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# Institutional Reform With Popular Support for Private Sector Growth in Latin America

Presented to:

U.S. Agency for International Development  
Lima, Peru  
and  
Bureau for Latin America and the Caribbean  
U. S. Agency for International Development  
Washington, D.C.

Presented by:

Instituto Libertad y Democracia  
Avenida Benavides 881  
Miraflores, Lima, Peru

October 1988



October 17, 1938

Mr. Donor Lyon  
Director  
U.S. Agency for International Development  
Larrabure y Unanue 110  
Lima, Peru

**SUBJECT: Proposal for Institutional Reform with Popular Support for  
Private Sector Growth in Latin America**

Dear Mr. Lyon:

We are pleased to present our proposal to carry out research, promotion, implementation, and training activities to stimulate institutional reform and economic growth in Latin America. This proposal presents our intention to perform research at an increased scale, scope and complexity. We believe our record of achievements demonstrates the great promise for the application of the kind of research we are pursuing. We also believe that this pioneering effort which you have been supporting will result in a new, cost-effective means for A.I.D. to support economic change in other third world countries on a regional and worldwide basis.

We have attempted to clarify, in this proposal, to the extent we can at this juncture, the nature of our activities and tasks, especially during the first two years of the five-year grant period. Our proposal provides sufficient detail and milestones so that your office can provide oversight of our activities and finances. We have also provided for an external operational evaluation, reprogramming, and financial review in our budget request.

The proposal sets forth two new activities:

- An international training and dissemination program that will promote the methodologies and approaches we are employing and annually train up to 145 persons involved in institutional and legal reform efforts in Latin America and elsewhere.

**Instituto Libertad y Democracia**

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Benavides 881 - Casilla Postal (P. O. Box) 18-1420 - Lima - Perú Telfs. 470916 - 469128

- A liaison office in Washington to facilitate relationships with U.S. academics and experts, and others.

We appreciate immeasurably the resources and cooperation provided by your office in the past and we look forward to a fruitful working relationship in the future.

Please be advised that this proposal is being submitted simultaneously to A.I.D. in Washington, D.C.

Sincerely yours,

A handwritten signature in black ink, appearing to be 'H. de Soto', written in a cursive style.

Hernando de Soto  
President

Attachment

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## EXECUTIVE SUMMARY

This proposal emphasizes the approach and the plan of activities of the ILD for the next five years. It also responds to specific issues raised by the Office of Private Enterprise of the LAC Bureau and other A.I.D/Washington officials.

It provides the following information not previously submitted to A.I.D.:

- A summary of the record of achievements of our organization
- Brief resumes of the staff members who will execute the tasks
- An approach and action plan for each principal activity stressing how the work will be accomplished -- as well as an evaluation and reprogramming process. Manpower deployment plans and task plans are presented for the first two years of the grant period
- A plan for providing training, information and assistance to other groups in Latin America that wish to research and promote institutional reform, using the informal sector as one of the key components to their research programs
- A summary of the management and staffing improvements recommended by Arthur Young in August 1988 and an indication as to which of these have been adopted by ILD
- A summary of the financial management recommendations made by Arthur Young in August 1983 (virtually all of these recommendations have been or will be adopted shortly), and by Deloitte, Haskins & Sells in October 1988

- A realistic fund-raising plan to generate counterpart financing through the life of the project.

For those reviewers who have not had access to the previously submitted proposal, the findings and implications of our previous research are included in Appendix A as background information.

AID/Washington has raised several questions about our previously submitted proposals in memoranda dated September 22 and October 5, 1988. For ease of review, we have summarized our responses to those concerns in the following paragraphs:

Methodology for the international programs. The heart of this program would be a training course on measurement methodology, analysis of legal and institutional costs faced by the informal sector, and development of legal and institutional reform proposals, implementation and promotion. We estimate that up to approximately 145 persons can be trained annually in short courses, once we have the program organized. We expect to be able to organize the program in the first five months of the grant period. We will hire a program coordinator and members of our staff will serve as instructors. Our teaching materials will be based on our experience in Peru, but the methodology will be generic enough to allow foreign participants to develop their own program, according to realities in their countries. While they are establishing their program in their countries and once underway, we will continue to provide them with technical assistance and support. We will also develop other means of disseminating knowledge (a newsletter, international conferences, etc.) that will keep policymakers and others abreast of current activities in this important development area.

Personnel and management plan. We have presented in this proposal the most detailed plan to date regarding utilization of present staff to perform proposed activities in research, promotion, implementation, training and other areas. This plan is presented in

Chapter III of this proposal. We are also recommending a brief external evaluation of our program in the ninth month of every year, enabling us to reprogram and reallocate resources to maintain a program that will yield the maximum benefit possible over the grant period.

Financial management systems. The financial management systems of ILD have been intensively reviewed by both Arthur Young (August 1988) and Deloitte, Haskins & Sells (September-October 1988). We have already adopted most of the recommendations made by Arthur Young, as indicated in Chapter II. We have just received the draft recommendations of DHS, and our financial administrator (a Stanford M.B.A.) will be using those recommendations to fine-tune the financial system to accommodate and account for larger inflows of cash. We have also included costs in our budget for an annual financial review by international auditors.

Regional programs costs. Because members of our research, promotion and implementation staffs will participate as instructors in regional training courses and will occasionally work to assist in the formation and development of research programs in other countries, we estimate that the direct cost our international program will be \$470,000 in year one and \$490,000 in year two. A summary of our initial planning and programming was indicated above.

AID management and monitoring responsibilities. We recommend that AID/Lima monitor our physical accomplishments (deliverables, training numbers, etc.) but that AID/Washington provide a semiannual program and regional impact review. We have also budgeted for an annual external evaluation which will serve, as noted above, as our reprogramming exercise for the subsequent year.

Specificity of the budget. We have developed budgets for the next five years based on current program costs and the estimated costs of those components that will be added. Types of personnel to be hired are specified.

Fund raising and self sufficiency. While we recognize the desirability to be self-sufficient in terms of funding, our experience has shown us that this activity can absorb considerable management resources. We propose, therefore, that A.I.D. and ILD conduct a major performance review at the end of the second year. If ILD is providing A.I.D. with a cost-effective means to meet the latter's objective, we propose that A.I.D. substantially increase either its direct funding or funding for informal sector and institutional reform to the A.I.D. missions in the region, which can be directed to ILD for specific services. This will enable us to focus on our major activities over the next two years to produce the maximum possible benefit.

## I. BRIEF BACKGROUND OF ILD

This chapter will briefly discuss the Instituto Libertad y Democracia (ILD) in terms of its present organizational status, its research findings and program strategy, and its experience and record of achievements. With the exception of our record of achievements, the information presented in this chapter is a summary of information previously submitted to A.I.D.

### 1. A Brief Description of ILD

Our organization is a research and advocacy institute located in Lima, Peru. It was founded in 1982 to study the impact of legal institutions on economic development based on intensive research of the Peruvian informal sector, which has been forced outside of these institutions.

It has grown to 22 professionals with 15 support staff members; generally half of the professional staff are economists and half are lawyers. A discussion of the capabilities of the staff is included in the next chapter. The ILD staff will be expanded slightly to accommodate the increased workload discussed in this proposal.

Our staff is presently divided into four areas: Presidency and General Management, Research, Promotion and Implementation, and Finance and Administration. Two new divisions will be established with the funds from A.I.D.: an international training and dissemination program and a U.S. liaison office (ILD-USA).

Exhibit I-1 demonstrates the increase in donations from A.I.D. and other sources in the 1982-1988 period.

### 2. Research Findings and Program Strategy

The ILD was created in 1982 to develop a better understanding of underdevelopment. Our approach is based on the study of the

EXHIBIT I-1

ILD PROGRAM BUDGET BASED ON AID AND OTHER DONOR SUPPORT

1982 - 1988  
(U.S. dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
AID	35,772	149,773	351,197	552,072	466,628	331,603	550,000
Other Donors:							
CIPE			36,000	176,789	187,208	199,253	160,800
Smith-Richardson			10,000	40,000	84,800		75,000
Francisco Marroquin			2,000	2,000	2,000		
IAF				60,000	70,000	39,600	
FMME				3,507			
Calmedon Foundation				1,551			
Tinker						30,000	
CINDE							95,000
Ford							49,850
UNDP							51,000
Total Other Donors	<u>0</u>	<u>0</u>	<u>48,000</u>	<u>283,847</u>	<u>344,008</u>	<u>268,853</u>	<u>431,650</u>
Total Program	35,772	149,773	399,197	853,919	810,636	600,456	981,650
Increase (decrease) over previous year		318%	166%	109%	(3.1%)	(26%)	63.5%
In Percentages:							
AID	100%	100%	88%	66%	57%	55%	56%
Other Donors	0	0	12%	34%	43%	45%	44%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

formal institutional system of Peru, its effect on the economy (especially upon the informal sector), and the structural adjustment proposals that can be envisaged based on the study of informal common law and international comparative law.

After researching various aspects of the informal sector, the evidence collected by the ILD has led to two important conclusions:

- The failure of private enterprise to produce growth in Latin America does not occur because market economies do not function, but, rather, because the legal institutions that control private economic activity are mercantilist in nature, and therefore stifle private initiative.
- The failure of democracy to provide a stable framework for peaceful and pluralistic development is not the failure of democracy as such, but the fact that Latin American democracies are incomplete and lack many of the institutions and practices that have proven crucial to Western democracies and even to informal organizations in Peru.

Mercantilism centralizes economic and political decision-making to the benefit of a small elite. In much of the third world today, no matter what political system is at work, the elite controls in the same way: through closed, special-interest rulemaking that is not subject to scrutiny by the majority of the citizens.

The ILD has identified the following manifestations of mercantilism:

- Obstacles and barriers that raise the costs of entry into the formal economic system
- Restraints on growth due to inefficient government regulation

- The absence of facilitative law (property rights, contracts, torts, limited liability, business organizations, insurance, legal instruments for collateral and credit, etc.)
- The systematic by-passing of existing law by most entrepreneurs -- the poorest of whom must do so to survive
- Excessive benefits to those who invest an important part of their time in politics, and an enormous prejudice against those who do not
- Massive migration to cities
- Growing illegitimacy of the law and a spontaneous emergence of extra-legal common law
- Inordinate violence, repression and corruption.

The overall objective of this proposed program is to overcome the above-mentioned barriers, and to structure a blueprint for peacefully and deliberately replacing mercantilist systems with modern market-oriented, democratic structures in less developed countries.

The work accomplished by ILD to date has led to the identification, description and quantification of informal economic activities in Peru. The results of this research were astounding: 39% of the GDP is produced by the informal sector, and about 60% of all employment is generated by this sector.

The work has also demonstrated that private entrepreneurship is a widespread phenomenon deeply rooted in Peru's national traditions, and is not an ideological import.

Analyzing the extra-legal rules created by the "informals," we have found that these rules are democratic and market-based. This is promising evidence that there can be widespread support for democratic and private sector-oriented institutional reforms.

The ILD has also begun an examination of legal institutions that the "informals" have avoided or from which they have been excluded. This institutional analysis has led to a preliminary identification of the levels and sources of institutional dysfunction, and together with information obtained on extra-legal rules and legal institutions abroad, it has provided the basic components of the institutional reform projects described in this proposal.

While the ILD's research has created an impressive record of achievements (to be discussed in the section below), we need to deepen it in the following areas:

- Further economic and legal research to examine capital, labor and foreign exchange markets, and the housing, manufacturing, transport and agriculture sectors
- Additional institutional research to identify reforms that encourage the expansion of private sector development and the adequate functioning of a democratic system.

It is also necessary to communicate the findings of our research and the proposed reforms so that they will energize public opinion to support the reforms and to test them. This has been a crucial element of our program to date.

Reactions in other countries seem to indicate that the findings and proposed reforms may have relevance and application in other third world countries, initially in Latin America. To that end, a program of international dissemination, including a training program for Third World participants, has been proposed.

### 3. Record of Achievements

The ILD has a record of achievements to date that indicates that its experience will serve as a strong basis for performance in the future.

The major achievements of the ILD to date have been:

- Seminal research on the scale and scope of the informal sector, social class analysis, impact of law on economic growth (barriers to business licensing, barriers to titling property, importance of property rights in investment, and other topics), and development of appropriate means and language to communicate these findings to those concerned
- Publication of findings on informal housing, commerce, and transport in several working papers and in the book El Otro Sendero, which has become the all-time best-seller of Peru, and the number one best-seller in Spanish-speaking Latin America
- Formation of two Office of Complaints (one for the Attorney General and one at the ILD offices) which transmit the problems of millions of citizens to government authorities and the media
- Because of ILD's studies, informality has come to be a euphemism for an indigenous, democratic market economy; therefore, the term is now a culturally acceptable form of understanding entrepreneurship and for breaking the paradigm that private entrepreneurship does not work in Latin America, or that it is not a suitable form of economic organization for the poor, or that democracy cannot function in our midst

- ILD's studies demonstrate the negative consequences of a statist and political administration of business. ILD has stimulated 3,000 articles in the Peruvian and international press, and, most interestingly, selected published writings of various marxist authors, editorial writers and politicians who acknowledge that their hegemony over the poor has been broken by the ILD
- Establishment of an institutional framework called the Formal-Informal Union, which is a forum and a vehicle to promote the common interests of formal and informal entrepreneurs. Representatives of more than 500,000 "informals" and the authorities of the Confederation of Institutions of Private Entrepreneurs (a formal union) subscribe to this ILD initiative that proposes 12 basic economic rights around which formals and informals are beginning to find a common cause
- Adoption in 1985 by President Fernando Belaunde of an ILD proposal for citizen participation in the rulemaking of the Executive Branch
- Draft law for Administrative Simplification (administrative deregulation), which was just approved by the Senate in early October 1988 with the support of all political parties and which is expected to be enacted by Congress by December 15, 1988. In the last three months, eleven municipalities around metropolitan Lima have also adopted ILD's program of administrative simplification
- The ILD's proposed law for titling of informal property has been approved by President Garcia and is actually being implemented by all Peruvian municipalities

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- The mayor of Lima has withdrawn Order 002 (which was to regulate ambulatory vendors), after the ILD demonstrated that the proposed rule went against the interests of these informal street vendors, without benefitting anyone
- President Alan Garcia and Congress recently adopted ILD's people's mortgage program (hipoteca popular), to facilitate banking financing to informal entrepreneurs, and to recognize informal possession as collateral. ILD has signed an agreement with the government to establish the system
- Practically all political parties in Peru today embrace components of the ILD program and all of them recognize the need for widespread entrepreneurship
- The ILD has received requests from 26 organizations in 14 Latin American countries for training and technical assistance. Various representatives of political parties, business and civic organizations have visited the ILD. Chiefs of state, church leaders, and politicians throughout the hemisphere continuously quote ILD literature.

\* \* \* \* \*

This chapter has briefly described the ILD, its research findings and development strategy, and its record of achievements. The next chapter will discuss ILD's approach, organization and staffing for carrying out the activities deemed to have the highest priority in terms of development impact.

## II. PROPOSED APPROACH, ORGANIZATION AND STAFFING

This chapter presents our general approach and the organization of key professional staff members who will perform major tasks in:

- Research
- Promotion and Implementation
- International training and dissemination.

In this chapter we also discuss the requirement for a U.S. liaison office, which we propose to establish in Washington, D.C.

ILD has recently undergone several financial system assessments; one by Arthur Young in August 1988 and one by Deloitte, Haskins & Sells in September-October 1988. Our adoption or proposed adoption of their recommendations along with a proposal for an annual financial review are detailed in this chapter.

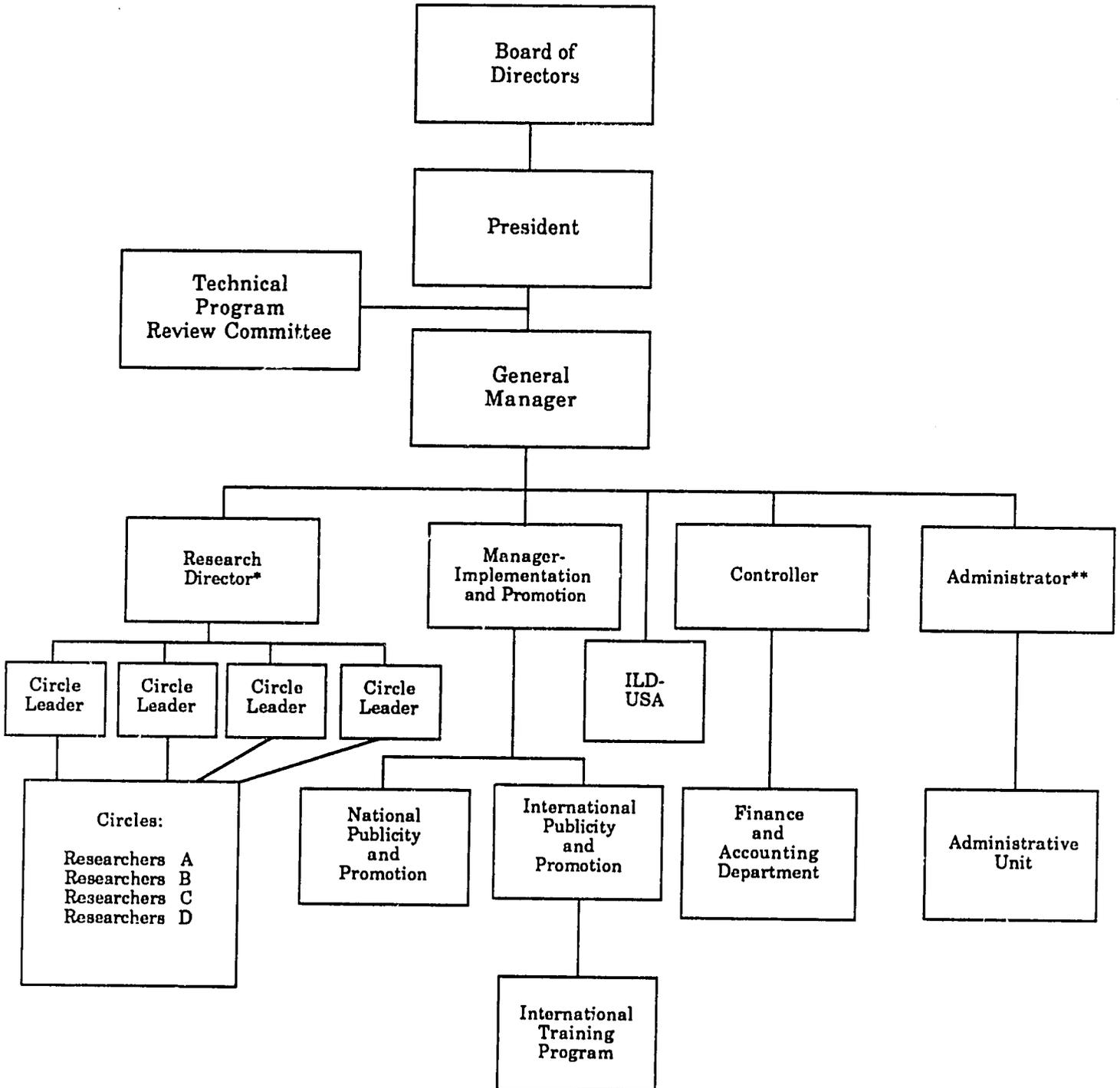
It has been suggested that ILD strengthen its relationships with U.S. institutions engaged in research on the informal sector. Our present position on this matter is presented below along with our approach to the formation of such relationships over the five-year grant period.

Finally, we present in this chapter a realistic approach to fund-raising over the next five years.

### 1. Introduction

In the previous chapter, we referred to the functional divisions within the ILD organization. Exhibit II-1 presents our present organization chart. Exhibit II-2 lists the present personnel under each major functional division.

EXHIBIT II-1  
ILD ORGANIZATION CHART



\* Duties executed by General Manager

\*\* Duties executed by Controller

EXHIBIT II-2

PRESENT DIVISION OF LABOR BY AREA

PRESIDENCY AND GENERAL MANAGEMENT

Hernando de Soto, President  
Luis Morales-Bayro, General Manager

RESEARCH

Julio Velarde, Director of Economic Research  
Alberto Bustamante, Director of Institutional Research  
Jorge Fernandez-Baca, Economist  
Hugo Eyzaguirre, Economist  
Pierina Pollarolo, Lawyer  
Maria de Los Angeles Murillo, Lawyer  
Mariano Cornejo, Architect  
Daniel Herencia, Engineer  
Maria del Carmen Delgado, Lawyer  
Ana Lucia Camaiora, Lawyer  
Fernando Chavez, Economist  
Clara Ogata, Economist  
Hugo Santa-Maria, Economist  
Ana Rosa Martinelli, Lawyer  
Percy Marquina, Economist  
Carlos Gandolfo, Lawyer

IMPLEMENTATION AND PROMOTION

Manual Mayorga, Implementation and Promotion Manager  
Guido Lombardi, Director of National Dissemination  
Humberto Ponce, Attorney  
Mario Guibellini  
Guillermo Guedes  
Pedro Salinas  
Jackeline Silva, Lawyer

EXHIBIT II-2 (Cont'd)

Maria Lourdes San-Martin, Lawyer

Rosa Estrada, Lawyer

FINANCE AND ADMINISTRATION

Daniel Saba, Controller

Elso Jo, Financial Assistant

Ricardo Espinoza, Accounting Assistant

Roger Espejo, Computing Assistant

Cesar Ocharan, Cashier Assistant

Orlando Eyzaguirre, Administrative Assistant

SECRETARIAL SUPPORT

Elvira Barua, Executive Secretary, Presidency

Maria Alejandra Rada, Executive Secretary, General Management

Roger Espinoza, Office Assistant

Jeannette Hognimann, Administrative Assistant, Implementation and  
Promotion

Ana Cecilia Gorrio, Secretary, Economic Research

Cecilia Gonaz, Secretary, Institutional Research

Silvia Ortigas, Secretary, Institutional Research

Patricia Jimenez, Secretary, Implementation and Promotion

Maria Esther Tamayo, Receptionist

In this chapter we demonstrate how key staff members fit into these functional divisions and how their experience and training ensure the success of proposed ILD activities. We believe the quality of our staff is strong evidence of our potential for continued success.

Brief resumes of our two chief operating officers are presented below:

- President - Hernando de Soto

Mr. de Soto has been President of ILD since its conception. He studied humanities in the Universidad Catolica in Lima, and economics in the University of Geneva, where he received his Licence from the Institute Universitaire de Hautes Etudes Internationales. Since then he has been an Economic Affairs Officer in GATT, President of the Executive Committee of the Intergovernmental Council of Copper Exporting Countries in Paris, Managing Director of Universal Engineering Corporation in Geneva, Director of the Central Reserve Bank of Peru, Chairman of a private mining company in Peru and since 1984 he has been a member of the United Nations Committee for Development Planning.

- General Manager - Luis Morales-Bayro

Mr. Morales-Bayro was appointed ILD's General Manager in February 1988, after serving as Research Director since November 1984. He studied economics at the Catholic University of Chile, Santiago, received his M.A. in development economics from Boston University and completed the coursework for his Ph.D. in economics at the same university. Mr. Morales-Bayro has twenty years of professional experience in domestic institutions (Central Reserve Bank of Peru, National Planning Institute) and

with the Inter-American Development Bank, working as an expert in cost-benefit analysis in Peru, Nicaragua, Barbados, Colombia, Costa Rica, Panama and Washington, D.C.

## 2. Research Program Structure and Staffing

Research is the activity that drives all other ILD components. The findings of our research have already formed the basis of our success in Peru and have drawn the attention of politicians, business groups, academics, journalists, and aid program personnel in Latin America and around the world.

Much of the research performed by the ILD involves economic and legal analysis of field-collected data. This type of research is difficult because it requires the collection of data from primary sources, many of whom are operating in the informal sector. Interviews with "informants" in both the formal and informal sectors go slowly, but are producing a reliable foundation of data in this field of development economics. As this particular type of research has never been done in such depth, the ILD is creating the building blocks for research on the informal sector.

Continuing areas of research are intended to dig deeper into the earlier findings of ILD in informal housing, commerce, manufacturing and transportation. An example of this deepening research is the considerable staff-time spent in 1988 on the concepts of the Possession Title and the People's Mortgage in the informal housing sector. These have recently been adopted by the Peruvian government and we are working to institutionalize them as national programs.

The research teams are organized into task forces or "work circles," which enable them to respond to research needs with speed and flexibility. The circles are formed to address specific, high-priority problems in a given economic sector or institution, and

transform themselves once the work results in a proposal for institutional reforms. The transformed circles therefore dedicate themselves to the promotion and implementation of the proposals.

Our approach to research over the next five years is to limit the number of circles so that we can deepen the level of understanding in certain fields and make recommendations adoptable by public institutions. The recommendations and "law projects" will primarily be structured to facilitate private sector development and the creation of democratic institutions that affect all levels of society. Unquestionably these reforms are designed to begin with the poorest levels of society.

Each research circle is responsible to the Research Committee, formed by the president, the general manager and the economic and institutional research directors, for frequent review of their research progress. The Research Committee and individual circles set milestones and dates for completion of reports on the research they are conducting. Then, the circle leaders are accountable for the quality and pace of work. This system is working well in 1988, and we are presently on schedule for all major research efforts projected for this year.

As a general approach to research, the work circles:

- Determine the nature of informality in whatever sector or activity being investigated by identifying and interviewing key formal and informal respondents in order to:
  - Identify the factor markets and economic sectors in which informality occurs
  - Identify and study the reasons for the existence of that informal activity

- Quantify the extent to which it occurs.
- Identify the laws and institutions that contribute to informality.
- Refine and apply the methodology for measuring the costs of legal and institutional barriers to:
  - Single out some of the most significant costs, and analyze the interaction of these inefficiencies in the different markets and sectors, thus clarifying the effects of one sector on the rest of the economy
  - Develop a methodology generally applicable in developing countries.
- Determine the existing cultural base on which new institutions should be based through:
  - Analysis of the extralegal norms developed by the informal sector to deal with the existing legal and economic institutions
  - Conduct of comparative international research to identify similar problems and their solutions in other countries, and analyzing these solutions to determine whether they could be adapted to Peru's situation.
- Develop alternative solutions, based on the above, that could remove or minimize the more disruptive structural barriers to economic and political participation, evaluating the effectiveness of the various alternative solutions relative to the existing situation.

- Once the best solution is agreed upon, this is structured into a draft law or policy proposal for reform that is published and subjected to public scrutiny and debate. ILD's experience in this matter shows that if the proposal is right it will be picked up by the authorities, and, if not, it will be enriched by the debate and returned to the drawing board for a comprehensive review and re-initiation of the process.

It is envisioned that the research program for the first two years will be in the following areas:

- Legal and institutional costs in capital markets
- Legal and institutional costs in the manufacturing sector
- Legal and institutional costs in housing
- Measurement of informal sector activity
- Democratic decision-making or rule-making
- Institutional checks and balances
- Access to information
- Legal and institutional costs in agriculture
- Legal and institutional costs in the labor market
- Legal and institutional costs in the transport sector
- Judicial systems.

Circles will be set up for each research thrust; Chapter III presents in considerable detail the research program for years one and two. Only seven of these areas will be research during year one. Establishment of new circles will be based on the following criteria:

- New research will be based on previous research activities
- New research should potentially affect the largest number of informal sector members as possible

- New research should hold promise for creating the greatest economic benefit possible for the country.

We anticipate undergoing an external evaluation once yearly. Funds are included in our budget for these expenses. This evaluation will also be an opportunity to review our program activities and plan the steps we will take in the subsequent year.

ILD's research efforts, in addition to the oversight and process management provided by Mr. Morales, will be led by Mr. Alberto Bustamante, our Institutional Research Director and Dr. Julio Velarde, our Economic Research Director. Brief resumes of Mssrs. Bustamante and Velarde are included below:

- Institutional Research Director - Alberto Bustamante

Mr. Bustamante is a lawyer who graduated from the Catholic University of Peru and holds an M.A. in Legal Institutions from the University of Wisconsin. He has been in charge of institutional and legal research for ILD since 1984. Mr. Bustamante is recognized as the leading expert in administrative law in Peru and has over twelve years of professional experience in prestigious universities and research institutions.

- Economic Research Director - Julio Velarde

Dr. Velarde is an economist from the Universidad del Pacifico in Lima, and received his M.A. and Ph.D. in economics from Brown University. He was appointed as Economic Research Director of ILD in July 1988. Dr. Velarde is a leading Latin American expert in monetary policy and has ten years of professional experience in private research institutions and the public sector.

Other key research staff members are presented below:

Jorge Fernandez-Baca

Economist

Mr. Fernandez-Baca has a B.A. in economics from the Universidad del Pacifico and is a Ph.D. candidate at the University of Paris. He has been a member of ILD's research staff since July 1985, and is the expert in ILD's methodology to measure the size of informal economic activity, using monetary aggregates.

Hugo Eyzaguirre

Economist

Mr. Eyzaguirre has a B.A. in economics from the Universidad del Pacifico and holds an M.P.A. in Public Policy from the Wharton School of the University of Pennsylvania. He has been with ILD since August 1987 and is an expert in the methodologies to measure costs created by institutional barriers.

Mariano Cornejo

Housing Sector Expert

Mr. Cornejo holds a degree in architecture from the Universidad Nacional de Ingenieria of Peru and has studied urban development in France, England, and Japan. Mr. Cornejo has worked at ILD since 1984 and is an expert in informal housing.

Pierina Pollarolo

Attorney

Mrs. Pollarolo holds a law degree from the Catholic University of Peru and an M.A. in law from Harvard University. She has been a member of ILD's research team since April 1987 and is an expert in rule-making and legislative procedures.

Maria de los Angeles Murillo

Attorney

Mrs. Murillo received her law degree from the Catholic University of Peru. She is an expert in informal housing and in the implications for investment due to uncertainty in property rights; Mrs. Murillo has been a member of ILD's

research team since June 1984. She has been a leading member of the team that worked on the ILD's research on the "popular mortgage" concept.

Maria del Carmen Delgado Attorney

Mrs. Delgado holds a law degree from the Catholic University of Peru. She is an expert in informal housing, "popular mortgage", and property investment under uncertain conditions, and has been member of the ILD's research staff since November 1985.

Fernando Chavez Economist

Mr. Chavez has a B.A. in economics from the Catholic University of Peru and has a masters degree in cost-benefit analysis from the Universidad Nacional de Ingenieria. He has worked for the ILD since 1985 and is an expert in measuring the costs of legal obstacles to economic activity.

Clara Ogata Economist

Mrs. Ogata has a B.A. in economics from the Universidad del Pacifico. She has been a member of ILD's research team since 1985 and is an expert in informal capital markets.

Daniel Herencia Engineer

Mr. Herencia has a mechanical and electrical engineering degree from the Universidad Nacional de Ingenieria and an M.S. in Mechanical Engineering from the Catholic University of Rio de Janeiro, Brazil. He is ILD's expert in programming, survey processing and data collection. He has been with ILD since 1985.

Mrs. Camaiora holds a law degree from the Catholic University of Peru and is an expert in administrative simplification. She has been a member of ILD's staff since 1985, and is one of the key members of the circle that produced the proposed law for administrative simplification, which was approved by the Peruvian Senate in October 1988.

3. Implementation and Promotion Program Structure and Staffing

The role of the Implementation and Promotion Program is to communicate the ILD's findings to a broad public, both formal and informal, to test research results, and to build support for proposed reforms, both at the grassroots level and with decision-makers.

The ILD has developed the following techniques to create a successful public information campaign:

- Reinforce democratic concepts in the programs. All ILD research is converted into a legislative or policy proposal, the purpose of which is to test the effectiveness of the research invested and to reinforce the importance of widespread democratic participation in rulemaking. To this effect, ILD ensures that its legislative proposals are made available for comment and review through public hearings before final publication.
- Select issues on the basis of their relevance to the broadest stratum of the population, the poor. Thus, for example, the ILD deals with issues such as property rights in the context of informal home titling, a problem besetting more than half of the population of Peru.

- Set forth arguments based on reliable, factual data gathered from both the informal and formal sectors. The key is to produce publications that enable people to identify and agree with the points being made because they live with them every day. Entrepreneurs at all levels, except those in the elite, mercantilist group, face the same realities when dealing with the government.
- Adopt the language used by the audience to assure a better understanding of ILD's ideas. Thus, we use the term "entrepreneurship" or "informality" instead of "private sector," which is equivalent to the term "oligarchy" in Peru.
- Use widely read and listened to communication channels (popular press, magazines, radio and TV) directed to the target group, and use the informals' networks for distribution of information in the informal sector.

The ILD applies these general techniques to each of its promotion efforts. Below are brief descriptions of each national promotion activity, and the action that will be taken under each one.

(1) Dissemination of the Thesis of ILD

The ILD uses a wide range of communication channels, such as newspapers, magazines, radio and television to disseminate its thesis. One publication format has proved to be particularly effective: Analyses in Benefit of the Public Interest (ABIPs). These four page articles summarize research on a major topic, using numerous illustrations and photographs to focus attention and communicate the message.

The ABIPs are written specifically to illustrate the consequences of badly made laws and to indicate clearly the importance of adequate legal institutions for development.

They critique the laws that are causing barriers and propose market-oriented alternatives. In doing so, they illustrate the logic behind market-based legislation. They focus on issues such as home titling, anti-trust, rent control, and labor stability from the point of view of the poor majority. They are published in magazines and newspapers, reaching over 800,000 readers. They are also published separately and distributed among interested groups, including "informals," in flyer form.

ILD also publishes books, working papers and pamphlets. The books contain complete research work on economic sectors or relevant institutional areas. The working papers form part of a series of brief monographs applied to more specific problems or issues. The pamphlets are published and printed for wide distribution and for describing selected ILD projects. These publications are geared to different audiences (urban poor, academic, development experts, decision-makers).

(2) Dissemination of El Otro Sendero

El Otro Sendero has been one of the ILD's most effective means of communication, as it is the best selling book in Peruvian history. The ILD is committed to making this seminal work available as widely as possible. Arrangements have been made for serial publication of a synthesis of El Otro Sendero as a supplement in a widely circulated national newspaper. It is also being summarized in different forms for different audiences (for example, the chapters dealing with the informal activity in specific activities are being revised for popular publication).

In Latin America, El Otro Sendero has sold over 100,000 copies. Some 1,300 articles have been written on it in less than one year by Latin American politicians, analysts, philosophers, and journalists. The best of these articles,

both pro and con, are being edited into a book. The ILD is also studying effective means of encapsulating the book for radio, TV and comic editions. It should also be noted that an English version of El Otro Sendero will be published by Harper & Row in January 1989.

### (3) Dissemination of Legislative Proposals

Another ILD promotion program is the dissemination of legislative proposals. The objective of this effort is to propose specific changes in the legal and institutional structure of Peru and to build public support for these reforms. The ILD takes the following actions to achieve this objective:

- Publishes, based on its research, proposed legislation detailing how the identified problems could be solved
- Demonstrates, using concrete cases, how outdated legal institutions could be restructured
- Includes cost-benefit analyses of the existing and proposed laws
- Publishes the analyses and recommendations together in the official paper El Peruano
- Invites citizens and institutions to send in their comments on the theme within a period of thirty days
- Collects signatures in support of the ILD's thesis. For example, signatures representing more than 300,000 persons supported the ILD's proposal on titling for informal housing

- Organizes public hearings in which citizens can comment on the proposal and suggest modifications. The objective is to use factual analysis rather than ideology to develop realistic proposals for reform.

This mechanism for the dissemination of legislative proposals, which began with a program called "Everybody's Balcony" has been used successfully to date in proposing four pieces of legislation, all of which have been adopted in one form or another by the government. This system is also being used, in a larger scope, through the "Office for People's Defense", described further on.

(4) Formal-Informal Union

Peruvians live in a constant state of judicial instability, as demonstrated by the abrupt bank nationalization in August 1987. Neither formals nor informals feel secure about their property or other economic rights. Thus, in February 1988, the ILD created, in conjunction with the association of private business organizations (CONFIEP), a Formal-Informal Union of entrepreneurs to defend the economic rights of all Peruvians.

The Union represents a major step in the evolution of Peruvian formal business thinking. It is the first time formal business leaders have recognized the commonality of interest between themselves and informal entrepreneurs, and indicated a willingness to associate with informals.

The objectives of the Union are the following:

- Defend the twelve Economic Rights described by the ILD in a statement published in all major newspapers of Peru

- Detect and speak out against governmental abuse in this area
- Promote deregulation and simplification of the laws
- Channel public opinion toward necessary institutional reforms
- Oppose mercantilist practices.

The Union will undertake specific programs, including:

- Continue to support the now-established Committee for Credit Democratization
- Establish several Committees for Debureaucratization by sector
- Establish several Committees for the Promotion and Defense of Economic Rights
- Establish several Committees for Projects of Social Concern.

(5) Office for People's Defense

Reciprocity rules in the informal sector as in the rest of the world. One of the ways the ILD is repaying the informals who have provided it with such useful information is to provide them with free legal consulting services. Not only does this compensate for information received, but it also helps us to identify additional problems and develop case studies.

The ILD has implemented a legal counseling system under the Office for People's Defense and it is now working to organize a volunteer system in which law students and

professional attorneys will participate. Cooperative agreements are in effect with the Institute for the Defense of Constitutional Rights and the Pontificia Universidad Catolica del Peru.

Key staff members in the program include:

- Implementation and Promotion Manager - Manuel Mayorga

Mr. Mayorga is a mechanical and electrical engineer graduated from the Universidad Nacional de Ingenieria in Lima. He was ILD's manager from 1984 to February 1988, when he was appointed as implementation and promotion manager. During these years Mr. Mayorga's talents as a project organizer have proven very useful to ILD's implementation and promotion program.

- Director of National Dissemination - Guido Lombardi

Mr. Lombardi holds a law degree from Catholic University of Peru. He has considerable international experience in the press and policy analysis, has been a magazine editor, and is one of Peru's most prominent TV anchorman. Mr. Lombardi joined ILD in July 1988.

- Humberto Ponce - Attorney

Mr. Ponce holds a law degree from the University of San Marcos in Lima, and is an expert with more than twenty years experience in press editorial work, and promotion at the highest levels of government. Mr. Ponce recently joined ILD's staff in July 1988.

The program is also staffed by three professionals and three non-professional persons.

#### 4. International Dissemination and Training Program Structure and Staffing

The book El Otro Sendero has struck responsive chords wherever it has been read. From Mexico to Argentina it has hit the best seller lists, stimulated over a thousand newspaper and magazine articles and editorials and, most importantly, captured the attention of leaders throughout the hemisphere. As a result, the ILD has received over 20 requests from leaders of government, heads of political parties, presidents of business associations and research institutions for training and help in launching programs in their countries. Requests have been received from as far as away as Asia and Africa. This strong response suggests that the problems described in the ILD's work are more common in less developed countries than was originally thought. The research techniques of the ILD may be applicable or useful in much of the third world and may provide an important explanation as to why economic growth has been limited in so many of these countries.

The proposed international dissemination and training program will put us in a position to provide training, strategic analysis, and technical assistance to parties interested in starting programs having objectives similar to ILD throughout Latin America and, to an undetermined extent, the rest of the world. In this role, we see ourselves as a catalyst for research and reform, but firmly believe that in-country programs must be at the initiative of local leaders, with financing or research institutions committed to spending the time, effort and funds required to promote change.

It is critical, however, that this international effort be based in Peru for several reasons. First, the basic work on informality being done in Peru is an invaluable laboratory for further work and training. Secondly, the experienced staff resides in Peru. Third, one of the great strengths of the ILD is that it was conceived and developed in the Third World by people from the Third World. To the extent that it appears to be a U.S. or

developed country idea being promoted in the developing world, it will be questioned and lose legitimacy.

While the ILD has been in contact with international figures all along, the international training and dissemination effort will require us to assume several new functions. Specifically, ILD would undertake to:

- Promote dissemination of the concept of institutional development through newsletters, speeches and presentations throughout the world
- Establish an information center
- Train interested parties from throughout the world in how to do what the ILD does--to measure the extent of informality by sectors, quantify its costs, identify the legal and institutional barriers and obstacles causing informality, develop proposals for reforming them, and build a base of support for change through public education
- Publish findings and methodology through a series of working papers and manuals.

Further detail of each component of the international dissemination and training program follows.

(1) International Dissemination Efforts

The ILD will become a source and clearinghouse of collected information on the informal sector, institutional reform and other pertinent issues in economic development. We plan to disseminate this information through speaking engagements, the information center, publications and newsletters.

## International Promotion and Speaking Engagements

It is expected that the ILD will continue to receive invitations to give speeches, debate issues, and generally "make its case." These invitations are considered an opportunity to educate and also serve to help local leaders raise interest in establishing a local program. Within the constraints of time and funds, the ILD will respond to such invitations. In order to do this, it will first be necessary to develop criteria for deciding to which groups we will speak. We also need to prepare more people to speak publicly. This will allow us to respond to the growing interest in our research activities.

Effective promotion of ideas requires that they be linked to the strongly felt needs of the audience being addressed. As the promotion and dissemination of the ILD's message expands beyond the nations similar to Peru, attention must be given to making the message relevant to the concerns of the audience. To this end, work will be undertaken to enable the ILD to determine how its message can best be adapted and conveyed to those groups throughout the world requesting its assistance.

## Information Center

As a natural outgrowth of its role as promoter and trainer, the ILD will have a wealth of information on people doing research in the field of informality and the role of institutions in development. And, as a result of the on-going research program, the ILD will be a source of new ideas which should be made available to those working in the field. Finally, the ILD already has (and is expanding) a list of consultants whose knowledge can be adapted to assist in such areas as measurement of informality, quantification of the costs of legal

institutions, recognition of legal and institutional barriers, and identification of realistic and tested alternatives for institutional change.

Thus, the ILD can serve as a source of information on relevant research and experience throughout the world. Through a computerized information center this information can be made easily and quickly available to local groups throughout the world. We propose to hire a librarian to be in charge of this component.

### Newsletter

One of the most important elements of any reform program is a steady source of information on the topic and the sense of belonging to a movement. The ILD will periodically publish a newsletter to be distributed to those undertaking programs in their countries, to theoreticians, and development practitioners interested in the concepts and programs as well as any other interested parties. The newsletter will focus on both practice and theory and the relationship between them. It will enable groups in one country to learn from the experience of others, and will challenge those in the field by providing new insights on the relevant issues. The newsletter will keep all of the various actors abreast of development in the field.

### Training Programs

The objective of the Training Program will be to share the knowledge that ILD has gained regarding the measurement of informality, identification of legal and institutional obstacles, measurement of costs, development of alternative solutions, and mobilization of support for change. The ILD will make available what it has learned, directly through training programs and technical

assistance, and indirectly through manuals. Responsibility for initiating, funding, and implementing local programs must reside with the local groups. The true test of their commitment to undertaking long-term reform is their dedication of time, effort and funds to a reform program.

The individuals and institutions participating will come from two basic sources: those who contact the ILD as a result of reading or hearing about its work and those who are recommended by funders and third parties. To date, the ILD has requests from throughout Latin America from informal organizations, formal private sector organizations, universities, research organizations, political parties, and governments. The first step in this project will be to work out a set of criteria to define selection rules, including estimations of the seriousness of the candidates, as measured by their willingness to commit resources to participation and follow-up.

Training will take a number of forms depending on who is to be trained and what the objective of the training is. At present, at least five types of training programs are envisioned, including:

- Receipt of high-level delegations
- Seminars
- Manuals and training materials
- Technical assistance
- Fieldwork.

Each of these are briefly described below.

## Receipt of High Level Delegations

A number of those who have inquired about the ILD's programs are leading government officials (from prime ministers to mayors), party officials, presidents of national business associations, and others. They are interested in the concepts, not in the details of how research is conducted. They have limited time available, yet wish to familiarize themselves with the ILD's thesis, explore the ramifications of the different approaches that ILD has used, and think through what they mean in their national context.

The ILD proposes to continue its current program, hosting officials and policymakers upon their request to spend one to three days with top ILD staff in Lima in programs specifically designed to meet their interests. The programs of seminars, technical assistance, and publications described below will be made available to their staff as follow-up to their visits.

### Seminars

Seminars, generally ranging from one to two weeks, will be held in Lima for those who will be undertaking the actual work in their countries. The seminars will cover both theory -- why look at informality, what does it signify about a society -- and practice:

- Measurement of informality and quantification of costs
- Identification of legal and institutional obstacles
- Development of proposals for reform

- Public education.

Emphasis will be placed on the importance of reliable data, the crucial role of language, and the effective use of media. Depending on need, specialized seminars may be held on specific aspects of measurement, on work in sectors such as housing or commerce, or techniques for mobilizing public opinion.

The seminars may be given specifically for a group from one country, if it is large enough, or for representatives from a number of countries. It is expected that participation will run from ten to not more than 20 in each seminar.

These seminars will be held in Lima where field trips can be made and all the data is available. The curriculum will be designed and taught by ILD staff who have been involved in actually doing the work in Lima, giving participants the advantage of their practical experience. Training materials and techniques will be developed with assistance from experts in training.

As noted above, this would be a brand new program for ILD. Therefore, we will need to establish the program in the first five months of the grant period. During that period, we will:

- Hire a training director and administrative assistant who can develop and take charge of the program
- Formalize curricula
- Conceptualize logistical arrangements
- Schedule trainings
- Select and invite trainees

- Set up classrooms and make support arrangements.

We project that we will initiate the training program in the sixth month of the grant period.

### Manuals and Training Materials

The development of manuals outlining the ILD's methodology will serve as basic training materials for the seminars. They will also be available upon request to groups who may not be able to attend the seminars but are interested in a concise presentation of the concepts.

In addition to the manuals, the ILD is developing a series of working papers describing in detail various aspects of its program, such as the Ombudsman System, Methodology and Results in Housing, Urban Transport, Street Vending and Markets, and Labor Policies. These, too, will be published for use in the seminars and for general distribution to those interested in pursuing the ILD approach.

### Technical Assistance

As groups in different countries begin to apply the ILD methodology, it is likely that they will confront problems and request technical assistance from the ILD, in the form of written or oral consultations or visits to their operations. Criteria will be established to evaluate these requests and decide how they should be met given the staff time and resources available.

### Fieldwork

Under fieldwork, selected individuals would be invited to participate for several months to one year in

an ILD project in Lima. Detailed work on a project would enable them to lead a research or advocacy group doing similar work in their country.

#### 5. U.S. Liaison Office Structure and Staffing

The Arthur Young report suggests that the funding channel from A.I.D. be through an ILD office set up in Washington. There are several reasons for this:

- ILD will have, through its international training activities, a greater regional focus, and should not be perceived merely as a Peruvian program
- Severe inflation in the Peruvian economy is affecting ILD's ability to maintain its high-caliber staff, primarily because the funds that it receives through AID/Lima are subject to exchange rates that lag behind the current rate. This seriously affects the buying power of ILD staff.
- Transfer of the funds through this channel will insulate ILD-Peru from sanctions that may be imposed by the U.S. Government upon the Government of Peru.

The ILD-USA office can serve several important purposes:

- Maintaining close contact with officials of A.I.D., the Inter-American Development Bank, and the World Bank regarding projects and other opportunities to involve ILD in activities related to institutional reform
- Coordinating the logistical arrangements for the consultants who will be working with ILD in Peru or who may be contracted to carry out comparative international research on the role of law and institutions in economic development

- Organizing internal working groups, when necessary, on the implications of the different programs of the ILD
- Coordinating the activities and flow of information to and from the Technical Review Committee
- Translating and disseminating information prepared by the ILD-Peru staff.

ILD-USA will be staffed by one professional director and one administrative assistant. This office need not be large, but should have enough space for a modest-sized meeting (15-20 persons). It will have access to word processor, copying, and telephone services. We anticipate that this office can be set up for \$150,000.

#### 6. Management and Staffing Actions to be Taken in 1988-89

This section discusses actions that we are taking in response to the recent management assessment by Arthur Young. It also includes steps we will take to expand our staff to implement the proposed program.

The Arthur Young report made a series of management and organizational recommendations, which will be set forth below along with actions we have taken or intend to take:

- Expansion of the Board of Directors

We have already identified one candidate, and intend to increase the board from four to six persons in the near future.

- Formation of a Technical Program Review Committee

Five academics have been identified for this committee, which will be formed by the end of the year.

- Organization Chart

We have adopted the organization chart recommended by Arthur Young. This organization chart incorporates the circle concept and several needed adjustments in our organizational structure (see Exhibit II-1).

- Reduction of the Number of Circles

In early 1988, we were carrying out research in 17 circles. The number has currently been reduced to twelve. For 1989, we hope to reduce that number further.

- Modest Increase of ILD Staff

ILD now has nine economists on its research staff. We plan to hire four more economists, three at the A-level and one at the B-level. Presently we employ eight attorneys and propose to employ two additional A-level lawyers.

In line with this modest increase in staff, we also plan add an international training and dissemination director, a translator, a librarian, an administrative assistant for international training and a secretary.

We will be moving to a larger building, probably in early 1989, which will accommodate this additional staff and provide space for the international training program.

- Benefits Program

We have incorporated a fringe benefit amount for each full-time ILD employee in the budget. This figure has been estimated at 10 percent.

- Additional Computer and Telephone Equipment for Greater Staff Efficiency

ILD installed a new telephone switchboard with three lines and 22 extensions to replace the old rented switchboard that only had 12 extensions. ILD has also applied for two more telephone lines.

As soon as the A.I.D. grant is approved, we intend to purchase eight additional personal computers with those funds, and we hope these can be procured on a tax-free basis through A.I.D./Lima.

## 7. Financial Management Actions

ILD has recently undergone financial reviews by Arthur Young (August 1988), and Deloitte, Haskins & Sells (September-October 1988). In this chapter, we list the changes in the financial systems that were recommended and note whether we have adopted them, or when we plan to adopt them.

The following recommendations were included in Arthur Young's report:

- "At month-end an unpaid expense incurred should be recorded as a liability to expedite account closings."  
Will be adopted by the end of October 1988.

- "Requests for reimbursement of expenses should be prepared and forwarded to donors ten days after the end of each month."

Will be adopted by the end of October 1988.
- "International telephone calls are an exception that should be accounted for when cost is known rather than when cost is incurred."

Will be adopted by the end of October 1988.
- "Expenses remaining unpaid at the end of a grant period should be paid promptly so that reimbursement from donors can be received within the period allowed by the grant agreement."

Will be adopted by the end of October 1988.
- "The procedure ILD is now studying to issue checks with simultaneous computer entry program should be implemented as a top accounting priority."

Will be adopted by the end of November 1988.
- "In addition to the micro-computers needed for research projects, the accounting department should have one for its exclusive use."

Will become operative as soon as this grant is approved.
- "Research and other personnel should be trained in the use of spreadsheets and other computer tools."

We are providing selected personnel with short courses during the month of October 1988.
- "The chart of accounts should be expanded to accommodate certain types of assets, liabilities and revenues and certain expense accounts should be re-coded."

Will be operative by the end of November 1988.

- The balances of certain asset and liability accounts should be analyzed by components and/or reconciled with the control accounts to provide a sound starting point for fund accounting."

Will be operative by the end of November 1988.

- "A User's Manual should be prepared for the computerized accounting system and a second operator should be trained."

Will be operative by the end of November 1988.

- "Procedure manuals should be updated."

Will be operative by the end of November 1988.

- "As a first step toward project control and financial planning, a time-keeping system should be established."

Will be operative by the end of November 1988.

- "The time-keeping system should incorporate costs of personnel."

Will be operative by the end of November 1988.

- "In addition to annual budgets, cash flow projections should also be prepared for every project on a monthly basis for the next twelve months."

Will be operative by the end of November 1988.

We have received the draft report of Deloitte, Haskins & Sells and find the recommendations to be acceptable; however, most appear to pertain to previous years. As these recommendations are acceptable, we will move to immediately rectify the problems indicated.

Our Financial and Administrative Manager whose resume appears below will work aggressively to assure that our accounting system will be capable of handling an increased volume of expenditures and donations.

Daniel Saba

Financial and Administrative Manager

Mr. Saba holds an industrial engineering degree from the Universidad Nacional de Ingenieria in Lima. He also holds a master's degree in Business Administration from the Escuela de Negocios para Graduados (Esan) in Lima, and an M.B.A. from Stanford University. He was appointed as financial and administrative manager of ILD in April 1988. Mr. Saba is assisted by five accounting staff.

#### 8. Linkages to Academic Researchers and Institutions

ILD has had working relationships with U.S. institutions, including Brookings Institution, Georgetown University, Washington University at St. Louis and the Small Business Administration. We hope to work with the Lincoln Land Institute in the near future. However, the ILD does not want to establish a relationship with a single institution because knowledge on this subject is extremely dispersed throughout the world. Whenever we have entertained the possibility of an exclusive relationship, it has tended to close off cross-fertilization from other academic sources and has produced resentment. In fact, there is no institution currently in existence that has informality and institutional reform as its major focus.

We have utilized a series of academic researchers, thinkers and experts, primarily from the U.S., who have assisted us in the formulation of specific aspects of our program. We propose to continue to utilize such expertise, which normally emanates from eclectic sources. If in the course of this grant period we encounter a U.S. research institution with which a close working

relationship is possible and an interchange of personnel, ideas, resources, etc. will be fruitful, we will be willing to formalize such an arrangement.

#### 9. Fund-raising Activities

Exhibit I-1 demonstrates that we have been able to raise an increasing portion of our budget from sources, ten donors, that are non-A.I.D. Some of this support will continue. At the present time, we anticipate receiving \$210,000 from CIPE. As of yet, no other donors have committed funds for 1989. For example, the Inter-American Bank was considering a grant for about \$300,000, but the outcome of our request is as yet uncertain.

Our overall quest for funds will continue, but our experience is as follows:

- Grants from non-A.I.D. and non-CIPE sources have come in smaller amounts (an average of \$38,000). These have involved an inordinate amount of time to raise, report on, and account for.

Therefore, the budget proposed in Chapter IV is based on a more or less constant amount from the other donors during the first two years of the grant. This will allow us to focus strongly on the activities that will make our program successful, and not dissipate our energies during this two-year period. At that juncture, we request that A.I.D., in the course of the semi-annual program review proposed above, examine the effects of our program on a regionwide basis. If we are achieving the effects that we believe we can, we would pursue one or a combination of two courses:

- A.I.D. increases the present grant to create an even greater regional and worldwide impact

- A.I.D. channels substantial additional funds to its missions throughout the region and worldwide for informal sector research and institutional reforms. These funds could be structured so that individual A.I.D. missions could buy our services for their countries.

A.I.D. has offered technical assistance on fund-raising, and if such activities are approved by OMB, we would find that type of technical assistance very useful. The ILD presently has considerable material in English with which a fund-raising campaign could be mounted.

EXHIBIT II-2

PRESENT DIVISION OF LABOR BY AREA

PRESIDENCY AND GENERAL MANAGEMENT

Hernando de Soto, President  
Luis Morales-Bayro, General Manager

RESEARCH

Julio Velarde, Director of Economic Research  
Alberto Bustamante, Director of Institutional Research  
Jorge Fernandez-Baca, Economist  
Hugo Eyzaguirre, Economist  
Pierina Pollarolo, Lawyer  
Maria de Los Angeles Murillo, Lawyer  
Mariano Cornejo, Architect  
Daniel Herencia, Engineer  
Maria del Carmen Delgado, Lawyer  
Ana Lucia Camaiora, Lawyer  
Fernando Chavez, Economist  
Clara Ogata, Economist  
Hugo Santa-Maria, Economist  
Ana Rosa Martinelli, Lawyer  
Percy Marquina, Economist  
Carlos Gandolfo, Lawyer

IMPLEMENTATION AND PROMOTION

Manual Mayorga, Implementation and Promotion Manager  
Guido Lombardi, Director of National Dissemination  
Humberto Ponce, Attorney  
Mario Guibellini  
Guillermo Guedes  
Pedro Salinas  
Jackeline Silva, Lawyer

5)

EXHIBIT II-2 (Cont'd)

Maria Lourdes San-Martin, Lawyer

Rosa Estrada, Lawyer

FINANCE AND ADMINISTRATION

Daniel Saba, Controller

Elso Jo, Financial Assistant

Ricardo Espinoza, Accounting Assistant

Roger Espejo, Computing Assistant

Cesar Ocharan, Cashier Assistant

Orlando Eyzaguirre, Administrative Assistant

SECRETARIAL SUPPORT

Elvira Barua, Executive Secretary, Presidency

Maria Alejandra Rada, Executive Secretary, General Management

Roger Espinoza, Office Assistant

Jeannette Hognimann, Administrative Assistant, Implementation and  
Promotion

Ana Cecilia Gorrio, Secretary, Economic Research

Cecilia Gonaz, Secretary, Institutional Research

Silvia Ortigas, Secretary, Institutional Research

Patricia Jimenez, Secretary, Implementation and Promotion

Maria Esther Tamayo, Receptionist

### III. PLAN OF ACTIVITIES

This chapter presents our plan for carrying out tasks within the research areas discussed above. In Exhibits III-1 and III-2 we have broken down the tasks that will be required to meet the research objectives of our circles.

We demonstrate the scheduling and sequence of these activities and tasks in Exhibits III-3 and III-4. It should be pointed out that these tasks and activities are dynamic and, from time-to-time, subject to exogenous circumstances, which may require their adjustment. For example, our people's mortgage program and the administrative simplification proposal are presently being institutionalized, and this may require additional staff effort over the next several months, and possibly into next year. For this reason we have planned for a project evaluation and reprogramming exercise once yearly. But we also anticipate making minor programmatic adjustments as we go along. Implementation and promotion activities are not included in these exhibits because it is a continuous activity, which for the most part utilizes the outputs of the research efforts and responds to political and economic realities.

Exhibits III-5 and III-6 demonstrates the allocation of our present and proposed professional staff time among management and coordination, research, implementation and promotion and international training.

## EXHIBIT III-1

### TASK BREAKDOWN YEAR ONE

#### CIRCLE 1: CAPITAL MARKETS

##### A. FORMAL MARKET

1. Describe the structure and size of the formal credit markets
2. Identify legal rules that regulate legal access to credit.
3. Describe steps with which citizens must comply to legally obtain credit.
4. Estimate through field studies the economic costs of complying with identified regulations.
5. Estimate the relative importance of legal and institutional costs (as a percentage of the amount of money borrowed) to compare it with official interest rates.
6. Report.

##### B. INFORMAL MARKET

1. Describe the structure of the informal capital market
2. Describe the mechanisms by which money is lent, and conditions for lending (interest rates, payback period and guarantees required)
3. Estimate the size of the informal capital market

#### CIRCLE 2: HOUSING SECTOR

##### A. LEGAL AND INSTITUTIONAL COSTS OF ENTRY INTO FORMAL MARKETS

1. Select specific activities where the informal economic activity is of major importance.
2. Identify the legal norms that regulate legal entry into the selected activities.

3. Describe the specific steps a citizen must complete to register a house. The description should include all state agencies the person has to visit and the form-filling requirements for each agency, as well as an estimate of the fares, rates and taxes to be paid in each stage.
4. Estimate through field studies the amount of working and calendar days which a typical citizen, without legal advice, must spend to comply with regulations and red tape established by law, in order to legally register a house.
5. Quantify the economic cost of complying with identified regulations.
6. Compare legal and institutional costs with selected economic indicators.
7. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
8. Report.

**B. LEGAL AND INSTITUTIONAL COSTS OF OPERATING IN FORMAL MARKETS**

1. Identify legal rules affecting the operation of a house legally registered in each of the specific activities selected.
2. Quantify the economic cost of complying with identified regulations.
3. Compare legal and institutional costs using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

C. LEGAL AND INSTITUTIONAL COSTS OF EXIT FROM FORMAL MARKETS

1. Identify legal rules affecting the transference of a house in each of the selected activities.
2. Quantify the economic cost of complying with identified regulations.
3. Compare legal and institutional costs, using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

D. COSTS OF TRADE WITHIN INFORMAL MARKETS

1. Identify and quantify economic costs which informal home owners must incur as a result of not having legal status.
2. Identify and quantify the economic costs which informal home owners must incur as a result of being unable to use the facilitative aspects of law.
3. Quantify the economic impact of not having access to formal factor markets.
4. Report.

E. INDIRECT COSTS ABSORBED BY THE REST OF THE ECONOMY

1. Efficiency loss in the allocation of scarce resources
2. Undesirable distributional effects
3. Undesirable social and political climate
4. Report.

F. FINAL REPORT

### **CIRCLE 3: MANUFACTURING SECTOR**

#### **A. LEGAL AND INSTITUTIONAL COSTS OF ENTRY INTO FORMAL MARKETS**

1. Select specific activities where the informal economic activity is of major importance.
2. Identify the legal norms that regulate legal entry into the selected activities.
3. Describe completely the specific steps a citizen must complete to register an enterprise. The description should include all state agencies the person has to visit and the form-filling requirements for each agency, as well as an estimate of the fares, rates and taxes to be paid in each stage.
4. Estimate through field studies the amount of working and calendar days which a typical citizen, without legal advice, must spend to comply with regulations and red tape established by law, in order to legally register an enterprise.
5. Quantify the economic cost of complying with identified regulations.
6. Compare legal and institutional costs with selected economic indicators.
7. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
8. Report.

#### **B. LEGAL AND INSTITUTIONAL COSTS OF OPERATING IN FORMAL MARKETS**

1. Identify legal rules affecting the operation of an enterprise legally registered in each of the specific activities selected.
2. Quantify the economic cost of complying with identified regulations.

3. Compare legal and institutional costs using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

#### **CIRCLE 4: MEASUREMENT OF INFORMAL ECONOMIC ACTIVITY**

##### **A. REVISION OF METHODOLOGY**

1. Review the ILD's methodology in microeconomic and macroeconomic terms
2. Study and include additional criteria to improve the ILD's methodology
3. Report.

##### **B. MANUAL PREPARATION**

1. Describe the ILD's methodology in microeconomic and macroeconomic terms
2. Prepare case studies to illustrate ILD's methodology
3. Report.

##### **C. APPLICATION**

1. Select ten Latin American countries to apply the ILD's methodology
2. Collect relevant information
3. Report

#### **CIRCLE 5: DEMOCRATIC DECISION-MAKING**

##### **A. RULEMAKING IN PERU**

1. Review the actual performance of the legislative elements of Parliament.

2. Study the procedures followed for the issuance of laws in the last three government terms, in the Municipalities and the Executive branch
3. Describe and analyze selected cases of state regulations, to get general conclusions with respect to the Peruvian rulemaking system.
4. Study the decision-making process in some informal organizations.

**B. ADMINISTRATIVE ADJUDICATION**

1. Study the existing administrative procedures in Peru, and compare with other systems.
2. Compile and analyze the regulations on public bidding.
3. Analyze the exonerations to public bidding since 1980, approved invoking "emergency" or foreign financing reasons.
4. Study the cases in which Public Administration adjudications were objected.
5. Analyze the internal composition of the entities that adjudicate rights and concessions, their formal or informal relationship with the bidders and contractors and their ties with the political power.
6. Study the costs for the State and society, in direct contracts by the State because of exonerations for public biddings.
7. Elaborate proposals to reform, order, reconcile and standardize the administrative procedures in Peru.
8. Report.

**CIRCLE 6: INSTITUTIONAL EQUILIBRIUM THROUGH CHECKS AND BALANCES**

- A. Compare legislative capacities of the Parliament and the Executive branch during the period 1980-88.
- B. Evaluate the actual capacity of the Parliament to supervise the Executive Power.

- C. Study a sample of lawsuits filed by private concerns against the State.
- D. Revise the role played by the Public Ministry during the 1980-88 period, in defending the Constitution and legality and, specifically its faculty to act as an ombudsman before the Public Administration.

**CIRCLE 7: ACCESS TO AND DIFFUSION OF INFORMATION**

- A. **FREE AND COMPETITIVE PRESS**
  - 1. Compile and systematize the norms that regulate the activities of the mass communication media.
  - 2. Establish the existing relationship between the magnitude of the debt owned by the communication media to the State and the dependence of the former towards the latter.
  - 3. Establish the existing ties between the volume of publicity directly and indirectly controlled by the State and the dependence level derived therefrom
  - 4. Determine the relationship between the economic dependence and the contents of information transmitted by the communication media.

## EXHIBIT III-2

### TASK BREAKDOWN YEAR TWO

#### **CIRCLE 1: CAPITAL MARKETS**

##### **B. INFORMAL MARKET**

3. Estimate the size of the informal capital market.
4. Estimate the transaction costs in the informal credit markets, as a percentage of the official interest rates.
5. Report.

##### **C. FINAL REPORT**

#### **CIRCLE 3: MANUFACTURING SECTOR**

##### **C. LEGAL AND INSTITUTIONAL COSTS OF EXIT FROM FORMAL MARKETS**

1. Identify legal rules affecting the exit of a formal enterprise from the market in each of the selected activities.
2. Quantify the economic cost of complying with identified regulations.
3. Compare legal and institutional costs, using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

##### **D. COSTS OF TRADE WITHIN INFORMAL MARKETS**

1. Identify and quantify economic costs which informal enterprises must incur as a result of not having legal status.

2. Identify and quantify the economic costs which informal enterprises must incur as a result of being unable to use the facilitative aspects of law.
3. Quantify the economic impact of not having access to formal factor markets.
4. Report.

**E. INDIRECT COSTS ABSORBED BY THE REST OF THE ECONOMY**

1. Efficiency loss in the allocation of scarce resources
2. Undesirable distributional effects
3. Undesirable social and political climate
4. Report.

**F. FINAL REPORT**

**CIRCLE 4: MEASUREMENT OF INFORMAL ECONOMIC ACTIVITY**

**C. APPLICATION**

1. Apply the ILD's methodology
2. Analyze results
3. Report.

**D. FINAL REPORT**

**CIRCLE 5: DEMOCRATIC DECISION-MAKING**

**A. RULEMAKING IN PERU**

5. Compare the Peruvian rulemaking system with systems of selected countries.
6. Elaborate proposals to reform the regulatory system presently in force, in order to guarantee the participation of citizens in governmental decisions.
7. Report.

C. CIVIL SERVICE

1. Determine the remuneration level of public officials and civil servants.
2. Analyze the relationship of dependence between the political power and the bureaucratic systems to detect the incidence that certain laws or regulations have had on this process.
3. Compile data for a profile of the public official or civil servant in Peru.
4. Investigate circumstances in which the vulnerability of the bureaucratic system has enabled the direct handling of administrative decisions.
5. Determine the means of access of bureaucratic personnel to administrative positions, evaluating the possible incidence of political factors.
6. Study cases related to control procedures established against officials or civil servants.
7. Elaborate proposals to reform the institutional mechanisms that select, promote and control the civil service.
8. Report.

D. FINAL REPORT.

**ARTICLE 6: INSTITUTIONAL EQUILIBRIUM THROUGH CHECKS AND BALANCES**

- E. Study the jurisdictional activity of the Court of Constitutional Guarantees.
  - F. Study the controlling actions by the Comptroller General of the Republic.
  - G. Elaborate institutional reforms to enable a balanced relationship among the Public Powers and constitutionally autonomous institutions.
  - H. Final Report.
- 65

## **CIRCLE 7: ACCESS TO AND DIFFUSION OF INFORMATION**

### **A. FREE AND COMPETITIVE PRESS**

4. Determine the relationship between the economic and financial dependence and the contents of the information transmitted by the communication media.
5. Elaborate proposals for institutional reforms in order to achieve a free press.
6. Report.

### **B. ACCESS TO PUBLIC INFORMATION**

1. Review mechanisms (laws, regulations and bureaucratic procedures) that presently deny access to public information in Peru.
2. Identify the criteria advanced democracies use in order to define the type of information that should be made available to the public.
3. Analyze the behavior of governors, public officials, and civil servants with respect to their furnishing the information held by them.
4. Elaborate proposals for institutional reforms to guarantee free access to public information.
5. Report.

### **C. FINAL REPORT**

## **CIRCLE 8: LABOR MARKETS**

### **A. FORMAL LABOR MARKET**

1. Describe the structure and size of the formal labor market.
2. Identify legal rules that regulate formal labor contracts.
3. Estimate the economic costs of complying with identified regulations.

4. Estimate the average cost of regulations per worker as a percentage of actual and market wage rates.
5. Report.

#### **CIRCLE 9: THE JUDICIAL SYSTEM**

- A. Estimate the number of lawsuits filed and settled by Judges during a given period of time.
- B. Compare the salary levels of judges with remunerations earned in the private sector.
- C. Compare the budgetary allocations corresponding to justice administration in Peru with those in developed countries and some developing countries.
- D. Select a representative number of judges to evaluate their qualifications and university and professional records.
- E. Select a sample of judicial resolutions and evaluate the quality of the judicial work and their consistency with previous resolutions on similar cases.
- F. Analyze the most common judicial procedures, illustrating the steps taken, the average time spent and cost of such procedures.
- G. Study the possibility of using extra-judicial procedures for settling disputes based on extra-legal systems of law.
- H. Report.

#### **CIRCLE 10: AGRICULTURAL SECTOR**

- A. **LEGAL AND INSTITUTIONAL COSTS OF ENTRY INTO FORMAL MARKETS**
  1. Select specific activities where the informal economic activity is of major importance.
  2. Identify the legal norms that regulate legal entry into the selected activities.
  3. Describe completely the specific steps a citizen must complete to register an enterprise. The description should include all state agencies the person has to visit

and the form-filling requirements for each agency, as well as an estimate of the fares, rates and taxes to be paid in each stage.

4. Estimate through field studies the amount of working and calendar days which a typical citizen, without legal advice, must spend to comply with regulations and red tape established by law, in order to legally register an enterprise.
5. Quantify the economic cost of complying with identified regulations.
6. Compare legal and institutional costs with selected economic indicators.
7. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
8. Report.

**B. LEGAL AND INSTITUTIONAL COSTS OF OPERATING IN FORMAL MARKETS**

1. Identify legal rules affecting the operation of an enterprise legally registered in each of the specific activities selected.
2. Quantify the economic cost of complying with identified regulations.
3. Compare legal and institutional costs using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

C. LEGAL AND INSTITUTIONAL COSTS OF EXIT FROM FORMAL MARKETS

1. Identify legal rules affecting the exit of a formal enterprise from the market in each of the selected activities.
2. Quantify the economic cost of complying with identified regulations.
3. Compare legal and institutional costs, using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

D. COSTS OF TRADE WITHIN INFORMAL MARKETS

1. Identify and quantify economic costs which informal enterprises must incur as a result of not having legal status.
2. Identify and quantify the economic costs which informal enterprises must incur as a result of being unable to use the facilitative aspects of law.
3. Quantify the economic impact of not having access to formal factor markets.
4. Report.

E. INDIRECT COSTS ABSORBED BY THE REST OF THE ECONOMY

1. Efficiency loss in the allocation of scarce resources
2. Undesirable distributional effects
3. Undesirable social and political climate
4. Report.

F. FINAL REPORT

## **CIRCLE 11: TRANSPORT SECTOR**

### **A. LEGAL AND INSTITUTIONAL COSTS OF ENTRY INTO FORMAL MARKETS**

1. Select specific activities where the informal economic activity is of major importance.
2. Identify the legal norms that regulate legal entry into the selected activities.
3. Describe completely the specific steps a citizen must complete to register an enterprise. The description should include all state agencies the person has to visit and the form-filling requirements for each agency, as well as an estimate of the fares, rates and taxes to be paid in each stage.
4. Estimate through field studies the amount of working and calendar days which a typical citizen, without legal advice, must spend to comply with regulations and red tape established by law, in order to legally register an enterprise.
5. Quantify the economic cost of complying with identified regulations.
6. Compare legal and institutional costs with selected economic indicators.
7. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
8. Report.

### **B. LEGAL AND INSTITUTIONAL COSTS OF OPERATING IN FORMAL MARKETS**

1. Identify legal rules affecting the operation of an enterprise legally registered in each of the specific activities selected.
2. Quantify the economic cost of complying with identified regulations.

3. Compare legal and institutional costs using selected economic indicators.
4. Estimate the "excessive" legal and institutional costs and compare these costs with selected economic indicators.
5. Report.

Exhibit III-3  
Proposed ILD Research Activity Schedule  
Year One

**CIRCLE 1: CAPITAL MARKETS**

**A. Formal Market**

1. Structure and size of formal credit markets
2. Regulations governing access to credit
3. Present credit application process
4. Economic costs of compliance with above
5. Costs of borrowing in addition to interest rates
6. Report

**B. Informal Market**

1. Structure of informal capital market
2. Lending mechanisms and terms
3. Size of informal capital market

**CIRCLE 2: HOUSING SECTOR**

**A. Legal and Inst Costs of Entry into Formal Markets**

1. Select important informal activities
2. Identify entry regulations
3. Describe specific steps to title property
4. Determine average time for titling
5. Quantify economic costs of compliance
6. Compare costs with economic indicators
7. Estimate "excessive" costs based on econ. indicators
8. Report

**B. Legal and Institutional Costs of Compliance**

1. Identify laws for house ownership
2. Quantify cost of compliance
3. Compare costs with econ. indicators
4. Estimate excessive legal/instit. costs
5. Report

**C. Costs of Formal Transfer**

1. Identify rules for sale
2. Quantify economic costs of compliance
3. Compare costs to econ. indicators
4. Estimate "excessive" legal/instit. costs
5. Report

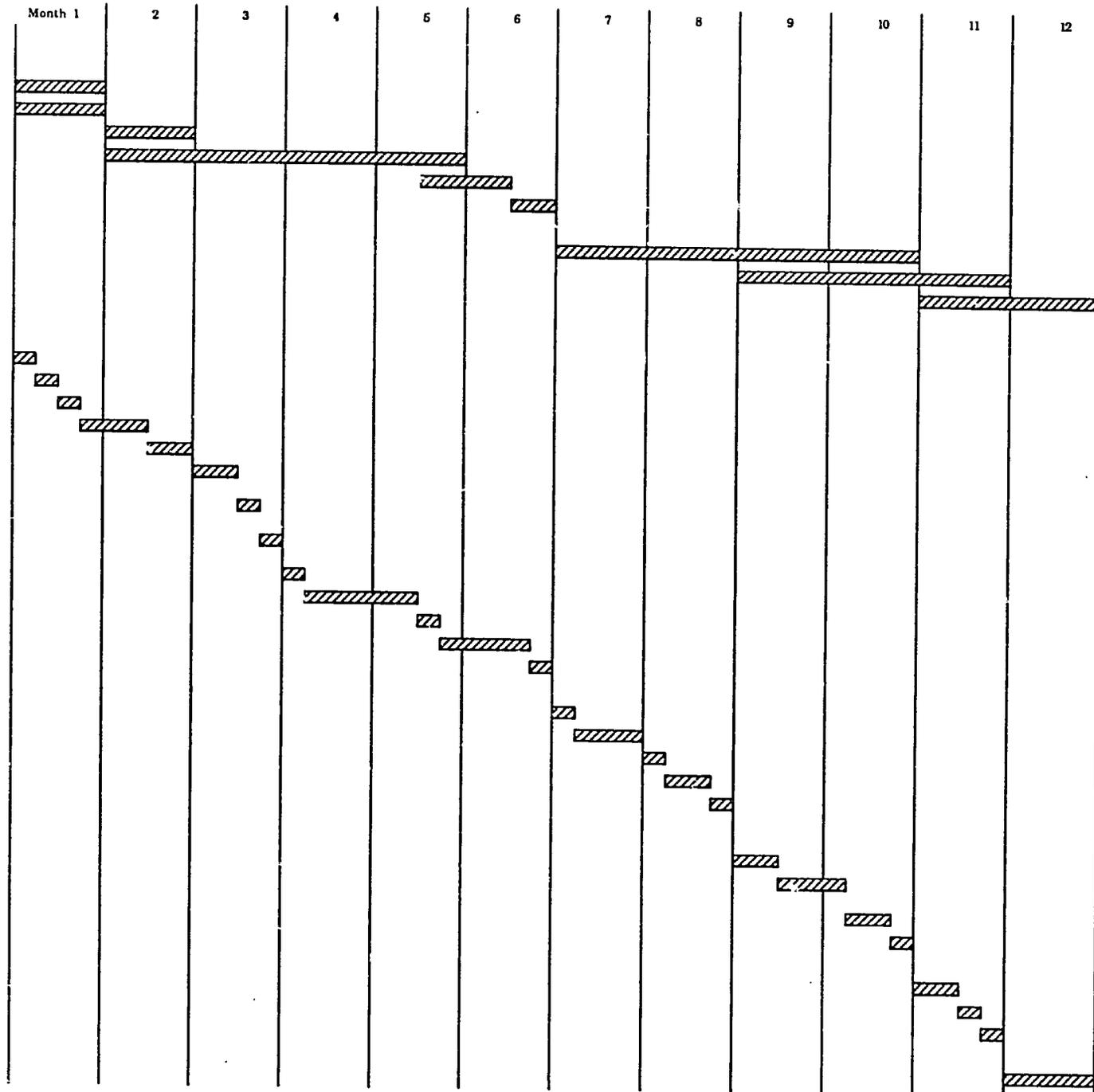
**D. Costs of Trade in Informal Markets**

1. Quantify econ. costs due to unofficial status
2. Econ. costs from inability to use facilitative law
3. Econ. impact of lack of access to formal factor markets
4. Report

**E. Indirect Costs**

1. Efficiency loss in resource allocation
2. Distributional effects
3. Social and political climate
4. Report

**F. Final Report**



AV

**CIRCLE 3: MANUFACTURING SECTOR**

**A. Costs of Entry**

1. Select activities where informality prevalent
2. Identify entry regulations
3. Describe specific steps to register enterprise
4. Estimate time to meet regulations
5. Quantify economic costs of compliance
6. Compare costs with economic indicators
7. Estimate "excessive" costs based on econ. indicators
8. Report

**B. Costs of Operating in Formal Markets**

1. Identify laws affecting operation of legally registered enterprise
2. Quantify econ. cost of compliance
3. Compare costs with econ. indicators
4. Compare "excessive costs with econ. indicators
5. Report

**CIRCLE 4: MEASUREMENT OF INFORMAL ECONOMIC ACTIVITY**

**A. Revision of Methodology**

1. Review ILD's methodology
2. Find any additional criteria
3. Report

**B. Manual Preparation**

1. Describe ILD methodology
2. Prepare case studies to illustrate methodology
3. Report

**C. Application**

1. Select ten Latin American countries to apply ILD methodology
2. Collect data
3. Report

**CIRCLE 5: DEMOCRATIC LAWMAKING**

**A. Rulemaking in Peru**

1. Review legislative performance of Parliament
2. Study issuance of laws in last three govt. terms
3. Analyze state regulations
4. Study decision-making process in informal organizations

**B. Administrative Adjudication**

1. Compare administrative procedures in Peru vs. other countries
2. Analyze public bidding regulations
3. Analyze exceptions to public bidding since 1980
4. Study cases where Public Administration adjudications were objected
5. Analyze composition and relationships of adjudicating entities
6. Study costs due to exceptions to public biddings
7. Propose administrative procedure reforms
8. Report

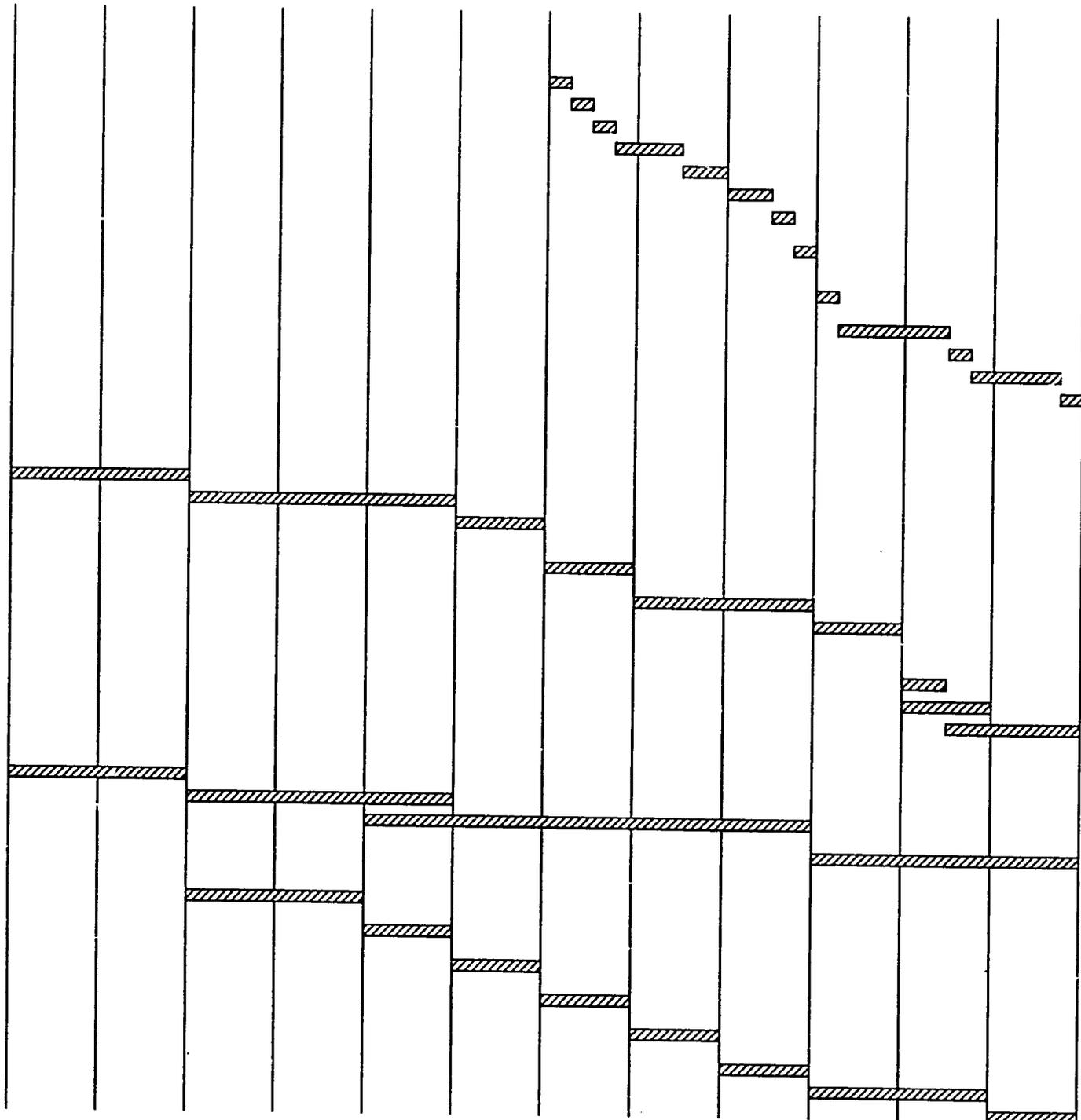
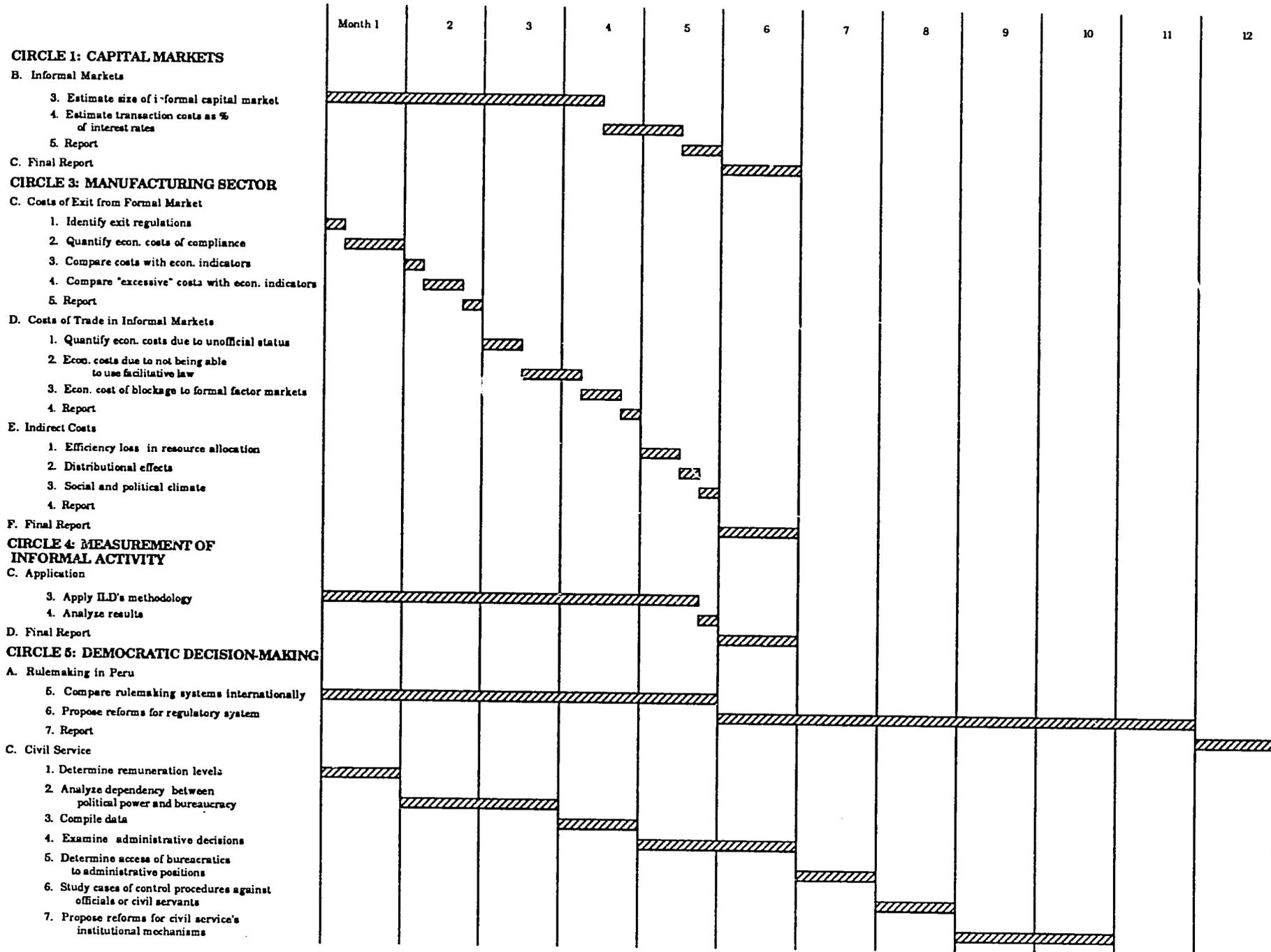




Exhibit III-4  
Proposed ILD Research Activity Schedule  
Year Two



- 8. Report
- D. Final Report
- CIRCLE 6: CHECKS AND BALANCES**
- E. Study activities of Court of Constitutional Guarantees
- F. Study activities of Comptroller General
- G. Propose reforms for checks and balances between Public Powers and other institutions
- H. Final Report
- CIRCLE 7: DIFFUSION OF INFORMATION**
- A. Free and Competitive Press
  - 4. Relationship between econ. dependence and info.
  - 5. Propose institutional reforms for free press
  - 6. Report
- B. Access to Public Information
  - 1. Review mechanisms blocking public info.
  - 2. Analyze official behavior towards public info.
  - 3. Identify criteria used by advanced democracies to define public info.
  - 4. Propose reforms to guarantee access to public info.
  - 5. Report
- C. Final Report
- CIRCLE 8: LABOR MARKETS**
- A. Formal Labor Market
  - 1. Describe structure and size
  - 2. Identify regulations
  - 3. Economic costs of compliance
  - 4. Estimate cost of regulations per worker as % of wage rates
  - 5. Report
- CIRCLE 9: JUDICIAL SYSTEM**
- A. Estimate number of lawsuits filed and settled
- B. Compare salary levels of judges vs. private sector
- C. Compare budget for justice administration internationally
- D. Examine qualifications of selected judges
- E. Evaluate the quality and consistency of judicial resolutions
- F. Analyze steps, time and cost of most common jud. procedures
- G. Extra-legal procedures for settling disputes
- H. Report
- CIRCLE 10: AGRICULTURAL SECTOR**
- A. Costs of Entry
  - 1. Select activities
  - 2. Identify entry regulations
  - 3. Describe specific steps to register enterprise
  - 4. Estimate time to meet regulations
  - 5. Quantify economic costs of complying
  - 6. Compare costs with economic indicators
  - 7. Estimate "excessive" costs vis-a-vis econ. indicators
  - 8. Report

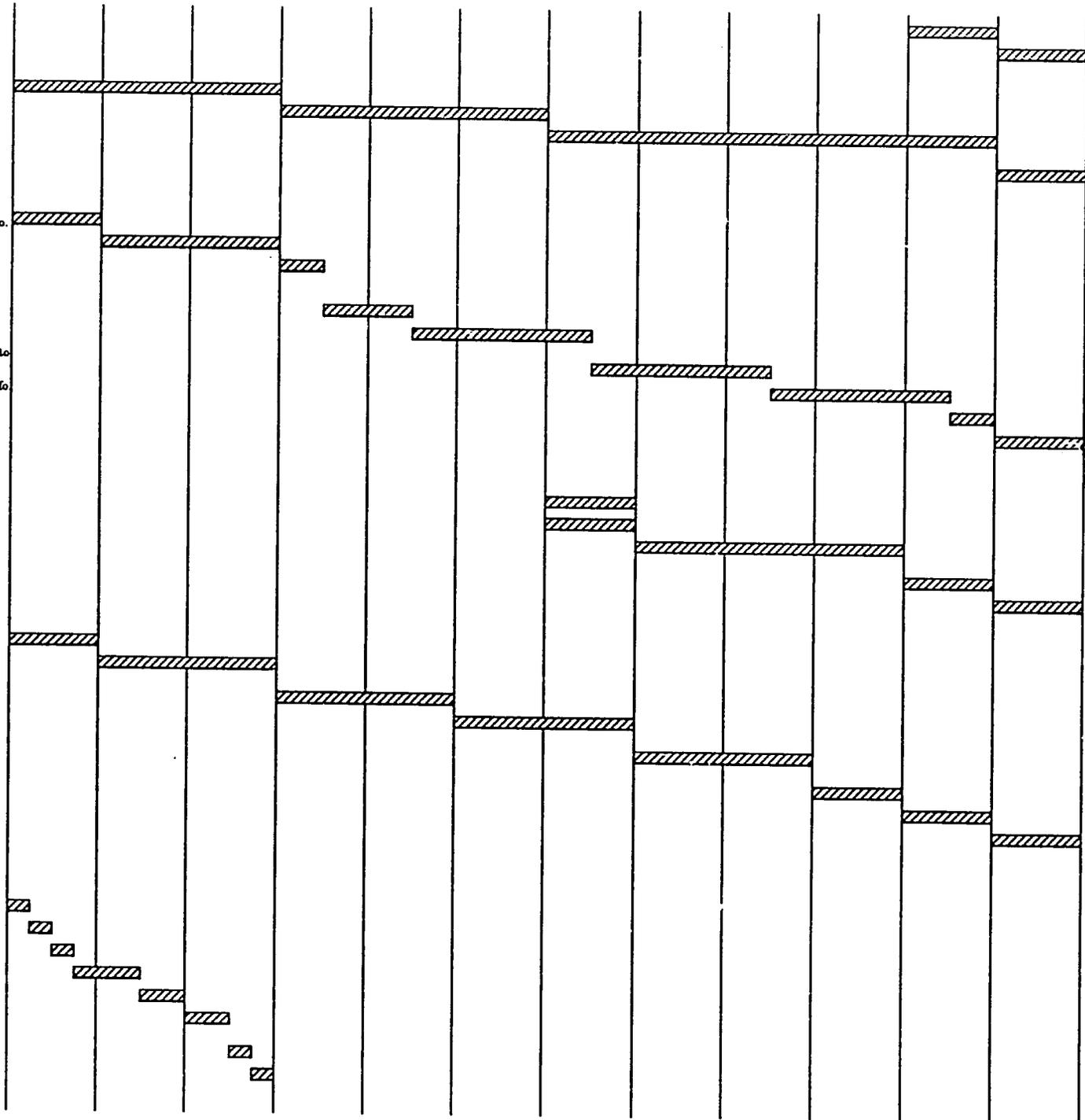


Exhibit III-4 (cont'd)

- B. Costs of Operating in Formal Markets
  1. Identify laws affecting operation of legally registered enterprise
  2. Find econ. cost of compliance
  3. Compare costs with econ. indicators
  4. Compare "excessive" costs with econ. indicators
  5. Report

- C. Costs of Exit
  1. Identify exit regulations
  2. Find econ. costs of compliance
  3. Compare costs with econ. indicators
  4. Compare "excessive" costs with econ. indicators
  5. Report

- D. Costs of Trade in Informal Markets
  1. Quantify econ. costs due to unofficial status
  2. Econ. costs due to lack of facilitative law
  3. Econ. impact of inability to access formal factor markets
  4. Report

- E. Indirect Costs
  1. Efficiency loss in resource allocation
  2. Distributional effects
  3. Social and political climate
  4. Report

F. Final Report

**CIRCLE 11: TRANSPORT SECTOR**

- A. Costs of Entry
  1. Select activities
  2. Identify entry regulations
  3. Describe specific steps to register enterprise
  4. Estimate time to meet regulations
  5. Quantify economic costs of complying
  6. Compare costs with economic indicators
  7. Estimate "excessive" costs vis-a-vis econ. indicators
  8. Report

- B. Costs of Operating in Formal Markets
  1. Identify laws affecting operation of legally registered enterprise
  2. Find econ. cost of compliance
  3. Compare costs with econ. indicators
  4. Compare "excessive" costs with econ. indicators
  5. Report

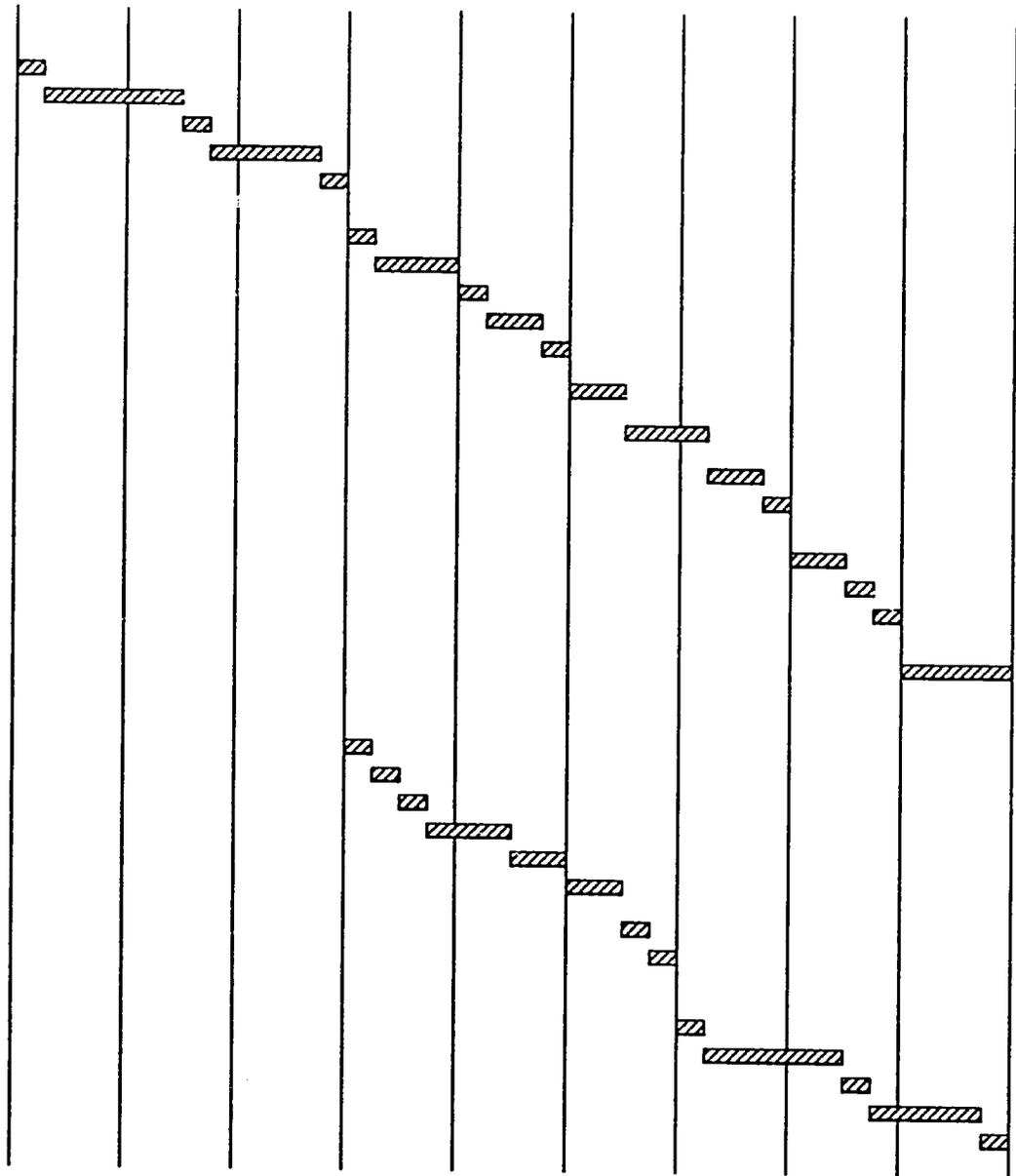


EXHIBIT III-5

MANPOWER DEPLOYMENT  
YEAR ONE

**MANAGEMENT AND COORDINATION** **% of time spent**

Hernando de Soto	90%
Luis Morales-Bayro	90%
Julio Velarde	15%
Alberto Bustamante	15%
<b>Total Person-Years</b>	<b>2.1</b>

**CIRCLE 1: CAPITAL MARKETS**

Circle Leader:	Julio Velarde, Economist	30%
Members:	Economist, Category A	100%
	Clara Ogata, Economist	100%
	Ana Lucia Camaiora, Lawyer	10%
	Percy Marquina, Economist	40%
	<b>Total Person-Years</b>	<b>2.8</b>

**CIRCLE 2: HOUSING SECTOR**

Circle Leader:	Jorge Fernandez-Baca, Economist	20%
Members:	Economist, Category A	100%
	Maria del Carmen Delgado, Lawyer	65%
	Mariano Cornejo, Architect	85%
	Percy Marquina	10%
	<b>Total Person-Years</b>	<b>2.8</b>

**CIRCLE 3: MANUFACTURING SECTOR**

Circle Leader:	Julio Velarde, Economist	30%
Members:	Economist, Category A	100%
	Hugo Eyzaguirre, Economist	40%
	Fernando Chavez, Economist	100%
	Pierina Pollarolo, Lawyer	10%
	<b>Total Person-Years</b>	<b>2.8</b>

**CIRCLE 4: QUANTIFYING THE INFORMAL ECONOMIC ACTIVITY**

Circle Leader:	Jorge Fernandez-Baca, Economist	30%
Members:	Hugo Santa-Maria, Economist	100%
	Economist, Category B	100%
	Percy Marquina, Economist	50%
<b>Total Person-Years</b>		<b>2.8</b>

**CIRCLE 5: DEMOCRATIC DECISION-MAKING**

Circle Leader:	Alberto Bustamante, Lawyer	70%
Members:	Pierina Pollarolo, Lawyer	75%
	Ana Rosa Martinelli, Lawyer	100%
	Julio Velarde, Economist	10%
	Jorge Fernandez-Baca, Economist	25%
	<b>Total Person-Years</b>	

**CIRCLE 6: INSTITUTIONAL EQUILIBRIUM THROUGH CHECKS AND BALANCES**

Circle Leader:	Ana Lucia Camaionæ, Lawyer	75%
Members:	Lawyer, Category A	100%
	Carlos Gandolfo, Lawyer	100%
	Jorge Fernandez-Baca, Economist	10%
	<b>Total Person-Years</b>	

**CIRCLE 7: ACCESS TO AND DIFFUSION OF INFORMATION**

Circle Leader:	Maria de los Angeles Murillo, Lawyer	85%
Members:	Lawyer, Category A	100%
	Hugo Eyzaguirre, Economist	45%
	Maria del Carmen Delgado	20%
	Maria Lourdes Sanmartin, Lawyer	20%
	<b>Total Person-Years</b>	

**IMPLEMENTATION AND PROMOTION**

Manuel Mayorga, Implementation and Promotion Manager	100%
Guido Lombardi, Director National Dissemination	100%
Humberto Ponce, Lawyer	100%
Daniel Herencia, Engineer	100%
Maria Lourdes Sanmartin, Lawyer	80%
Jackeline Silva, Lawyer	100%
Rosa Estrada, Lawyer	100%
Pedro Salinas	100%
<b>Total Person-Years</b>	<b>7.8</b>

**TRAINING**

Director of International Training	100%
Administrative Assistant, Training Program	100%
Hernando de Soto	10%
Luis Morales-Bayro	10%
Julio Velarde	15%
Alberto Bustamante	15%
Jorge Fernandez-Baca	15%
Hugo Eyzaguirre	15%
Mariano Cornejo	15%
Pierina Pollarolo	15%
Maria de los Angeles Murillo	15%
Maria del Carmen Delgado	15%
Ana Lucia Camaiora	15%
<b>Total Person-Years</b>	<b>3.55</b>

	<b>Person-Years</b>	<b>% of time spent</b>
Management and Coordination	2.10	6.5%
Research	19.55	59.2%
Implementation and Promotion	7.80	23.6%
Training	<u>3.55</u>	<u>10.7%</u>
<b>TOTAL</b>	<b>33.00</b>	<b>100.0%</b>

EXHIBIT III-6

MANPOWER DEPLOYMENT  
YEAR TWO

<b>MANAGEMENT AND COORDINATION</b>		<b>% of time spent</b>
	Hernando de Soto	90%
	Luis Morales-Bayro	90%
	Julio Velarde	15%
	Alberto Bustamante	15%
	<b>Total Person-Years</b>	<b>2.1</b>
 <b>CIRCLE 1: CAPITAL MARKETS</b>		
Circle Leader:	Julio Velarde, Economist	15%
Members:	Economist, Category A	90%
	Economist, Category B	50%
	Clara Ogata, Economist	50%
	Ana Lucia Camaiora, Lawyer	10%
	<b>Total Person-Years</b>	<b>2.15</b>
 <b>CIRCLE 2: LABOR MARKETS</b>		
Circle Leader:	Julio Velarde, Economist	15%
Members:	Economist, Category B	85%
	Clara Ogata, Economist	50%
	Ana Lucia Camaiora, Lawyer	10%
	Percy Marquina, Economist	60%
	<b>Total Person-Years</b>	<b>2.2</b>
 <b>CIRCLE 3: TRANSPORT SECTOR</b>		
Circle Leader:	Jorge Fernandez-Baca, Economist	20%
Members:	Economist, Category A	85%
	Economist, Category B	20%
	Mariano Cornejo, Architect	85%
	Maria de los Angeles Murillo, Lawyer	20%
	<b>Total Person-Years</b>	<b>2.3</b>

**CIRCLE 4: MANUFACTURING SECTOR**

Circle Leader:	Julio Velarde, Economist	15%
Members:	Economist, Category B	100%
	Hugo Eyzaguirre, Economist	30%
	Fernando Chavez, Economist	50%
	Pierina Pollarolo, Lawyer	10%
<b>Total Person-Years</b>		<b>2.05</b>

**CIRCLE 5: AGRICULTURE SECTOR**

Circle Leader:	Julio Velarde, Economist	15%
Members:	Economist, Category A	100%
	Hugo Eyzaguirre, Economist	30%
	Fernando Chavez, Economist	50%
	Pierina Pollarolo, Lawyer	15%
<b>Total Person-Years</b>		<b>2.1</b>

**CIRCLE 6: QUANTIFYING THE INFORMAL ECONOMIC ACTIVITY**

Circle Leader:	Jorge Fernandez-Baca, Economist	35%
Members:	Hugo Santa-Maria, Economist	100%
	Economist, Category E	45%
	Percy Marquina, Economist	40%
<b>Total Person-Years</b>		<b>2.2</b>

**CIRCLE 7: DEMOCRATIC DECISION-MAKING**

Circle Leader:	Alberto Bustamante, Lawyer	70%
Members:	Pierina Pollarolo, Lawyer	60%
	Ana Rosa Martinelli, Lawyer	100%
	Julio Velarde, Economist	10%
	Jorge Fernandez-Baca, Economist	10%
<b>Total Person-Years</b>		<b>2.5</b>

**CIRCLE 8: INSTITUTIONAL EQUILIBRIUM THROUGH CHECKS AND BALANCES**

Circle Leader:	Ana Lucia Camaiora, Lawyer	30%
Members:	Lawyer, Category A	100%
	Carlos Gandolfo, Lawyer	100%
	Jorge Fernandez-Baca, Economist	10%
	Hugo Eyzaguirre, Economist	10%
	<b>Total Person-Years</b>	<b>2.5</b>

**CIRCLE 9: JUDICIAL SYSTEMS**

Circle Leader:	Ana Lucia Camaiora, Lawyer	30%
Members:	Maria del Carmen Delgado	85%
	Lawyer, Category B	100%
	Jorge Fernandez-Baca, Economist	10%
	Hugo Eyzaguirre, Economist	10%
	<b>Total Person-Years</b>	<b>2.35</b>

**CIRCLE 10: ACCESS TO AND DIFFUSION OF INFORMATION**

Circle Leader:	Maria de los Angeles Murillo, Lawyer	65%
Members:	Lawyer, Category A	100%
	Economist, Category A	25%
	Maria Lourdes Sanmartin, Lawyer	20%
	Hugo Eyzaguirre, Economist	10%
	<b>Total Person-Years</b>	<b>2.2</b>

**IMPLEMENTATION AND PROMOTION**

Manuel Mayorga, Implementation and Promotion Manager	100%
Guido Lombardi, Director National Dissemination	100%
Humberto Ponce, Lawyer	100%
Daniel Herencia, Engineer	100%
Maria Lourdes Sanmartin, Lawyer	80%
Jackeline Silva, Lawyer	100%
Rosa Estrada, Lawyer	100%
Pedro Salinas	100%
<b>Total Person-Years</b>	<b>7.8</b>



#### IV. BUDGET

This chapter presents our budget for the next five years. This budget incorporates annual increases of about 5 percent in expenses.

Exhibit IV-1 reflects additional staff, equipment, and space costs. It also includes the new proposed activities of the international training and dissemination program and ILD-USA.

It should be noted that the line item for international training and dissemination does not include all costs proposed for that activity. The salaries and fringe benefits of the director of international training and dissemination and his/her administrative assistant are included under ILD-Lima direct labor and fringe benefits. Also, 15 percent of the direct labor and fringes of ILD management and staff will be applied to international training. In addition, 10 percent of the total direct costs have been attributed to international training. The international training activity in the first year will amount to approximately \$470,000, in direct costs.

Exhibit IV-2 lists all current employees, their salaries and fringe benefits, and the employees that we propose to hire if this grant is approved.

**EXHIBIT IV-1**  
**ILD PROJECTED BUDGET**  
**FIVE YEAR BUDGET**  
**TOTAL PROJECTED EXPENSES AND INCOME**

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
<b>PROJECTED EXPENSES:</b>					
1. DIRECT LABOR					
A. ILD-Lima	\$978,000	\$1,026,900	\$1,078,245	\$1,132,157	\$1,188,765
B. ILD-USA	\$75,000	\$78,750	\$82,688	\$86,822	\$91,163
C. Consultants					
1. International	\$126,000	\$132,300	\$138,915	\$145,861	\$153,154
2. National	\$66,000	\$69,300	\$72,765	\$76,403	\$80,223
Total Direct Labor	\$1,245,000	\$1,307,250	\$1,372,613	\$1,441,243	\$1,513,305
2. FRINGE BENEFITS					
A. ILD-Lima	\$104,400	\$109,620	\$115,101	\$120,856	\$126,899
B. ILD-USA	\$15,000	\$15,750	\$16,538	\$17,364	\$18,233
Total Fringe Benefits	\$119,400	\$125,370	\$131,639	\$138,220	\$145,131
3. TRAVEL AND TRANSPORTATION	\$120,000	\$126,000	\$132,300	\$138,915	\$145,861
4. NATL ADVOCACY & DISSEMINATION	\$116,400	\$122,220	\$128,331	\$134,748	\$141,485
5. INTL TRAINING & DISSEMINATION	\$165,600	\$173,880	\$182,574	\$191,703	\$201,288
6. OTHER DIRECT COSTS					
A. Telephone/Telex/Telefax	\$30,000	\$31,500	\$33,075	\$34,729	\$36,465
B. Mail and Courier Services	\$30,000	\$31,500	\$33,075	\$34,729	\$36,465
C. Computers and Equipment	\$78,000	\$20,000	\$0	\$0	\$30,000
D. Rent	\$48,000	\$50,400	\$52,920	\$55,566	\$58,344
E. Security	\$30,000	\$31,500	\$33,075	\$34,729	\$36,465
F. Custodial Costs	\$12,000	\$12,600	\$13,230	\$13,892	\$14,586
G. Insurance	\$5,000	\$5,250	\$5,513	\$5,788	\$6,078
H. Evaluation and reprogramming	\$20,000	\$21,000	\$22,050	\$23,153	\$24,310
I. Financial review	\$10,000	\$10,500	\$11,025	\$11,576	\$12,155
J. ILD-USA	\$60,000	\$63,000	\$66,150	\$69,458	\$72,930
K. Other	\$36,000	\$37,800	\$39,690	\$41,675	\$43,758
Total Other Direct Costs	\$359,000	\$315,050	\$309,803	\$325,293	\$371,557
<b>TOTAL PROJECTED EXPENSES</b>	<b>\$2,125,400</b>	<b>\$2,169,770</b>	<b>\$2,257,259</b>	<b>\$2,370,121</b>	<b>\$2,518,627</b>
<b>PROJECTED INCOME:</b>					
7. OTHER DONORS INCOME					
A. CIPE	\$210,000 *	\$210,000 **	\$210,000 **	\$210,000 **	\$210,000 **
B. Others	\$115,400 **	\$114,770 **	\$117,259 **	\$60,121 **	\$98,627 **
Total Projected Income	\$325,400	\$324,770	\$327,259	\$270,121	\$308,627
3. AID REQUIREMENT	\$1,800,000	\$1,845,000	\$1,930,000	\$2,100,000	\$2,210,000
<b>TOTAL PROJECTED INCOME</b>	<b>\$2,125,400</b>	<b>\$2,169,770</b>	<b>\$2,257,259</b>	<b>\$2,370,121</b>	<b>\$2,518,627</b>

\* Not committed, but anticipated

\*\* Not committed

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EXHIBIT IV-2  
SUPPORTING INFORMATION

DIRECT LABOR- YEAR ONE  
ILD Lima

<u>Name</u>	<u>Salary</u>	<u>Fringe Benefits *</u>
Hernando De Soto	\$72,000	\$7,200
Luis Morales-Bayro	\$60,000	\$6,000
Julio Velarde	\$54,000	\$5,400
Alberto Bustamante	\$36,000	\$3,600
Manuel Mayorga	\$36,000	\$3,600
Daniel Saba	\$36,000	\$3,600
Jorge Fernandez-Baca	\$30,000	\$3,000
Hugo Eyzaguirre	\$24,000	\$2,400
Guido Lombardi	\$24,000	\$2,400
Mariano Cornejo	\$24,000	\$2,400
Daniel Herencia	\$19,200	\$1,920
Pierina Pollarolo	\$18,000	\$1,800
Maria de los Angeles Murillo	\$18,000	\$1,800
Maria del Carmen Delgado	\$15,600	\$1,560
Fernando Chavez	\$15,600	\$1,560
Clara Ogata	\$15,600	\$1,560
Ana Lucia Camalora	\$15,600	\$1,560
Humberto Ponce	\$15,600	\$1,560
Hugo Santamaria	\$12,000	\$1,200
Maria Lourdes Sanmartin	\$9,600	\$960
Ana Rosa Martinelli	\$9,600	\$960
Jackeline Silva	\$9,600	\$960
Elsa Jo	\$9,600	\$960
Percy Marquina	\$8,400	\$840
Carlos Gandolfo	\$7,200	\$720
Rosa Estrada	\$7,200	\$720
Elvira Barua	\$7,200	\$720
M. Alejandra Lada	\$6,600	\$660
Ricardo Espinoza	\$6,000	\$600
Mario Mendieta	\$4,800	\$480
Pedro Salinas	\$4,800	\$480
Roger Espejo	\$4,800	\$480
Cesar Ocharan	\$3,600	\$360
Roger Espinoza	\$3,600	\$360
Patricia Jimenez	\$3,000	\$300
A. Cecilia Gorrio	\$3,000	\$300
Cecilia Goñaz	\$3,000	\$300
Silvia Ortigas	\$3,000	\$300
<b>SUBTOTAL</b>	<b>\$655,800</b>	<b>\$65,580</b>
<i>To Be Hired:</i>		
Director of Intl. Training & Dissemination	\$66,000	\$13,200 **
Economist, Category A	\$42,000	\$4,200
Economist, Category A	\$42,000	\$4,200
Economist, Category A	\$42,000	\$4,200
Lawyer, Category A	\$36,000	\$3,600
Lawyer, Category A	\$36,000	\$3,600
Economist, Category B	\$30,000	\$3,000
Administrative Assistant, Training Program	\$3,600	\$360
Secretary, Finance Manager	\$3,000	\$300
Translator	\$18,000	\$1,800
Librarian	\$3,600	\$360
<b>SUBTOTAL</b>	<b>\$322,200</b>	<b>\$38,820</b>
<b>TOTAL</b>	<b>\$978,000</b>	<b>\$104,400</b>

\* 10% of salary

\*\* 20% of salary



## APPENDIX A

# FINDINGS AND IMPLICATIONS OF ILD'S PREVIOUS RESEARCH



## THE FINDINGS OF THE INSTITUTE FOR LIBERTY AND DEMOCRACY 17

### A. First Findings: The existence of an Entrepreneurial Energy of Popular Origin

The ILD's work has revealed the existence of great entrepreneurial energy in the popular classes of Peru. After several years of research it discovered that, in aggregate terms, 39% of the 1984 Gross Domestic Product was produced informally and that 61% of total man-hours worked were in informal economic activity. This activity is composed of those people who, although pursuing legal ends, such as building a house or operating a small business, have not met all of the legal requirements to do so.

In addition, it was learned that official statistics underestimated the amount of informality existing in many economic sectors. Housing provides a good example. When the ILD began its research, official statistics indicated that only 14% of the housing in Lima was informal; nevertheless, ILD's studies demonstrated over 42% of all housing in the capital is informal and shelters 47% of the population. Through a house by house measurement, informal housing construction over the last 20 years was valued at US\$ 9.3 billion, all generated by popular classes. In this same time period the government built popular housing worth US\$ 174 million.

In commerce, through field work and two censuses conducted in 1985 and 1986, it was established that there are 91,485 street vendors in the capital city of Lima, representing 42.2% of labor involved in commerce, distributing approximately 60% of the food in the city and earning an income almost 40% greater than the minimum wage prescribed by labor laws. A second stage of the research found that entrepreneurial energy in this sector is not limited to street vending but that street vendors themselves have begun an enormous effort to leave the streets for markets and commercial centers specially constructed for this purpose. In all, former street vendors have put up 274 markets and commercial centers, worth US\$40.9 million and employing 40,000 individuals. This compares very favorably with the state effort over the last 20 years. For each market put up by the state, informals put up 12, including the largest lot and most conveniences found in modern day installations.

17 An important part of the ILD's findings described in this chapter are contained in the book "El Otro Vendedor" and its technical appendixes.

In the case of transport, findings of equal importance were made. It was discovered that the informals provide 93% of the mass transportation fleet and 80% of seating capacity. This fleet has a replacement value of US\$ 620 million to which must be added US\$ 400 million invested in repair and service stations, spare parts, and other infrastructure. If taxi service is added, the informal presence in public transportation rises to 95%. The average fare on a Peruvian informal bus is 10 cents while in many western cities it approaches US\$ 1.50.

Finally, in spite of the fact that informal manufacturing is the most difficult sector to quantify because it operates strictly "underground", the methodology used by the ILD has provided meaningful information. Informality covers areas as broad as mining equipment, bicycles, preserved meat and fruits and that it accounts for at least 60% of the garments and furniture production and some 35% of textile production. The ILD's estimates indicate that informal industries comprise 52% of industrial production establishments, employ 34% of industrial workers and generate 18% of the value added in the sector.

## **II. Second Findings: The Existence of Institutional and Legal Obstacles**

As a result of its findings, the ILD decided to investigate why all of this entrepreneurial energy was channeled informally. Through simulations and the study of real cases, it discovered that numerous obstacles of legal origin constrain the development of these activities. In effect, it was determined that the lack of legality has very costly consequences for the informals because it deprives them of the facilitative aspects of the law -property rights, contracts and torts- which are indispensable for growth. Finally, it became apparent that the principal cause of these problems was the way in which the rules and regulations were made.

### **1. The obstacles to formal economic activity**

Obstacles occur at two levels: in access to formal economic activities and in remaining in them. The ILD found that in order to operate legally people have to meet a series of costs imposed by the state under different regulations. For example, in the case of housing, a large portion of the population does not have the resources to buy a piece of developed land in a residential zone. Thus, their only legal alternative is to request government adjudication of an undeveloped plot of desert land, the most abundant resource in the country.

However, by following the trail of actual documents, the ILD found that the procedures for adjudicating undeveloped state land actually take a minimum of 56 months and the completion of 207 administrative steps, involving 48 public offices. The average cost per family, not including the purchase price of the land, is US\$ 2,150, the equivalent of 4 years and 8 months of income for a person who earns the minimum wage. To this it must be added 27 months of red tape to obtain the license to develop the land and build on it. All this means, on average, 7 years.

As a result of such obstacles, the invasion of state land has become the only recourse of the poor for gaining access to housing. In 1985 in Lima, according to police statistics, there were 282 invasions of public and private land. In this same year, there were only 3 legal adjudications of land.

Most invaders of public land will eventually be recognized by the state, but in order to get legal title to their plots the settlers will have to comply with red tape that takes an average of 20 years. Until they obtain title, their status is informal.

With regard to commerce, the ILD has calculated that street vendors, due to the fact that they do not have access to adequate legal forms of business organization, have to wait an average of 12 years from the moment they decide to construct a market or commercial center until they can begin to do so. Of this, 9 years and 8 months are required for complying with bureaucratic steps and the rest of the time is taken in organizing themselves informally as entrepreneurs.

The case of transport is even more dramatic. The state simply does not permit legal access. It only sporadically allows those who have already invaded transport routes to receive formal recognition. If legal access were permitted, ILD's best estimate is that compliance with red tape would take 3 years.

Finally, in manufacturing, the ILD conducted a complete simulation of the process that must be followed to legally register an activity and start production. This was done by installing a small garment factory, with two sewing machines, in an industrial site on the outskirts of Lima. Four university students and one administrative lawyer completed all of the legal requirements, going from office to office soliciting the different, required permits and licenses. They kept careful records of the time spent and, afterwards, diagrammed the results on a chart. Working 6 hours a day, it took 289 days to complete the red tape requirements. Ten times they were asked for bribes and were forced to pay them on two occasions in order to proceed. In terms of foregone income and expenses incurred, the 289 days

are equivalent to a cost of US\$ 1,231: 32 times the minimum monthly wage established by the government.

Legal obstacles not only limit access to sectoral activities, but also to factor markets. One dramatic example is access to capital. Even before the law nationalizing the banks, 85% of all credit in the financial system was provided by institutions partially or totally controlled by the state. Yet the informal sector receives only 0.2% of credit in the official system and must resort to costly and complex informal sources. Meanwhile, some units in the formal sector receive subsidized credit which, of course, comes at the expense of savings since the inflation rate is four times the nominal interest rate. Thus, no real credit market exists but rather a politically controlled allocation of available credit based to a great extent on influence. As a result, the possibilities for economic expansion and social progress by the most needy classes are stunted.

A similar situation exists with regard to the external debt. The oppressive weight of the debt is the direct result of an inadequate institutional structure that permitted government and state-owned companies to contract large loans without an effective cost-benefit analysis and procedures to ensure oversight by or accountability to the electorate. Now that the debt has become too heavy to be supported by these entities, the rest of Peru has to pay the price.

The ILD's empirical research has proved that legal obstacles also increase the operating costs of formal units. The ILD evaluated the costs of remaining legal by interviewing fifty small, formal firms with 1-4 employees each. These formal entrepreneurs keep only 23.3% of their gross profits; the rest (76.7%) goes to the government, but only 22.9% is the result of tax laws; the majority is spent on bureaucratic red tape or in meeting government mandated social benefits.

It is clear that many costs are borne by formal business which contribute greatly to increasing costs of production and/or reducing output, such as price controls, compulsory purchase of inputs from and sale of output to state-owned companies, etc. While the ILD has not researched these to date, it would do so under this proposal. The full cost to the society of legal and institutional constraints is not complete without it.

## 2. The lack of facilitative law

The excessive cost of entering the formal sector and remaining there means that informals cannot take advantage of the facilitative aspects of the law, principally property rights, security of contracts, and torts. As the ILD has discovered, this has enormous implications for development.

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Indeed, how much investment would have taken place in the western world without well defined and secure property rights and court systems to protect them? How many inventions would there have been without patents or royalties? How many long term investments would have been made without secure contracts? How many risks would have been taken if there were no limited liability or insurance policies? Or how much capital could have been pooled without limited liability companies and shareholder systems? How many times could one have failed and then started again if debts could not be converted into shares? And how many companies could have prospered and grown over time if there were no perpetual succession? Could industrialization have taken place without the ability to exploit economies of scale? Given the importance of these facilitative aspects of the law, it is worthwhile considering them separately.

**Property Rights** serve a fundamental economic function: the assignment of resources. Without well defined property rights, all activity and exchange is difficult. When neither exclusivity nor the right to transfer resources exists, the means for determining relative values and for maximizing economic benefits are lacking. On the other hand, the more secure property rights are, the less costly transactions will be and the greater will be the interest in discovering and taking advantage of existing economic opportunities.

Thus, the function of property rights is to encourage those who hold them to add value to them by innovating, investing, or combining them productively. All of the ILD's empirical research regarding property demonstrates incontrovertibly that the lack of secure property rights enormously reduces the productivity of the majority of Peruvians.

Not having legal recognition of their possessions causes people in informal settlements to limit their investment in them. Through a sample of 38 settlements, it was determined that, on average, investment increased 9 times over 10 years once people had title to their land.

**Contracts** to exchange goods freely are also crucial to development. To do so, the law must provide for security of contracts. In this regard, courts and judges to ensure enforcement are critical.

Nevertheless, informals, precisely because of their informality, do not have such security. As a result, they cannot make long term contracts or finance themselves with contracts containing enforceable guarantees. They have no protection in the face of broken promises. They cannot obtain insurance to reduce their risks.

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Contracts also allow resources from different sources to be combined productively to create a business through limited liability corporations. Under the law, a corporation is an autonomous entity with rights and obligations enabling it to act as a business, but, since informals do not have access to formal law, they cannot benefit from such organizations.

Among other things, they cannot limit their liability to the amount of their capital contribution, they cannot combine inputs efficiently, they cannot share risks with other investors, and they lack the means for receiving intangible contributions. As a result, they lose the stimulus to invest over the long term. As a result, informals have little choice but to associate themselves with close family members and to limit themselves to artisan production and small firms.

Torts, a final facilitative function of the law, prevent or repair the effects of a person's actions on others, activities not foreseen in specific contracts. A formal society establishes a system of torts, which requires compensation for those injured by negative externalities.

In Peru, while informals may have established extralegal norms, they lack enforcement power. Thus, informality brings a series of uncompensated negative externalities. For example, in Lima there are 14 times more deaths in transport than in western European countries. A similar thing occurs with the street vendors; who, in some cases, sell food products without sanitary control.

The lack of a tort system to deal with negative externalities reduces the real contribution of the informal sector, turns people against popular enterprise, and induces its substitution instead of its optimization.

Other advantages of the Law are lost without adequate institutions. Lacking formal status, informals do not have access to credit nor can they advertise effectively. For fear of detection, it is virtually impossible to achieve economies of scale. For lack of coercive power, they cannot develop the public goods they need nor stand up to the power of monopolies. And the lack of efficient courts and tribunals means that more conflicts end up being resolved violently.

As a result, it is obvious that informality impedes society from obtaining full advantage from its human and physical resources. The value of production is not maximized and transactions costs are clearly greater than they would be under an efficient juridical system.

### C. Third Finding: Inadequate Decision-making

Once the importance of legal institutions in development was established, the IID set about answering questions such as: How were these obstacles that cause informality and damage the formals generated? Why has the law in Peru not adapted itself to the needs of a diffuse, popular entrepreneurial class?

On inquiring into how laws, specifically rules, are created in the country, it was discovered that, to a great degree, they were dictated without any procedures to ensure oversight by or accountability to the electorate. There is no "rule making", no "comment and notice" periods, no public consultations through hearings, no cost-benefit studies of the foreseeable consequences of the approved norm, and there is no way to make the state or the authorities accountable for the norms once they have been enacted.

From 1947 to 1985 the Executive Branch enacted yearly 99% of the Peruvian rules and regulations while Congress approved only 1%. Thus, on average, 99% of the 27,400 rules and regulations issued annually have been approved without the most minimum "rule making" procedures to ensure oversight and accountability by either the elected officials or the citizenry. As a result, rules are made without any consideration for the costs imposed on the rest of society, responding to narrow political interests rather than broader social and economic concerns. This, the IID believes, is directly linked to the obstacles both formals and informals face, and to the lack of facilitative law.

There is a close relationship between the lack of an institutional structure that allows a market economy to operate and lack of one that allows a democratic decision-making to function in the country.

This centralization of power in a group of authorities also relates to the geographic concentration of investment in that all investors need to be close to the power. One proof of this is that the greater part of provincial companies maintain their general managers in the capital city, far away from their factories, because they can get better output from negotiations with the authorities for favorable rules and regulations than from directly supervising production in their plants.

To place this type of regime in context, the IID has compared it with mercantilism with predominated in Europe between the XI and XIX centuries. It was a type of capitalism without free markets and competition. With the pretext of redistributing wealth, production was hindered and those with privileged access to political decisions were favored. In both cases, the past and the present, the

mercantilist state is characterized by its bureaucracy, excessive regulation and politicization. And the law, instead of being nourished by reality, responds to the vision and interests of the few with access to it.

Both Karl Marx and Adam Smith were critics of the internal contradictions engendered by this system. As it decayed in Europe, it was replaced in the west by participatory democracies with openly accessible markets. In the east it was replaced by communism. The ILD argues that the rapid growth of informality suggest that mercantilism is now decaying in Latin America as well. (See Appendix II. The Implications of the ILD's Findings, for a more detailed discussion.)

The crucial issue, then, is how to help the system evolve into one that provides economic and political liberty for all. While the mechanisms of transition to communism are well known, those of evolution to a modern democracy are not. It is to this critical question that the ILD addresses itself in this proposal.

#### **D. The Road to Reform: Reducing the Obstacles to Growth by Creating Broad Support**

Determining empirically the magnitude and nature of informal economic activity has pointed to institutional faults in the system. From these the ILD has derived the costs of not having an efficient and open, formal system of decision-making. To date, the evidence suggests that much progress can be made by bringing the legal system closer to reality. The present system of decision-making has not kept pace with events. This has led to growing discrimination against those who lack access to rulemakers and it has caused the law itself to fall into disrepute.

In considering how to reduce the obstacles it has identified, the ILD has used two basic inputs. The first is the extralegal norms the informals themselves have developed. These indicate what types of norms are necessary and acceptable. The second source is comparative law - the experience of other countries which have faced similar problems and devised solutions to them.

From these two sources of information, the ILD has developed two types of proposals for reform: those specific to problems in the sectors it has researched and those dealing with the institutional system for rule-making.

More importantly, it has demonstrated that the informals are not only a symptom of the problem facing Peru, which is its mercantilist structure of governance, but also a potential route to reform. Representing some 60% of the population,

they are a potent source of support for reforms that would give them a stake in the society. Two examples should suffice. The ILD's proposal on informal housing was supported by more than 300,000 complaints against the existing system. The President of the Republic immediately launched his own titling law which was passed by Parliament, with a few modifications suggested by the ILD.

And, following publication of *El Otro Sendero*, 300,000 transport drivers of Peru, through their federation, asked the ILD's support in developing the legal structures needed for a private, market-based transport system in Peru in a signed newspaper ad.

#### E. The Relevance of ILD Research to the Theory of Economic Development

The ILD's approach stresses the role of rules and institutions in determining costs in a developing country. Its focus is on the bulk of the population which encounters severe difficulties in functioning within the formal sector and thus resorts to costly, informal alternatives. It broadens the scope of standard economics by concentrating not just on individual behavior in response to differing market constraints, but also in response to the institutional environment in which the product or service is produced and the exchange is conducted.

Traditional economic models have assumed that the costs of exchange are zero and function in a world of non-existent information costs. While modern work has extended the standard paradigm through the explicit modelling of different economic constraints, particularly informational costs, their empirical relevance is still unclear. Moreover explicit attention to the costs of transactions is rare, and detailed empirical studies focussing on particular, industry- or group-specific transactions costs are rarer still.

Although many economists acknowledge that there exist links between specialization, the costs of trade, and growth, their models are limited by the categories of costs generally permitted within the discussion. Within strict neoclassical models, the only relevant trade barriers are those which visibly affect transportation costs and international exchange, such as tariffs, quotas and freight. They underestimate the extent to which non-tariff barriers may dominate in the determination of the final pattern of trade. However empirical work by the ILD reveals that transactions costs, legal constraints, and multi-layered entry barriers often predominate, rendering many standard studies incomplete. Additional work in this area may confirm that these obstacles are the principal or a very important

reason why developing countries have not succeeded in growing.

Much work in economic development is criticized on the grounds that the models it employs contain assumptions too rigidly tied to the experience of developed market economies. Consequently, there is a tendency to dismiss the entirety of economic theory as simply being inapplicable to the developing economies. However, the ILD suspects that further research along the lines it proposes may lead some substance to growing awareness that economic laws are more universal, only the circumstances differ.

Most people respond to changes in relative prices, new profit opportunities and market incentives. Only their different positions with respect to income, mobility, access to capital, ability to work within the existing legal system, change the observed behavior, but not the basis for that behavior. In other words, it may well be that different societal structures do not invalidate the universal nature of economic laws. Although historical circumstance or government policy or the limitations of existing technologies may distort the market outcomes by unduly constraining individual action, they do not change the economics.

Evidence obtained suggests that legal structures that distort the workings of the market or that seek to restrict trade only serve to provide incentives for people to work around them. The classic metaphor of economic behavior holds: the economy is like a balloon; squeeze it in one place and it only bulges out someplace else.

Moreover, it seems obvious that there are costs to adapting to different institutional restrictions. Barriers to entry and favoritism invite rent-seeking behavior and wasteful competition for artificial monopoly rents. The often high costs of circumventing costly strictures reduce the willingness to provide desired goods and services. High legal and institutional costs reduce the overall level of trade and restrict people's ability to exchange property rights in order that they end up being held by their most productive users.

Where property rights are insecure, the incentives to invest are reduced and the costs of exchange are increased. Insecurity regarding the rules of ownership and exchange lead to attempts by individuals to invest in ways that are less productive but which leave them less vulnerable to changing circumstance. Where these factors are present, individuals are reluctant to invest and trade, thus retarding growth.

Much research by economists in the West suggests that the behavior of economic agents is dependent on the structure of incentives facing the economic actors. Most of this literature, however, is purely theoretical. And, even when empirical issues are raised, the evidence is taken from developed nations such as the United States. The many scholars who are convinced that transactions costs play an important, in fact, fundamental, role in economic growth have little evidence concerning actual transactions costs to back up this conviction, particularly evidence derived from growing, developing nations. There is no work on the quantitative importance of these costs for developing nations, nor information on the evolution of these costs as the countries develop, nor studies of the impact of various institutional arrangements on these costs.

In this regard, the work of the ILD on the informal economy in Peru is unique and thus important as ground-breaking work. The ILD's studies indicate that where institutions fail in facilitating exchange, individuals may function outside of the law. This is particularly true of developing nations where the institutional structures make the costs of legal participation in the economy high and the benefits do not outweigh the costs. That is, when the economic decision-making system has a built-in bias toward setting barriers to exchange instead of providing the necessary means to reduce transactions costs, few people will find it profitable to engage in legal economic activity. Further, incentives are set up for widespread illegal and quasi-legal economic activity. Agents and firms in this informal sector confront a range of costs that would not be present in the legal, formal sector. The tolerance for such costs created by the high barriers to entry makes for much of the economic waste that impedes economic progress.

The work of the ILD goes beyond most of the current literature in seeking to understand how the failure of legal institutions to play a positive role in safeguarding property rights and ensuring the functioning of well-developed markets may lead just as surely to economic backwardness as inefficient intervention. Which institutions and which rules are most conducive to growth and development are issues at the heart of the ILD's work.

In terms of the research carried out by the ILD in Peru it is obvious that the country is operating well below its economic potential. It is also clear that tremendous entrepreneurial energy exists but is not being effectively channeled to produce growth. The work of the ILD indicates that legal and institutional obstacles impede people, particularly the poor, from utilizing their resources in the most efficient manner, and from effective democratic participation. In its initial work, the ILD has documented these obstacles in several sectors (housing, commerce,

transport) and begun to look at them in industry. And it has identified the rulemaking system as the major cause of these obstacles. However, much remains to be done in documenting the obstacles to growth in key sectors and factor markets, in developing and refining procedures for removing them, and in responding to international interest in the approach.

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**APPENDIX II**  
**IMPLICATIONS OF THE ILD'S FINDINGS**

## IMPLICATIONS OF THE ILD'S FINDINGS

Although much more research and analysis is necessary, what the ILD has done to date has begun to undermine the major anti-democratic and anti-entrepreneurial theories current in Latin America today. It has done so by demonstrating conclusively that some of their fundamental assumptions about the nature of the social and economic order are simply incorrect. This is certain to have practical consequences since the policies current in Latin America today are backed by one or more of these development theories.

It is important to realize that Latin American political culture is characteristically more theoretical and somewhat less pragmatic than that of the United States. The ideologies that give form to the political culture lead not only to policy; they condition the way in which people think. Thus, to effect change, it is crucial to deal not only in terms of policies but in terms of the ideas that motivate people and guide their action.

In the following subsections we indicate, first, what the core concepts of each ideology are and how they translate into policies, and, second, how the ILD's findings and future research are and can continue to undercut one or more of these ideologies.

### A. The Cultural Hypothesis

**The Theory:** many theories, ranging from the anthropological, based on ancient Indian forms of organization, to the political, rooted in Marxism-Leninism, take off from the premise that Latin American culture, particularly that of the Indian and mestizo, is basically anti-entrepreneurial in the western sense of the word. The result is a widespread belief that a western style democracy and a market economy are not natural components of Latin American culture.

Therefore, any attempt to foster a society based on entrepreneurship and democratic participation is immediately labeled as cultural imperialism.

**The ILD Position:** our research into the informal sector undermines this argument. An important part of the findings describe the incipient market economy and democratic systems spontaneously generated by the informals. We believe that one of our major contributions is the description of the extralegal norms, or common law, created by the informals once they arrive in the cities. We have found no dictatorships or mafia type organizations, no kolkhoz or

ayllus but, rather, individual or family ownership, and rules that attempt to create fair competition through extralegal norms for property, contract rights and loans.

When large segments of the population, and primarily indigenous ones at that, have set up participatory democratic structures and a market economy, then in no way can such structures be considered alien to Latin America.

Secondly, it is clear that part of the problem is definitional. It must be realized that what is broadly termed a market economy, that existent in the formal sectors of Latin America today, is not that at all, but a mercantilist economy. Thus, those who would discard a market economy on the basis of the results of Latin America's present day economic structures would, in reality, discard not a market economy but a mercantilist one.

This is not to deny the importance of culture. But rather to indicate that there is no basis in Latin American culture to declare a participatory democracy and market economy incongruous with national inclinations. It is obvious that the manner in which we Latins conduct our activities and manifest our preferences reflects both culture and ideology.

But, if we are to overcome barriers and open the road to reform, then we must be willing to carefully examine preconceived ideas in the light of what people are actually doing.

## **B. Marxism-Leninism**

**The Theory:** all variants of Marxism teach that capitalist society is a system of domination and subordination with economic roots deriving from control over the means of production. Market relationships, particularly those between "free" wage laborers and the capitalists who contract for their services, are never relationships among equals but conceal domination and exploitation. Politics, as such, including the legal prescriptions and institutions, are merely a reflection of the economy and the structures of domination that it establishes.

Essential to Marxist orthodoxy is the notion that domination is embodied in a dichotomous social structure composed of two fundamental classes. In the Marxist view, classes are composed of all those who share a similar position or orientation with respect to control over the means of material production. In capitalist society these are the bourgeoisie (capitalists) and proletariat (wage-workers).

They are related dialectically in that the on-going development of capitalism necessarily causes the proletariat to increase in size, class consciousness, and antagonism

toward the capitalist order. Therefore, the proletariat is the "universal class". Its condition of exploitation and subordination represents the condition of all but a tiny handful of oppressors; and its conditions of liberation represent the liberation of all. This dialectical process, i.e., the unavoidable development within the bowels of the capitalist system of a new, implacably hostile, and eventually majoritarian oppositional force- forms the basis of all Marxist politics.

**The ILD Position:** our findings undercut local Marxism-Leninism in two ways. First, they make clear that the economic system operative in Peru today is not modern, market capitalism as it is known in the developed countries, but mercantilism. Thus it positions itself against the "same control by special interests" as do the Marxists. Second, our research revealing the size of the informal sector negates the orthodox understanding of domination by demonstrating that a large part of the society in Peru is not proletarian in any sense. Instead, this group is basically entrepreneurial in its interests and world view.

As documented in *El Otro Sendero*, its primary objective is secure rights of property, a bourgeois rather than proletarian objective in Marxist terminology. That the informals happen to be poor and culturally different from the more traditional middle classes in no way affects their objective class situation or interests. What is more, the ILD's research, particularly when considered in the light of comparable trends away from traditional factory employment in the developed countries, suggests that, far from becoming the "universal" or even a majoritarian class, the pure proletarian is a minority. Of the economically active population in Peru, formal workers represent 20% and organized labor, 4.8%.

Thus, any communist revolution in Peru that would claim to be "proletarian" would represent a dictatorship or a minority of the society over the majority.

Latin American Marxist parties have tried to get around this inconvenient fact by subtly redefining "proletarian" so as to embrace all who are left out of, exploited or oppressed by capitalism, whether or not it occurs by way of the wage system. To do otherwise, to admit that the proletarian condition is nowhere near universal, would undermine the fundamental base of their ideology.

To the degree that the informals do feel excluded and blocked from socioeconomic advancement, they can be expected to support any political movement that allies itself with their interests. Pressed hard enough, they will become revolutionary. In other countries -Italy in the 1920s, Argentina in the 1940s- the poor have supported fascism. In

Peru, for specific historical reasons, they now support varieties of political Marxism. In fact, Marxist ways of thinking command considerably more support among the mass of Peru's population than does any other single ideology, as the outcomes of the last two elections indicate, especially when it is recalled that Aprismo is rooted in Marxism.

Unlike the proposals of the Marxists, those of the ILD are based on the empirically identified class interests of the people who are to be aided and offer practical remedies that depend largely on their mobilization on their own behalf.

Even if Marxism has had some success in coopting urban informals by fighting for their rights, studies have shown repeatedly that these people support it for purely tactical reasons and rarely, if ever, share its larger vision. A recent political incident in the Lima barrio of San Martin de Porres confirms that this approach exists even among fairly high-ranking Marxist party cadres. The district Mayor, an official of the most "hard-line" component of the United Left coalition, was attracted by the value of the ILD's proposals for the needs of his constituency. He asked us to design the program specifically for his district and publicized the ensuing joint venture. His daring initiative subjected him to intense political pressures from the party leadership and he was ultimately forced to undergo a humiliating public "self-criticism". However, following this incident, three of the council members came to work with us, attracted by the practical solutions proposed.

There are numerous other examples of support for our positions by those of supposedly Marxist inclinations. For example, the Parliamentarians of United Left Party have been among the main supporters of various ILD legislative initiatives. Much of the press on the left has also been supportive, designating *El Otro Sendero* "a support to the construction of socialism in Peru". What all of these examples indicate is that practical solutions to reform the system have much more appeal to most than empty ideological abstractions.

This demonstrates precisely the danger that our research represents for Marxism-Leninism. Because it has defined the situation of the informals correctly, in class terms, whereas the Marxists have not, there is every reason to believe that the ILD analysis should win this particular contest at both levels: by attracting the base of support or changing their outlook, and by instituting changes that have real and beneficial consequences for the informals.

It is very hard for ideologies that operate largely in the realm of values and are thus resistant to empirical falsification to survive for long if they clash continually and fundamentally with lived experience.

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It is also interesting to note that one of the leading Peruvian Marxist theorists has already stated that the ILD's position represents the third option on the Peruvian ideological scene, along with Marxism and Aprismo.

### C. Dependency Theory

**The Theory:** dependency theory is distinguished by its insistence that the biases of the international system are rooted in capitalism as such. Beginning around 1950, the United Nations Economic Commission for Latin America (CEPAL in Spanish) began to develop its structuralist theory of economic underdevelopment. It posits that the world capitalist economy embodies an international "division of labor" that is structurally biased against the interests of the newly industrializing countries. Such biases take the form of "unfair" terms of trade, the transnationalization of capital, the "monopolization" of technology by transnational firms, and so on.

CEPAL, thus, concludes that only inadequate or "distorted" development is possible for a country that participates fully in the world economy. The remedy is said to be a significant degree of withdrawal from the world economy and the implementation of an inward-looking strategy of industrial promotion. This strategy typically has taken the form of import-substitution industrialization.

Then, starting in the early to mid-1960s, leftists found a way to combine CEPAL's structuralism with Lenin's ideas about the inherently imperialist nature of capital on a world scale. Lenin argued that certain internal "contradictions" of the capitalist system required the systematic colonization and exploitation of the world "periphery" by the developed countries of the "center", since otherwise the system would collapse.

To this the leftists added two innovations. Whereas Lenin had pictured the "center" as rent by "inter-imperialist" rivalries and doomed to constant warfare, the new paradigm portrayed the "center" as a cohesive structure of domination organized and led by the United States. And whereas Lenin had relatively little to say about the detailed forms that this "exploitation" assumed, the new paradigm professed to find these forms in the structural features that CEPAL had identified. This marriage of Leninist theory and "Cepalismo" became known as "dependency theory".

Dependency theory has stimulated a vigorous debate in the field of development studies and has spawned an enormous number of publications pro and con. Today the overwhelming weight of the evidence is heavily against every one of the core dependency propositions. Likewise, the policies which

emanated from it (import substitution industrialization, the favoring of foreign borrowing over foreign investment, subsidization of urban consumers at the cost of undermining production in rural areas) have proved to be counterproductive, particularly when implemented by a mercantilist state.

However, the dependency idea has acquired an ideological presence independent of its failures as theory. There are three reasons for its continuing appeal. The first is that it is an eminently nationalistic ideology in third world terms. In fact, it is the characteristic form assumed by Latin American radical nationalism in our time, which points to an important historical lesson: nationalism, not Marxism, has consistently proven to be the most attractive political ideology of modern times. Second, dependency theory enables third world political leaders, along with the oligopolistic, privileged, corporate elites who associate closely with them, to shift the blame for their policy failures on to the shoulders of an international system for which these leaders and oligopolists could not be expected to be responsible.

Finally, the apparently radical features of dependency theory give the leaders who cater to exacerbated nationalism a way of coopting local Marxists and/or of appealing directly to the Marxists' ideological constituency.

Since dependency theorists equate development with large-scale, high-technology industrialization, they have rarely paid much attention to the informal sector except to ratify CEPAL's claim that its presence reveals "distorted development". A partial exception to this neglect, however, is the work of the Regional Employment Program for Latin America and the Caribbean (PREALC), an arm of the International Labor Organization (ILO). PREALC embodies an institutional and theoretical bias in favor of viewing the problem of informality as one of employment instead of entrepreneurial outlets and opportunities. Its policy recommendations, which call for the aid and protection of the state, contain an implicit assumption of informals as unemployed proletarian victims while ignoring or not perceiving their qualities as independent economic actors in need of a sound legal-institutional regime that would grant them opportunity.

The ILD Position undermines dependency theory in three ways. First, the dependency position falls to the ground as soon as it is shown that most of the "distortions" it identifies can be corrected by purely local measures that have nothing to do with the country's relations to the world economy. For if local solutions suffice, it is obvious that the main source of the "distortions" was local all along and could not have resulted from international economic structures.

The ILD has identified these local sources and recommended purely domestic policies to eliminate them.

This is not to say that the international economic system is necessarily just and free from bias against the third world. Rather it points out that there are steps third world countries can take, irrespective of the international economic system, which will improve the condition of their people. It introduces a note of optimism in the face of the deep pessimism of dependency theory, which posits that nothing can be done until the developing countries break completely with the international capitalist system.

Second, as noted above, our research to date suggests that much or most of the informal sector is entrepreneurial rather than proletarian in composition. Therefore, what it needs most are entrepreneurial opportunities, which will create more jobs, rather than measures designed to cause confrontation between the proletarian and entrepreneurial classes.

Third, one of the strengths of dependency theory is its nationalist appeal. What the ILD's position has done is to substitute a positive nationalism, based on indigenously developed institutions and incorporating much of what is distinctly Peruvian, for a negative nationalism based on opposition to foreign models.

As the over 250 articles on El Otro Sendero from Colombia and Peru and the some 2,700 on the ILD's research over the last years indicate, the primary critics of the ILD's thesis are proponents of dependency theory.

#### D. Liberation Theology

**The Theory:** twenty-odd years ago there arose a Latin American variant of European "political theology." It first took institutional form as "Cristianos por el Socialismo" in Chile during the Allende period, although its best-known current embodiment is the Sandinista "Iglesia Popular" in Nicaragua. The prominence of Liberation Theology as both a political ideology and as a movement is particularly noteworthy in Peru and Brazil, where two of its major proponents (Gustavo Gutiérrez and Leonardo Boff, respectively) reside. It has gained strength within a surprisingly high strata of the Church hierarchy in addition to the priesthood and laity. It also enjoys a considerable following in the United States, especially within those priestly and monastic orders that operate programs in Latin America.

Liberation Theology is not and does not pretend to be a theory of development. The "theory" that it offers, and the

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prescriptions for action that it derives therefrom, have been borrowed directly from Marxism and dependency theory.

It adopts from dependency theory the explanation of the plight of the poor as beset by an unjust economic system, applying to them the new definition of proletarian as synonymous with the poor and propertyless. It generally needs to accept the Marxist idea that class interests in capitalist society are antagonistic and cannot be harmonized.

What Liberation Theology adds to both dependency theory and Marxism is the moral justification for the right of the poor to organize themselves and revolt against the existing system.

Liberation Theologians maintain, without deviating from the Church's long ideological tradition, that a solidaristic, cohesive society is God's plan for humanity. They continue to find in the capitalist system and underlying individualistic ideology the principal impediments to the realization of this plan. And, like the earlier Catholic corporatists whose lack of a political strategy ended in overt support for Fascism, they seem to have no way of assuring that their new political order will be any more just than the old one.

The real question is whether social revolution, as opposed to other less apocalyptic strategies for helping the poor to help themselves, is truly central to Liberation Theology or whether, on the other hand, a small number of Marxist extremists have managed to bend the Church's old anti-liberal currents to their particular purposes. Without doubt the question bears further investigation.

In the interim, three points must be registered in Liberation Theology's favor. One is that it represents the Church's recognition that economic circumstances are a central element of the human moral as well as material condition. Second, this makes the attainment of a just and moral social order in the church's conception extremely unlikely in the absence of fundamental change. And, third its strategies of action emphasize empowerment of the poor from the bottom up in place of their organization from the top down by a dictatorial party-state.

**The ILD Position:** the proposals of the ILD are by no means utterly out of tune with the moral thrust of Liberation Theology. The ILD, too, identifies structures of power in the existing system that embody special privilege, that are biased against the poor, and that must be overcome through direct political action. It stresses the self-organization of informals as one of the principal, viable, political means by which reforms can be enacted. And it abjures the

extremes of self-interested individualism, in the negative context of a mercantilist society, maintaining that deliberate efforts must be made, both at the level of the state and at the level of civil society, to assure equality of opportunity for all.

Thus, we would not claim that the ILD's work in any way undermines the social concerns expressed by Liberation Theology. It does, however, undermine any strand of political ideology, even if disguised as theology, which insists that there is no way to improve the lot of the poor short of all-out revolution and the elimination of entrepreneurship. It is interesting to note, in this context, the strong support El Otro Sendero is receiving from church authorities around Latin America.

As we are not theologians, we have no desire to interject ourselves into the deeper theological debate now raging within the Catholic Church over the issue of Liberation Theology. But as concerned lay people we know of no basis in Catholic doctrine for opposing systems based on widespread entrepreneurship per se, if they can be made to operate fairly and justly, as we believe they can. In fact, the ILD's case studies should challenge Catholic social thinkers to give renewed attention to the need to reconcile morally the just aspirations of individual human initiative with the goal of a just society.

#### **E. The Foreign Policy and Assistance Programs of the Developed Countries**

**The Problem:** developed countries have faced two problems in achieving constancy between their basic values and their foreign policy and assistance programs. The first is that they have often confused mercantilists with modern market systems and democratic elections with full-fledged participatory democracy. Yet, as the ILD's research has shown, the mercantilists are not capitalists of the type found in the western world and democratic elections in no way guarantee citizen input and oversight in the rule-making process nor any accountability what so ever. Thus, many occidental nations have often ended up supporting regimes whose practices bear little resemblance to the values for which they stand.

Second, the west has traditionally given great importance to stability, believing it crucial to economic growth and, generally, to western interests. Because in many Latin America countries, stability supports the existing mercantilist structure, efforts to change it have primarily come from the left while the west has been identified with support for the status quo. Yet, as our research has demonstrated, the status quo is contrary to, rather than supportive of, economic growth and political democracy.

Since the majority of the population, including the informals, does not generally support the status quo, western policies are identified with the existing oligarchies.

In terms of foreign assistance, the same mis-conceptions mean that western foreign assistance has often failed to bring the desired results. It has promoted the state by concentrating funds (and, therefore, power) in the hands of politicians and government bureaucrats. It has strengthened the business elite, mistakenly identifying them as competitive entrepreneurs like most of those in the west. It has helped create and maintain a labor elite that has become part of the mercantilist structure. And it has provided charity to the poor which, while admirable in humanitarian terms, has not helped them to change the institutional structures impeding their progress.

In addition, by supporting, or appearing to support, special interests, western developed nations have been playing into Marxist hands. The Marxists have identified themselves with the interests of the "proletarians" whom they have redefined to include the poor and oppressed. Thus they are seen as standing for change in the present structure while the West is left as the guardian of the status quo.

**The ILD Position:** by identifying the ruling structure as mercantilist -anti-democratic and anti-market- and proving that it is the poor -and majority- who support and practice democracy and accessible markets, the ILD's research has given the west the opening to place itself squarely on the side of democratic participation and economic opportunity. The primary effort in passing from a mercantilist to a democratic, market-based society is, of necessity, a local one. But foreign governments through their policy and assistance programs, can slow the process or encourage it. The proposals set forth in this paper indicate some of the things we in Peru must do if we are to reform our society. And, therefore, they suggest the direction that western policies and assistance should take to assist in this process.

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