.

The main moral of the story is that free-market opportunity depends on bottom-up social choices that Planners usually don't begin (or try) to understand. When researchers try a little harder (as did many of the hardworking researchers on whose work this chapter draws), there is hope for gradual, piecemeal reform and spontaneous efforts by Searchers among poor people themselves.

And things are not so impossibly complex that policymakers should just throw their hands up and say it's hopeless. Poor people are resourceful despite the screw-ups by Planners.

Stagnant Economies, Dynamic Individuals

In fact, there have been positive bottom-up market trends in Africa, Latin America, and the ex-Communist countries, even though top-down structural adjustment and shock therapy failed. The younger generation is seizing opportunities to expand its horizons, with many more people getting advanced degrees both at home and in the West (which is part of the India and China success stories). Children in the new generation are coming of age knowing only markets, and there is hope that they will make markets work better than their parents did. New electronic technologies are spreading rapidly, such as computers, Internet access, cell phones, VCRs, and DVDs.

In 1992, Nigerian moviemaker Ken Nnebue released a film called*Living in Bondage,* a melodrama about a man who joins a secret sect that promises him great wealth if he sacrifices his wife. The film's dialogue is in Igbo, with subtitles in English. Rather than showing the movie in theaters, which many Nigerians could not have afforded, Nnebue released the film directly to video. Thus was born the Nigerian movie industry, known as Nollywood, sometimes called the third most vibrant movie industry in the world after Hollywood and Bollywood. Shooting with a very low budget and a tight schedule, Nigerian moviemakers churn out thousands of titles affordable to poor Africans. The industry reaches the African mass market by emphasizing local cultures and themes most relevant to Africans. People in Nigerian video stores often pass up the latest Hollywood release in favor of one from Nollywood.[53]

Despite Africa's economic stagnation, this is not to say that life is unchanging. New technologies have been spreading, giving Africans more information, more entertainment, more choices. The number of TV sets on which to watch Nollywood films has skyrocketed, following the previous explosion of radios. (See figure 9.)

There is another interesting indicator of the growth of bottom-up markets. I noticed sometime in the late 1990s the remarkable prevalence of cell phones almost everywhere, from Moscow to Prague to Accra to Soweto to La Paz. Sometimes it seemed to me there were more people walking on the street with cell phones in these places than in much richer places, such as the United States. The figure shows the growth of cell phone density in Africa, Latin America, and the ex-Communist countries (each unit increase on the graph represents an increase of tenfold in the number of cell phones per thousand people).

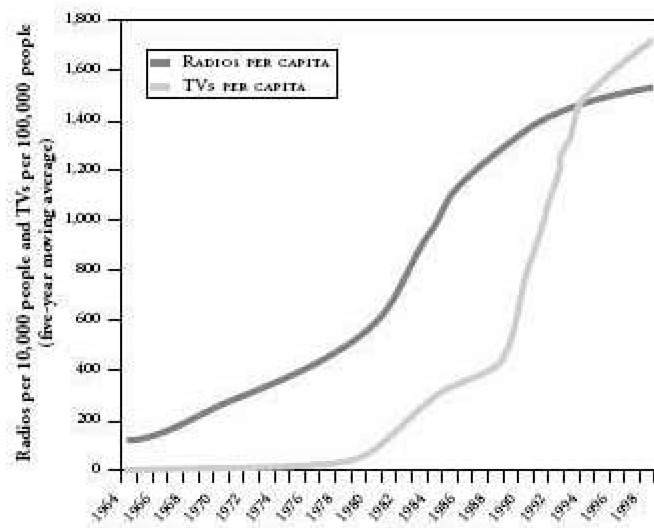

Fig. 9. Radios and TVs Per Capita in Africa

In Africa since 1996, the number of cell phones has been increasing by a factor of ten every three years. The explosion of cell phones shows just how much poor people search for new technological opportunities, with no state intervention, with no structural adjustment or shock therapy to promote cell phones. These are not just consumer pleasures. Cell phones help farmers, fishers, and entrepreneurs check out prices, suppliers, and consumers; arrange meetings; transfer funds; and lots of other things that are logistical nightmares in societies without good landline phones, functional postal services, or adequate roads.[54]

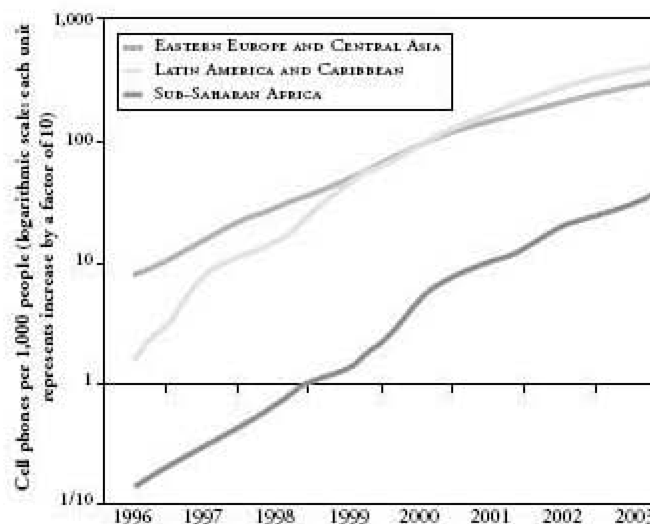

Fig. 10. Cell Phones Per Thousand People

Entrepreneur Alieu Conteh started building a cellular network in the Democratic Republic of the Congo (formerly Zaire) when it was still in the midst of its civil war in the 1990s. He couldn't get a foreign manufacturer to ship cellular towers into the country with rebel soldiers around, so he got local men to weld scrap metal into a makeshift tower. Demand exploded for Conteh's phones, and in 2001 he formed a joint venture with the South African firm Vodacom. One illiterate fisherwoman who lives on the Congo River without electricity relies on her cell phone to sell her fish. She can't put the

fish in a freezer, so she keeps them live on a line in the river until customers call to place an order. Vodacom Congo now has 1.1 million subscribers and is adding more than a thousand a day.[55]

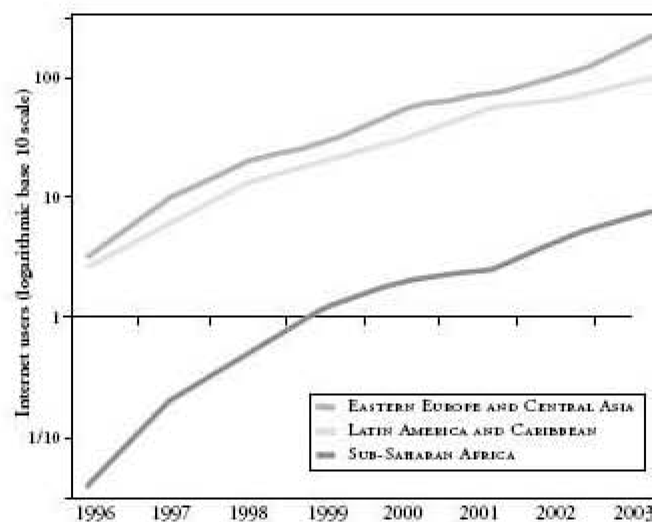

Fig. 11. Internet Users Per Thousand People

There has been a similar explosive growth in Internet users in Eastern Europe, Latin America and Africa. On my first World Bank trip to Ghana in 1985, I had to make an emergency call to the States at the only working overseas phone line in Accra—through a pre–World War II switchboard in the basement of a hotel. Now there is a Wi-Fi Internet connection in my hotel room, where I can communicate back home every day. Whereas in 1996 the typical African country had only one Internet user for every 27,000 people, in 2003 there was one for every 138 people, and it is still climbing rapidly. Although the ex-Communist countries also started with virtually no Internet users in 1996, the rate of adoption has climbed steeply there and now surpasses Latin America and the Caribbean (even though the latter region has also had rapid Internet expansion).

Even when the economy-wide story is disappointing growth, some individuals buck the trend. A forty-year-old woman named Ayorkor in Teshie, a town near Accra, Ghana, tells her story:

> *I managed to save a little and feed my children at the same time. When I managed to save enough, I started selling cooked yam, and here I made more money and managed to save. I was lucky to meet a friend who gave me secondhand clothes on credit to sell. This I did very well and started building my capital. Now I am trading with my own money. My first two children are in the secondary school and my last child, who is eighteen months old, is in a crêche [day-care center]. I managed to get out of poverty because I was not ready to give up, and so I fought hard, and with the help of a friend I succeeded.*

A seventy-six-year-old man named Udo from Ikot-Idem, Nigeria—a man with two wives and thirteen children—tells a similar story of climbing out of poverty:

> *When I grew up to fend for myself, I decided to trade soap. My initial capital came from*

picking and selling palm fruits, and saving the proceeds. My initial capital of two manilla [traditional currency] was wisely invested and yielded good dividends. When I had saved twenty manilla, I bought an initial stock of hens for three manilla. After toiling for many years, I was able to marry. Following marriage, I became poor again. But I continued harvesting palm fruits and tapping palm wine until I saved enough money to stand financially. When I saved fifteen shillings, I bought some kernel, which I carried on my head to sell in Azumini. By so doing we successfully combined soap trade with a palm kernel business. I saved up to twenty pounds to buy a new bicycle, which enabled me to ply my trade on a larger scale. My wife and I became adequately clothed. We bought additional farmland and intensified food production. Having acquired enough land, I proceeded to plant palms, which I obtained from the government. These plants I nursed, and with the subsidy received from the government for fertilizer and farm implements, I established my plantation. The palm estate has enabled me to build a house for myself and to feed my family.

These examples of dynamism at the bottom have not yet propelled the societies as a whole into sustained growth, for all the reasons given in this chapter and the next. Individuals are dynamic, yet the complex interactions of individuals in society can cause stagnant economies. Still, the dynamism of the poor at the bottom can sometimes lead to emergence out of stagnation of the wider society.

Miracle in Xiaogang

In the tiny village of Xiaogang, Anhui province—the heart of China's rice-growing region—twenty families held a secret meeting in 1978. The villagers were desperate because they were starving. As Stanford economist John McMillan tells the story, the commune system that the Communists had in place all over China was leading to a breakdown in food production. Under this system, everybody was collectively responsible for tilling the land, and everybody had a share in the land's output. You got your rice share whether you worked hard or not, and as a result people hardly worked. The villagers of Xiaogang reached an agreement: they would divide up the land and farm it individually, with each person keeping the output of his own land. They kept their agreement a secret out of fear of the Communist authorities. Rice production in Xiaogang shot up. The results were too spectacular to stay secret for long. Neighboring villages wanted to know how Xiaogang had increased its rice production so much. Other villages also put into place individual farming.

Before long, the Communist authorities got wind of the spontaneous outbreak of property rights in the countryside. The news arrived at a propitious moment, when reformers in the party were seeking to get rid of the doctrinaire Maoists. Confronted with the evidence that food production increased dramatically with individual farming, the provincial Communist Party officials gave their blessing and reported the developments to authorities in Beijing. By 1982, a Communist Party conference ratified what had already happened in the countryside, approving individual farming. By 1984, there were no communes left.[56] This was just one pebble that started the landslide of the Chinese economic miracle. Gradualist, homegrown reform in China did much better than did outsiders' fantasies of shock therapy in Russia.

Piecemeal reformers, foreign and domestic, can try to move toward better systems that are sensitive to local conditions and that unshackle the dynamism of individuals everywhere. The

dynamism of the poor at the bottom has much more potential than plans at the top.

SNAPSHOT: THE SHELL FOUNDATION'S BUSINESSLIKE APPROACH TO POVERTY

ONE OF THE LEASTknown problems of poverty is indoor smoke from cooking. During a recent trip to Africa, I saw a young girl cooking in an unventilated hut all day long, in smoke so thick I could not stand to stay in the hut for more than a few seconds. This scene is common in homes throughout Africa, multiplying many times children's chances of dying from respiratory infections. The World Health Organization estimates that indoor air pollution in a smoky hut exceeds by a factor of sixty the European Union's standard maximum for outdoor air pollution.[57]

The sufferings from acute respiratory infections are hard to convey to people in rich societies, who no longer experience them. The lungs fill with pus, some of which the patient coughs out. The infection causes chills, fever, shaking, sharp pains in the chest, nausea, and vomiting. Death follows when the infection goes untreated. This is how indoor smoke kills. The death toll is around 1.8 million a year worldwide.

The Shell Group is one of those large multinational corporations that are so feared by globalization protesters. Many of these corporations are responding to this social pressure by setting up charitable foundations. They bring to the table their own unique business skills, which makes them think more like Searchers than like Planners. The Shell Group's charitable wing, the Shell Foundation, explains its philanthropic approach:

> *Our partners need to be adept at applying business thinking and business principles to how they operate and to the interventions they propose.... [We stimulate] the deployment by our partners of the same set of skills and entrepreneurial instincts…that business people everywhere use to identify and assess business opportunities and then overcome the problems that must be solved en route to setting up and operating an enterprise. These include understanding the market and knowing who your customer is, what* they *want and will pay for…Our partners usually…will be particularly* enterprising *as they search for solutions.*

For example, the Shell Foundation is tackling the problem of indoor smoke. Traditional aid approaches have not made much headway on this problem. Official donor agencies tried to force technical fixes—such as stoves designed to reduce smoke—on the poor without consulting them on what kind of stoves they wanted and would use. The utilization rate of these new stoves turned out to be a big disappointment. The aid Planners were not thinking like businessmen—that is, giving the customers what they wanted at a reasonable cost. The Shell Foundation is experimenting with a market-based approach, in which dozens or even hundreds of microenterprises produce and distribute stoves, adapting them to local consumer wants. The approach is pragmatic: a combination of cash sales to consumers, sales to NGOs and to public institutions that use their own social distribution networks, experimentation with microcredit to finance stove purchases, and accepting payments in goods rather than cash.

Corporate charity cannot replace official foreign aid, but its marketlike approach is a good model of what it's like to be a Searcher.

SNAPSHOT: IMPROVEMENTS TO DOING BUSINESS

NOT ALL PIECEMEAL IMPROVEMENTS are tangible projects. Simeon Djankov at the World Bank, with many collaborators, has started a promising initiative to reduce obstacles to doing business in poor countries. He has found in his research that countries that require more red tape to start a new business have higher corruption and large informal sectors operating outside the law. Business is also shackled in poor countries by cumbersome procedures to collect debts, enforce contracts, register property, and collect from bankrupt business partner.[58]: "It takes 153 days to start a business in Maputo, but 2 days in Toronto. It costs $2,042 or 126% of the debt value to enforce a contract in Jakarta, but $1,300 or 5.4% of the debt value to do so in Seoul. It takes 21 procedures to register commercial property in Abuja, but 3 procedures in Helsinki. If a debtor becomes insolvent and enters bankruptcy, creditors would get 13 cents on the dollar in Mumbai, but more than 90 cents in Tokyo.[59]

Djankov and his collaborators have shined a bright light on this issue by compiling indicators of costs of doing business for as many countries around the world as possible. Every year, they issue a report highlighting the countries that have improved the most and those that failed to improve. This honest reporting affects a country's ability to attract capital and so creates incentives for piecemeal changes to cumbersome regulations.