

## LECTURE 16: GROWTH AND DEVELOPMENT II

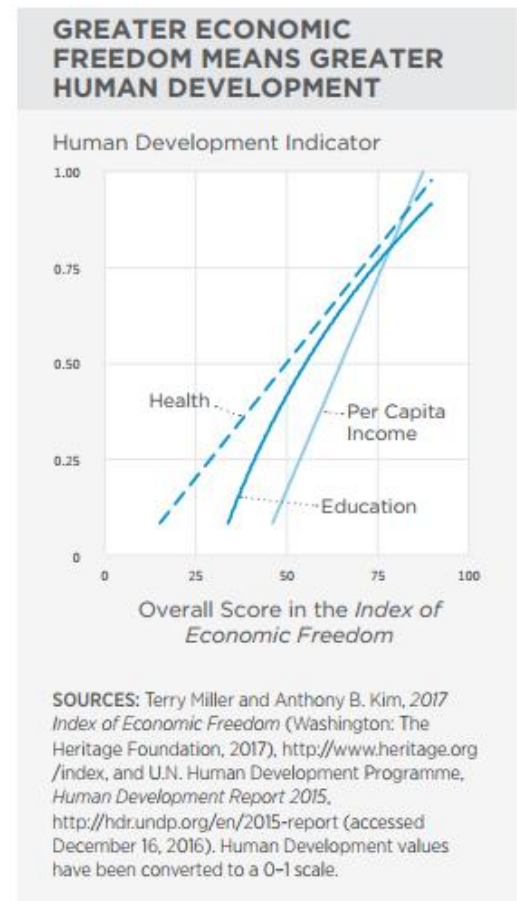
### I. Development as Freedom

a. Historically, economic development occurs in free societies. This “free society” can mean a lot of different things and the recipient of the 1998 Nobel Prize in Economics, Amartya Sen, outlined key freedoms needed (each a necessary condition):

- i. *Political freedoms.* Countries need free and fair elections as well as government transparency. This also includes cultural aspects such as equal treatment and respect.
- ii. *Economic freedoms.* Citizens need freedom of opportunities which includes free access to credit (borrowing money).
- iii. *Quality of life freedoms.* Society needs a social safety net, included basic access to health care, shelter, and food. In order to act on the other two freedoms, people need to be free to live securely.

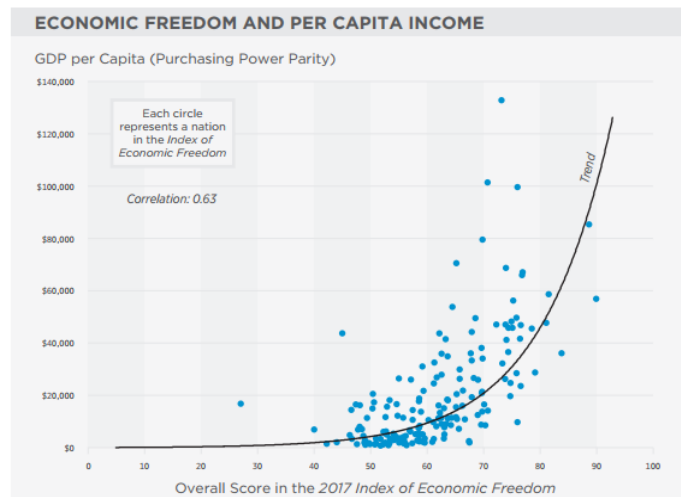
### b. The Economic Freedom Index

- i. Published by the Heritage Foundation, the EFI measures economic freedom on four broad measures: rule of law, size of government, efficiency of regulation, and the openness of the markets.<sup>1</sup>
- ii. These measures incorporate a wide variety of considerations, from how much people trust their government to how easy it is to trade with other countries.
- iii. Economic freedom correlates with other important measures, such as life expectancy and average income. These charts are from the 2017 Economic Freedom Index Report.<sup>2</sup>



<sup>1</sup> <http://www.heritage.org/index/book/methodology>

<sup>2</sup> [http://www.heritage.org/index/pdf/2017/book/index\\_2017.pdf](http://www.heritage.org/index/pdf/2017/book/index_2017.pdf)



- c. This measure doesn't include all of Sen's freedoms but it at least highlights the importance of some of them.
- II. The Mystery of Capital
- a. There are many possible reasons for poverty—overpopulation or overwhelming debt—which economists have considered. But few explanations hold as much promise as what Hernando de Soto describes in his landmark book, *The Mystery of Capital*.
  - b. De Soto argues physical capital in developing countries is dead. It's an asset, not capital; it can't be used to produce other things. Land is often unregistered, homes are built illegally, and businesses start outside the formal section.
    - i. Without legally recognized collateral or an official address, people can't get a business loan. Without a legal business, they have trouble expanding or selling it. They can't use the court systems. They can't advertise.
    - ii. Recall the key aspect of capitalism: private property which is strictly enforced and clearly defined. The developed world has a solid legal system for this reason.
  - c. People don't register their businesses or legally secure their land because it's really, really hard.
    - i. Armed with a research team, de Soto attempted to open a simple garment factory (one employee) in Lima, Peru. Working six hours a day, the team registered the business in 289 days. Similarly disastrous results were repeated with similar experiments in Egypt, the Philippines, and Haiti.

- ii. So people prefer to work in the extralegal sector (the black market). And it's hard to go back because that involves admitting to the authorities you've been breaking the law.
  - d. The key goal, then, is legal reform. But it's very hard as it involves:
    - i. Creating competitors for politically-connected businesses;
    - ii. Changing the minds of the custodians of the current bureaucracy;
    - iii. Titling land and assets based on hundreds of different local customs;
    - iv. Untangling decades or centuries of informal history; and
    - v. Convincing millions to change how they live their lives.
- III. See [this Planet Money episode](#) for an interview with De Soto.