

## **A case for simple laws**

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I start with deSoto's thesis that the poor of the world would prefer capitalism if they could obtain it at a reasonable price. DeSoto points out that poor countries typically lack the institutions to convert their wealth into working capital. Obviously, the legal institutions are in place in nearly all countries: there are laws defining ownership in land, land registration, and mortgages. These laws are just not used. Why?

I concentrate here on land and land ownership because these are the major assets of a country where much of its wealth is concentrated. Land (and the buildings on it) is a primary production factor and its capitalization in developed countries is often an order of magnitude larger than GNP. If this can be unleashed, resources for massive investment become available. One may argue that the rapid development of Spain in the 80s was fueled by a general reevaluation and capitalization of land.

The simple and general impediment to use the legal institutions to create capital is cost. There is a high non-monetary cost for the person to learn about the institutions and the procedures to follow and there is a high monetary cost to obtain the professional advice and assistance to follow them. Registration of land is most often made more difficult than strictly necessary by its primary purpose of securing ownership rights on land by legal procedural connections to, among others:

1. multiple tax laws
2. urban and rural planning laws
3. laws about agrarian reform
4. family law (inheritance, etc.)
5. social laws (e.g., protecting neighbors)

The simple procedure of land registration is so much burdened by these connections to make them essentially impractical. In Austria, registration of a land purchase can take up to one year, due to such constraints!

The corresponding institutions – especially the banks – are not ready to convert the abstract capital created by the legal institution in real working capital, i.e., cash. They are not prepared to grant mortgages because they do not have the experience that their investments are secure. This leads to the third issue:

Courts are necessary to enforce legal institutions. Our analysis and simulation of Searle's socially constructed legal realities demonstrate that they depend on the possibility of enforcement. If the interest on the mortgage is not paid, foreclosure must be possible and the lender (the bank) can proceed to sell the land to get the money owed. Such procedures are

very difficult, time consuming, and again at a high cost, for the bank; the uncertainty associated with them make mortgages a high risk and banks are not able to lend money, i.e., to contribute to the conversion of wealth in working capital.

The development of the court system in Europe in the late 19<sup>th</sup> and early 20<sup>th</sup> century has created a social expectation, namely, that debts are paid and if not, enforcement is swift and at a high price for the offender. This expectation is not universal. Reports from doing business in China point out that collecting outstanding debts is a major problem. The same is in my experience true for most of South America. In large parts of the world, there are no effective court procedures to enforce payment of debts or other contractual agreement.

Observation in Europe and the USA demonstrate that we are rapidly loosing this general social expectation. The popular belief in the fairness of tax laws is very low and cheating is in many countries the expected behavior; tax laws are also notoriously complicated and impossible to understand or predict. In contrast, rules of civil law, e.g. , rules about buying and selling, paying debts, etc., are in principle generally understood and observed. In many parts of Europe, Italy in particular, court decision take years, are too slow to be effective, and not predictable.

I see a single issue here: The laws have become too complicated. These are first, the substantive laws like land ownership and registration laws and second, the procedural laws of court procedures. The effect of complicated laws is high cost – cost to follow the law, cost to obtain the protection of the law for enforcement, cost for the individual, cost for the court system, cost from the uncertainty and risk.

DeSoto has asked whether we suggest to developing countries our methods, which are inappropriate for their situation. He points out that we have forgotten, how we got to our current system in the course of our development. I suggest that the export of the elaborate law systems of developed countries is counter-productive: the related institutions (courts, banks, etc.) cannot cope with the complexity and the fine distinction made (and most of these are probably not appropriate in the different environment). We have forgotten, how our legal system evolved from simple principles – the Roman law, captured in the Digestes – before it arrived at today's complexity. Research to identify the 'simple core' of a legal system is necessary. The historical development of legal institutions from simple rules to the complex constructions we have today can inspire such research. I believe that such 'simple laws' could also benefit the developed countries, where complexity of law has probably passed the optimal point.

I conclude with an observation of an Egyptian student of mine, confirming my position from a different perspective. He said that effective and functioning courts are necessary today for the middle class – the upper social strata know how to use them (for their advantage) and

the poor cannot use them because the cost is too high. In reverse: without effective court systems, the development of the poor to become middle class is not possible.