The Mirage of Capital:
Neoliberalism and the Rule of Law

by

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B.A., University of Alberta, 2004

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Supervisory Committee

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Abstract

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The rise of neoliberalism in the 1970s played an important role in renewing interest in the role which the rule of law could have in fostering free markets and economic growth in the developing world. One prominent participant in this neoliberal movement, which might be termed the Project for Markets, was Hernando de Soto, a Peruvian businessman who championed the extension of formal property rights as a solution to the developing world’s ills. In so doing de Soto became an international celebrity venerated by global leaders who welcomed a straight-forward free market solution to complex developmental issues. This thesis explores how de Soto’s work on property formalization in the last three decades both reflected the core assumptions of the Project for Markets as well as many of its short-comings. To do this I will rely on a case study of Cairo, a city central to de Soto’s work, to argue that de Soto ignores both the variable ways in which property rights can function “on the ground” as well as the extent to which there is rarely a technical “quick-fix” for serious problems in a nation’s political economy.
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Dedication

For Mom and Lobo
Epigraph

And each ruling group sets down laws for its own advantage; a democracy sets down democratic laws, a tyranny tyrannic laws; and the others do the same. And they declare that what they have set down—their own advantage—is just for the ruled, and the man who departs from it they punish as a breaker of the law and a doer of unjust deeds. This, best of men, is what I mean: in every city the same thing is just, the advantage of the established ruling body. It surely is master; so the man who reasons rightly concludes that everywhere justice is the same thing, the advantage of the stronger.

Thrasymachus, in *Plato’s Republic*, approximately 360 BC
Introduction

The rule of law, a term which loosely refers to the idea of judicial efficiency and fairness, is a concept which over the latter half of the twentieth century became increasingly incorporated in the discourse of numerous international financial institutions [IFIs] and international development agencies. Particularly in the 1990s, as IFIs became deeply involved in the liberalization of emerging economies in Eastern Europe: the idea that the market required a sound legal and institutional foundation upon which to rest became a consistent refrain of IFIs such as the World Bank and International Monetary Fund [IMF].

However, the rule of law had not always been held in such high esteem by the international development community.

It was after the Second World War that Western development agencies first began to experiment, on a very small scale, with the imposition of legal reforms to augment their development programs. This push was primarily led by the ‘Law and Development Movement’ [L&D], a movement composed of a small, disparate group of lawyers and academics working for universities, development agencies and foundations across North America and Western Europe. The L&D movement’s approach to law and economics was heavily influenced by the economic philosophy - then widely shared by development planners in the West - of embedded liberalism, an outlook that viewed state intervention in the economy as essential for stability and economic growth.

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a system was given life by the Bretton Woods conference of 1944, a meeting between
delegates from 44 countries that sought to create a framework for regulating their
economic relations. The conference was a predominantly Anglo-American, and to a
lesser extent Canadian, affair with 27 developing countries, mostly Latin American, also
present. France and the Soviet Union had only minor roles in the outcome of the
conference, the former still being under partial occupation and the latter not signing on to
the final draft agreements. The impending end of the Second World War weighed
heavily on the minds of the Bretton Woods negotiators. Planners such as John Maynard
Keynes of Britain and the American Harry Dexter White hoped the accords would
construct a multilateral framework that would prevent a return to the protracted economic
depression and protectionist policies that had marred the interwar years and, many
thought, borne much of the blame for the Second World War. One of the major
outcomes of the Bretton Woods accords was the creation of a new gold standard, a
system that pegged national currencies in relation to the US dollar’s convertibility to
gold. Bretton Woods also created international institutions such as the World Bank and
the IMF to advise states on how best to pursue their economic reconstruction and
development and to assist them in the case of a fiscal or financial crisis. Due to the
intimate connection between embedded liberalism and the L&D movement this first

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phase of law and development studies, which lasted from the 1950s to the mid-1970s, has been described as the ‘Law and the Developmentalist State’ phase.\footnote{Trubek and Santos, "Introduction: The Third Moment in Law and Development Theory and the Emergence of a New Critical Practice," 5.}

Both embedded liberalism and the L&D movement collapsed in the 1970s. The former broke down due to the protracted economic crisis of the 1970s and the sustained attack on its intellectual and structural foundations which this crisis produced. The latter collapsed due to programmatic failures and the struggles of embedded liberalism which underpinned many of the L&D movement’s core assumptions regarding development. The beginning of the end for the L&D movement is generally associated with David Trubek and Marc Galanter’s seminal article of 1974, entitled “Scholars in Self-Estrangement”, which described what they considered the emerging crisis of the L&D movement as well as the contradictions inherent in its approach to development and legal reform.\footnote{David Trubek and Marc Galanter, "Scholars in Self-Estrangement: Reflections on the Crisis of Law and Development Studies in the United States," Wisconsin Law Review: (1974): 1080.} While the L&D movement managed to put legal reform on the development policy agenda, the movement’s overall impact was minor.

In the last quarter of the twentieth century, however, legal reform projects, which had been relegated to the periphery of development agencies’ operations even during the heyday of the L&D movement, moved to the center of the work conducted by organizations such as the United States Agency for International Development [USAID], IMF, and World Bank. The increased interest in legal reform projects at these agencies during the 1980s and 1990s was intimately connected to the rise of neoliberalism, a movement which at a basic level sought to privatize state owned enterprises and liberalize the regulations, subsidies, tariffs and price controls that had characterized
embedded liberalism. Generally, neoliberalism sought to limit the government’s direct involvement in the economy, rather envisioning the government’s role as providing the legal framework for market activity. This approach encouraged interest in the role which laws and institutions could play as determinants of economic growth. The rise of law-in-development assistance programs was also tied to the international context in which neoliberal planners were operating. Beginning in the early 1980s, a wave of political liberalization began across Latin America, Asia, and eventually Eastern Europe, as formerly communist and authoritarian states began to hold elections and adopt democratic institutions. This provided ample opportunity for Western countries and development agencies to press the states in question towards economic liberalization and the benefits that it was thought would quickly accrue from such policies. However, the initial enthusiasm with which Western development planners met this transition towards both democracy and ‘free markets’ was soon stymied by the poor or patchy economic performance and persistent authoritarianism of many “emerging states.” This led some Western development planners to argue that their macro-economic policies had been betrayed by the dysfunctional legal and institutional environment prevalent in many developing nations. Essentially, it was argued, the developing world lacked the ‘rule of law’ or ‘good governance’, and sound macro-economic policy would come to naught if there did not exist a solid legal foundation on which the market could rest.

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Thus, by the mid-1990s, development agencies became increasingly preoccupied with the idea that improving developing countries’ institutions and legal systems might have a positive impact on economic growth. Such market-oriented legal and judicial reforms could, in the words of Richard Messick, include everything:

From writing or revising commercial codes, bankruptcy statutes, and company laws through overhauling regulatory agencies and teaching justice ministry officials how to draft legislation that fosters private investment… The core of a judicial reform program typically consists of measures to strengthen the judicial branch of government and such related entities as the public prosecutor and public defender offices, bar associations, and law schools.8

Such reforms generally aimed to make the judicial branch more independent, speed the processing of cases, increase access to dispute resolution mechanisms (such as binding mediation), and to increase the professionalism of the bench and bar.9 In terms of facilitating business transactions, many of these reforms placed a great emphasis on guarantees of property rights, enforcement of contracts, and protection against arbitrary use of government power and excessive regulation.10 Such market-oriented legal reforms were generally packaged under the rubric of good governance and deemed important both to stimulate domestic growth and attract foreign investment.

The trend among development agencies towards using the ‘rule of law’ to encourage economic growth during the 1980s and 1990s can be understood, at a very general level, as a major component of the second phase in law and development studies which, due to its close association with neoliberalism, could be termed The Project for

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9 Ibid, 118.
Markets. Another major component of the rule of law movement's second phase, which this study will not be focusing on, might be termed ‘the project for democracy’. Its proponents sought to use the rule of law, as the name suggests, to encourage democracy and protect human rights in the developing world and “emerging states.” Advocates of free market legal reforms, on the other hand, were preoccupied with using the law as an instrument to create a thriving market economy in developing nations. They lobbied for the state’s retreat from the economy, save in the realm of providing the legal and institutional framework for securing a functioning market economy.

For all its new found popularity, however, a great deal of intellectual uncertainty surrounded the rule of law’s practical application to development assistance. Despite almost 50 years of experimentation with legal reform projects in the developing world there remained a shocking lack of empirical data on the subject. Furthermore, in the field of development theory criticisms were mounting against neoliberalism by the end of the 1990s, further weakening the intellectual rationale for the Project for Markets, not least due to its practitioners’ indifference to the social dimension of their reforms. It thus seemed that the Project for Markets might be poised to suffer the same fate as the L&D movement had thirty years previous.

One concept which contributed to neoliberals’ interest in the rule of law during the 1980s and 1990s was that of informality. Informality encapsulated the idea that there existed a major gap between the formal or legible section of economies and the informal economy or ineligible section of economies in much of the developing world. In the 1980s

11 Ibid, 84.
12 Michael J. Trebilcock and Ron Daniels, Rule of Law Reform and Development: Charting the Fragile Path of Progress (Northampton: Edward Elgar Publishing, 2008), 4-5.
and 1990s many development theorists who highlighted the role played by the informal economy argued that if impoverished populations, trapped outside the formal economy, could be brought into the benefits of the formal capitalist economy, then the lot of millions would be improved. A consequence of this idea was that projects involving property formalization, particularly those aimed at making informal urban housing legible to the state and the international financial system, became a cause celebre during the 1980s and 1990s.¹⁴

One individual who played a pivotal role in popularizing the concept of a shift away from informality, particularly as it applied to housing, was Hernando de Soto, a Peruvian businessman turned economist who became a vociferous advocate of formalization schemes as a solution to the developing world’s ills. He is perhaps best known for his work as lead author of The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else (2000) and The Other Path: The Invisible Revolution in the Third World (1986).¹⁵ The idea at the heart of de Soto’s work was that the poor could be made wealthy if only they were allowed to use their property holdings to acquire credit, an idea that captivated proponents of free markets. For individuals such as the billionaire financier Steve Forbes or libertarians at Reason Magazine, de Soto’s ideas seemed almost too good to be true.¹⁶ De Soto offered a quick, painless and market-

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based path to economic development that seemed to circumvent politics, culture, and the unpleasant distributional or ‘redistributional’ issues that neoliberals so despised. De Soto’s work on informal housing, which initially focused on the situation in Lima, was expanded to make large generalizations about informal housing the world over. While not the originator of the idea of informality, nor the only individual promoting the formalization of property rights during the 1980s and 1990s, de Soto still played a prominent role both as promoter of the economic benefits of property formalization and as a member of the broader Project for Markets, his work both reflecting and reinforcing many of its assumptions and goals.

However, much like the broader Project for Markets, de Soto’s work has come under a great deal of criticism for lacking a sound empirical and theoretical foundation. One window on the pitfalls of de Soto’s approach is provided by an examination of Cairo, a city which figured prominently in The Mystery of Capital. A examination of USAID’s “Informal Housing in Egypt” [IHE] survey of 1980, one of the most expansive studies on informal housing in Cairo ever undertaken, as well as of Egypt’s political and economic history, reveals how de Soto shared not only many of the Project for Market’s core assumptions but also many of the challenges and criticisms that the Project for Markets faced by the turn of the millennium.

Keeping an examination of the Project for Markets to manageable proportions is no mean feat. The history of rule of law thinking in development assistance discussions is a new and not entirely coherent subject matter, dealing as it does, with the intersection of development studies, economics and legal studies. This task is not made easier by the
fact that the “rule of law” itself is a poorly defined term with a muddled past. In fact, contestation of the concept itself seems to be the one incontestable feature of the “rule of law”. In light of the great level of disagreement over what the rule of law means it is perhaps best to frame the “rule of law” tradition, as Jeremy Waldron does, not as a clear subject matter but rather as a “heritage of contestation.” Thus while a very broad definition of the rule of law may be able to find general approbation it is doubtful that there will ever be unanimity on a precise definition of the rule of law.

Constructing a history of the rule of law is as fraught with difficulties as is defining it. Many have tried to construct an intellectual genealogy of the notion of the rule of law, but to little avail, as the literature on the rule of law forms a disparate and poorly understood body of work. Part of the problem in reconstructing this debate stems from the fact that the rule of law discourse is a relatively recent one: the term was first coined by Andrew Dicey, in his 1888 Introduction to the Study of the Law and the Constitution in which he identified the rule of law as a characteristic of English institutions. Thus, discussing earlier writers’ opinions on the rule of law invariably involves a great deal of projection onto past events. While many theorists will talk about past scholars’ conceptions of the rule of law, as Michael Treblicock observes, “this is largely a term of art, applied retrospectively. In fact, many, if not the majority, of the most influential figures in political thought from Machiavelli to Burke held legal theory

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inseparable from personal and political ethics, as well as from the rules of skilled statecraft.”

To give the debate about the rule of law coherence one must inevitably make highly subjective decisions about which philosophers or cultural traditions to include. For example, Ancient Egypt and the Near East played an influential role in the development of Western political and philosophic thought. Yet the role of ancient Egypt’s influence on Greek philosophy, the code of Hammurabi or the near-eastern roots of Christianity and hence “Judeo-Christian” legal systems are often ignored in histories of the rule of law. Brian Tamanaha is one scholar who does so, discussing the rule of law as a largely closed intellectual debate within Western culture which can be traced from Ancient Greece to the present day, with only a brief interruption during the ‘Dark Ages’. Thus, while the debate on the law’s role in society is found, in one form or another, in the works of Plato, Aristotle, John Fortescue, Thomas Hobbes, John Lock, Adam Smith, Max Weber, Friedrich Hayek, Amartya Sen and a host of others, there remains no clear consensus on how these various authors and the various strains of thought they represent should be incorporated into a coherent intellectual history of the rule of law.

This thesis is an attempt to tackle an extremely large and complex subject matter, the Project for Markets, by way of an examination of one individual who participated in

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20 Trebilcock and Daniels, *Rule of Law Reform and Development: Charting the Fragile Path of Progress*, 14.
23 Santos, "The World Bank’s uses of the “rule of law” promise in economic development," 257.
the debate: Hernando de Soto. I have attempted not only to explicate the intellectual foundation for de Soto’s work but also, by way of a case study of Cairo and of Egypt more generally, to demonstrate why so many of de Soto’s and the Project for Market’s assumptions came under attack by the start of the twenty-first century. Chapter 1 of this thesis examines the rise of the Project for Markets following the collapse of the L&D movement in the mid-1970s in an attempt to explain how the idea that legal reform might have a major role to play in development emerged at the very core of the work done by the international development community. Chapter 1 also expands on many of the criticisms that eventually cropped up to challenge the Project for Markets – which will be linked to de Soto’s work in Chapter 3. Chapter 2 describes the economic development of Egypt, in a regional context, from the Free Officers’ seizure of power to the end of the twentieth century. This chapter is essential to the later discussion of de Soto and Cairo, particularly in terms of demonstrating why the Project for Markets and de Soto’s indifference to the political and social dimensions of economic reforms is so problematic. Chapter 3 examines de Soto’s work on informality generally and informal housing in particular. The discussion of de Soto will be followed by a description of the development of informal housing in Cairo and the view of informality provided by the 1982 Informal Housing in Egypt Survey. The IHE survey will then be used as starting point for a critical examination of de Soto’s work on informality.
Chapter 1: The Rise of the Project for Markets

The first phase of law and development studies took place between the end of the Second World War and the early-1970s. As noted above, during this period economic relations between countries of the developed world were characterized by a regime often referred to as ‘embedded liberalism’, a term that designates the multilateral international political and economic order formed by the Bretton Woods accords of 1944. This system relied on markets and free trade to achieve economic growth but attempted to regulate them through a framework of government rules and laws aimed at protecting society from market-shocks and at maintaining full-employment. This new multilateral arrangement was underpinned by the gold standard, a system which fixed national currencies in relation to the US dollar’s convertibility to gold. Under this system trade in goods was encouraged but trade in currencies was tightly regulated through a system of capital controls.24

The term embedded liberalism also refers to the general outlook and policies shared by many economic planners in developed capitalist nations during this period. While there was great differentiation among the policies advocated by planners of the developed economies, most planners shared a sense that state intervention in the economy was both legitimate and desirable even if, as John Ruggie avers, there was some

disagreement between left and right over the extent of that involvement. At the core of these assumptions lay the work of the economist John Maynard Keynes, chief British negotiator at Bretton Woods. Keynesian economics advocated using deficit spending by governments to generate demand during economic downturns to ‘re-inflate’ the economy. The decades of embedded liberalism were also marked in developed countries by a class compromise, between capital and labour, in hopes of easing the tensions and partisan divisions between left and right that had proved so divisive during the inter-war years.

Post-war development planners were sympathetic to the embedded liberal order and shared in the broad intellectual framework which viewed the state as the primary manager of the economy. Such management was seen as a means to ensure the state’s ability to affect macroeconomic changes in line with national development goals. While one of the aims of theorists during this period was generally to foster the creation of democracy in the developing world, in many cases little emphasis was placed on political or social reforms because planners believed that democracy would flow from economic growth as nations transitioned from ‘traditional’ to ‘modern’ societies. Legal reforms were thus not considered an essential component of economic development and their advocates found it difficult to gain much ground with agencies such as the World Bank or USAID.

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The notable exception to this general indifference to legal reform was the ‘Law and Development’ [L&D] movement of the 1960s and 1970s. Because the L&D movement was formed in an ad hoc manner, scholars have been consistently foiled in their attempts to clearly define its boundaries or even identify its underlying principles. At a basic level, the L&D movement was primarily an American affair, originating at the law schools of Harvard, Yale, Stanford, and the University of Wisconsin but also including a small group of lawyers working in development agencies and foundations in the United States and Western Europe. As Trubek and Galanter observe in their article entitled “Scholars in Self-Estrangement,” however, lawyers faced an uphill battle in the postwar decades: compared to economists and political scientists, they arrived very late to the development policy game. Nonetheless, with the support of USAID, the Ford Foundation and a variety of other donors, L&D proponents were able to publish hundreds of reports on the subject of legal transplantation. Yet they had no substantial impact on policy making or implementation. Though USAID did undertake a few minor programs inspired by the L&D reformers, most development agencies were largely unmoved by L&D’s arguments. The movement’s one major accomplishment was

27 The L&D movement should not be confused with Law and Development studies. The latter refers to a general field of academic inquiry while the former refers to a specific movement within that field.
simply to put the discourse of law and development on the agenda in the academic and policy making community.\textsuperscript{33}

In terms of theory, the L&D movement advanced the proposition that law was essential to the development process. L&D proponents emphasized that, by educating the bench and bar of developing countries in Western legal practices, lawyers and judges could essentially be transformed into social engineers. Implicitly the L&D movement was supported by what Trubek and Galanter term, ‘liberal legalism’.\textsuperscript{34} Liberal legalism is a position derived from liberal American legal thought that combined the latter with a great deal of theoretical seepage from modernization theory.\textsuperscript{35} Economic development, from this perspective, was interpreted as an expansion not only of material well being, but also of rationality and equality. Consequently both law and the state were considered central to the development process. According to Trubek, four assumptions were crucial to the L&D movement’s approach. These were: “A cultural reform and transplantation strategy; an ad hoc approach to reform based on simplistic theoretical assumptions; faith in spillovers from the economy to democracy and human rights; and a development strategy that stressed state-led import substitution.”\textsuperscript{36} By the mid-1970s, all of these assumptions faced increasingly intense criticism which in effect brought about the collapse of the L&D movement.

\textsuperscript{33} Ibid, 75.
\textsuperscript{35} Snyder, “Law and Development in the Light of Dependency Theory,” 728. Modernization theory is one approach to development theory which argues that countries move through similar evolutionary stages in their development, advancing along a linear path from ‘traditional’ to ‘modern’ societies. A developing state’s position in this evolutionary progression is often established by determining how closely it conforms to the social and technical practices of states in Western Europe and North America.
\textsuperscript{36} Trubek, ”The "Rule of Law" in Development Assistance: Past, Present, and Future,” 78.
The L&D movement’s collapse resulted from several factors. For Trubek, one major cause was that many participants in the L&D movement had become disillusioned. Attempts at reforming the legal culture of developing countries through educational reforms of law schools was not proving as fruitful as the L&D reformers had hoped.\textsuperscript{37} As another observer noted, many L&D assumptions were underpinned by nothing more than the idea “that (legal) education could overcome values instilled by family, class, religion, and other social forces.”\textsuperscript{38} Many L&D reformers found instead that societies and institutions in developing countries were far more resistant to formal legal transplantation than they had supposed and that laws introduced to developing countries could work in unpredictable and even counterproductive ways. Some participants worried that strengthening the formal legal powers of authoritarian regimes was actually enhancing the power of their repressive apparatus. Still others wondered if lawyers could really be effective agents of social change given that they so often came from the ruling class themselves.\textsuperscript{39} Nor did it remain clear to the reformers that democracy and economic growth necessarily flowed from legal reforms, as they had initially supposed. The L&D reformers’ failures brought into question the entire linear model of development that viewed development as a progression towards conformity with the economic, political and legal systems of America and Western Europe.

The L&D movement’s internal failings paralleled the collapse of embedded liberalism.\textsuperscript{40} While the embedded liberal regime appeared to function well during the 1950s and 1960s, managing high rates of growth for developed countries at least, by the

\textsuperscript{37} Ibid, 81.
\textsuperscript{40} Trubek, "The "Rule of Law" in Development Assistance: Past, Present, and Future," 78-80.
late 1960s and early 1970s faith in the embedded liberal regime had begun to erode as the world entered a prolonged period of high unemployment combined with high inflation, known as ‘stagflation’. During this period many states faced a severe fiscal crisis as tax revenues collapsed and expenditures soared. In the United States this situation was aggravated by the Vietnam War which placed a large burden on US resources. Exacerbating this predicament were the oil price-shocks of the 1970s, when disruptions of the oil supply led to panic and widespread hoarding.\(^41\) The 1970s also witnessed the collapse of the gold standard as exchange rates became misaligned and confidence in the stability of currencies collapsed.\(^42\) The Nixon administration’s 1971 switch from the gold standard to floating exchange rates which followed is generally considered the end of embedded liberalism as an international economic system.

What all these events amounted to by the end of the 1970s was the overthrow of the embedded liberal order in the developed world. What eventually came to replace embedded liberalism was neoliberalism, a movement that would place much greater emphasis on the free market as the means to foster economic growth and development. While the neoliberal era has many potential starting points, its inauguration has come to be identified in the minds of many with the election of Margaret Thatcher in Britain in 1979 and of Ronald Reagan in the United States in 1980 as both administrations were major proponents of free-market reforms.\(^43\) Such observable starting points should not,


\(^{43}\) Of course one could just as easily choose innumerable other potential starting points for the neoliberal era such as one of the earliest cases of neoliberal experimentation, Pinochet’s Chile in the early 1970s. For a short background on Milton Friedman’s role in neoliberal reforms in Chile see: Naomi Klein, *The Shock Doctrine: the rise of disaster capitalism* (United States of America: Knopf Canada, 2007), 56-83. Nancy Neiman Auerbach, "The Meanings of Neoliberalism," in *Neoliberalism: national and regional experiments with global ideas*, ed. Ravi Roy, Arthur Denzau and Thomas Willett (New York: Routledge, 2007), 31.
however, obscure the confusion surrounding the intellectual and political overthrow of the embedded liberal order by neoliberalism. This was, by most accounts, a poorly understood process.\textsuperscript{44} What can be said with certainty about neoliberalism’s ascendance is that it was during the crisis of the 1970s that opponents of the embedded liberal order and of Keynesian economics, particularly right-wing intellectuals and their wealthy supporters in America and Western Europe, seized the moment and offered up their explanation for, and solution to, the crisis.\textsuperscript{45}

One individual who played an influential role in generating intellectual resistance to embedded liberalism was Friedrich Hayek. As early as the 1930s, Hayek has been a serious critic of Keynes’ \textit{The General Theory}, arguing that his approach institutionalized inflation.\textsuperscript{46} Hayek’s \textit{The Road to Serfdom} (1944) was a major critique of Keynesianism and central planning. In 1947, Hayek convened a meeting at Mont Pelerin in the Alps and formed the aptly named Mont Pelerin Society, a group of intellectuals committed to overthrowing the embedded liberal order, over the course of decades if necessary.\textsuperscript{47}

Inspired by Hayek, many nascent neoliberals began to see themselves as belonging to a political “vanguard” that was attacking the foundations of ‘socialism’ which they identified “as much with the name Keynes as that of Marx or Stalin.”\textsuperscript{48} In terms of the rule of law, \textit{The Road to Serfdom} viewed the law as a means to facilitate economic life by

\textsuperscript{46} Daniel Yergin and Joseph Stanislaw, \textit{The Commanding Heights: the battle between government and the marketplace that is remaking the modern world} (New York: Touchstone, 1998), 142.
\textsuperscript{47} Ibid, 145.
\textsuperscript{48} Kennedy, "The "Rule of Law", Political Choices, and Development Common Sense," 97.
providing a predictable legal and institutional environment for individuals to operate in.\textsuperscript{49}

As Hayek asserted:

nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law. Stripped of all technicalities, this means that government in all its actions is bound by rules... which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one's individual affairs on the basis of this knowledge.\textsuperscript{50}

One young participant in the Mont Pelerin Society, who would have an important impact on the overthrow of embedded liberalism as profound as that of Hayek was Milton Friedman.\textsuperscript{51}

There were, and are, many competing academic explanations for the stagflation of the 1970s. But it was ultimately the arguments of monetarism, as championed by Milton Friedman, a movement distinct from neoliberalism but supportive of and connected to it in many respects, that were best able to advance an appealing explanation for stagflation. In so doing, monetarism was to become a powerful force in the overthrow of the embedded liberal order.\textsuperscript{52} In the view of monetarists, Keynesian fiscal expansion caused higher interest rates as governments borrowed to finance their budget deficits as well as a 'crowding out' of private sector expenditure as the public sector expanded. Monetarists argued that the solution was for macroeconomics to be premised on the stable control of the money supply rather than stable currencies and discretionary fiscal policy. While

\textsuperscript{49} Santos, "The World Bank's uses of the “rule of law” promise in economic development," 263.

\textsuperscript{50} Friedrich Hayek, \textit{The Road to Serfdom} (Chicago: The University of Chicago Press, 1944), 72.

\textsuperscript{51} Yergin and Stanislaw, \textit{The Commanding Heights: the battle between government and the marketplace that is remaking the modern world}, 145. Friedman and his fellow economists at the University of Chicago were, by the 1950s, viewed as constituting a distinctive Chicago School of Economics which stood in opposition to Keynesianism and for a belief in the power of markets and the effectiveness of competition in fostering economic growth.

monetarism lost much of its influence by the late 1980s, many of its policies proving less effective than originally supposed, its role in overturning the embedded liberal order is undeniable. Graham Bird argues that monetarist maxims were decisive in helping conservative politicians, such as Margaret Thatcher and Ronald Reagan, win public support for their project as monetarism embodied a simple message that carried straightforward policy implications regarding the need to curb government spending and lower taxes.53

Given the vast differentiation among ‘neoliberalisms’, such as those of the Chicago School, the Austrian School, Ordoliberalism, and libertarianism, defining what constitutes neoliberalism is another subject on which there has yet to emerge a clear academic consensus.54 This problem is compounded by the fact that neoliberalism has always been an evolving movement: one cannot simply fashion a transhistorical definition of it. Defining neoliberalism is further complicated by the fact that neoliberalism has traditionally been as much a political label as an economic one. As Nancy Auerbach points out, one’s definition of neoliberalism and who that definition includes often depends on who is using it.55 On the right, for example, American neo-conservatives have viewed neoliberalism in broadly ideological terms, generally equating neoliberalism with “freedom and liberty.”56 Auerbach classifies such individuals as “true

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55 Auerbach, "The Meanings of Neoliberalism," 27, 47.
56 Ibid, 26. One prominent historian who argues there exists an intimate connection between private property and democracy is Richard Pipes. Pipes contrasts the development of Russia and England arguing that the former was unable to develop democracy and the rule of law because it never adequately advanced the institution of private property. Pipes is particularly critical of the redistributive characteristics of embedded liberalism, or the ‘welfare state’, which he regards as inimical to freedom. On Pipes’ reading, property rights in the ‘welfare state’ are so insecure they have increasingly come to resemble ‘conditional tenure’. See Richard Pipes, Property and Freedom (New York: Vintage Books, 1999), 209-266. See also
believers,” as their support for specific economic policies is based less on research and analysis than on their faith in their ideological position.\(^57\) For left-wing critics of neoliberalism, on the other hand, it is often used as a pejorative term to refer to all the various injustices associated with globalization, capitalism, and, more than occasionally, the aforementioned neo-conservatives.\(^58\) However, it is important to keep in mind that there are many ‘neoliberals’, particularly mainstream economists, who want nothing to do with Reaganomics and the Laffer Curve,\(^59\) the policies of the Coalition Provisional Authority [CPA] in occupied Iraq,\(^60\) or even the monetarism of Milton Friedman.

As a concept, neoliberalism is best thought of as a mental model to direct learning, explanation, and interpretation of events and ideas rather than a fixed and static set of assumptions.\(^61\) Thus any sketch of neoliberalism must be understood as relating to a general framework for the evolving neoliberal mental model rather than a complete

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\(^{57}\) Auerbach, "The Meanings of Neoliberalism," 36.

\(^{58}\) Ibid, 26. Naomi Klein for example, one vocal critic of neoliberalism, views neoliberalism as a misguided, predatory project inseparable from the Chicago School of Economics.

\(^{59}\) The Laffer Curve was created in 1974 when Arthur Laffer sketched it on a napkin while at lunch with Dick Cheney as a way to demonstrate to Cheney the benefits of his recommendations to reduce tax rates. Essentially, Laffer argued that taxation beyond a certain point would not necessarily increase revenue. It is a theory which provided much of the underpinning for supply-side economics and was central to the Reagan administration’s attempts to lower taxation rates for the wealthy. Most mainstream economists regard the Laffer curve as crude at best and pseudo-intellectual at worst. Laffer was not a trained economist, he had received a regular BA in poor standing from Yale and later received a Masters in business administration from Stanford. This became an issue of some contention when he joined the faculty at the University of Chicago and was accused of actively concealing the fact he had not received a PhD. For a general background on the Laffer Curve and Reaganomics see: Haynes Johnson, Sleepwalking Through History: America in the Reagan Years (New York: Norton, 1991).


definition. Under this conception, Auerbach argues neoliberalism should be interpreted very broadly as a revived form of economic liberalism, which encompassed a variety of movements, institutions and individuals that shared core ideas about the importance of markets and thus constituted a shared mental model in the most general sense.

When discussing neoliberalism this study will use, as a general framework, ideas that had by the 1990s more or less gained acceptance among mainstream development institutions such as the World Bank, IMF and USAID. For this approach, John Williamson’s conception of the Washington Consensus works well as a basis for understanding what constitutes the core of neoliberalism. It is again worth stating, however, that the Washington Consensus and neoliberalism are not the same thing, even though the Washington Consensus formed an important component of neoliberalism. Williamson originally conceived of the Washington Consensus in 1989 as a way to understand the set of policies considered to be desirable for implementation at the time by the IMF, World Bank, the US Treasury Department and Latin American governments.

The ten objectives which Williamson identified were:

1. Maintaining small budget deficits.
2. The redirection of public expenditures towards health, education, and infrastructure.
3. A broadening of the tax base.
4. Financial liberalization and the adoption of market determined interest rates.
5. A unified exchange rate and the elimination of overvalued exchange rates.
6. The liberalization of trade.
7. The abolition of impediments to the entry of foreign direct investment.
9. The abolition of impediments to the competitive entry of firms.

62 Ibid, 54.
10. The provision of secure property rights, especially in the informal sector (Emphasis Added).  

These points formed a core which most who ascribed to the neoliberal model, whether of the mainstream or ideological variety, endorsed during the 1980s and 1990s. One of the central tenets of this approach was the importance of rapid economic growth. Between 1980 and 1994 both the World Bank and IMF were assured that rapid economic growth was the solution to the developing world’s economic and social problems. Thus, as outlined by the Washington Consensus, the development strategy advocated by neoliberals for the developing world was one that, at a very general level, encouraged privatization of state enterprises, freer markets, export-led growth, and foreign investment as the means to achieve economic development. Since the state was still essential for providing the overall framework in which economic growth could occur, the neoliberal model should be seen not so much as a withering or retreat of the state, rather it was a drastic reimagining of its role.

While presented as technical and managerial in character the neoliberal agenda was a deeply political enterprise. In so far as the Washington Consensus existed in direct opposition to the policies of state-led economies in the developing world it was inherently political. The primary way that the World Bank and IMF enforced the neoliberal reform agenda was by making loans conditional on conforming to their policy stricture. This idea was first proposed in 1979 by Robert McNamara, then president of the World Bank. Conditionality, introduced during the 1980s and 1990s, meant that

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70 Pender, "From 'Structural Adjustment' to 'Comprehensive Development Framework': Conditionality Transformed?" 399.
“loans from the World Bank, IMF and regional development banks, aid from bilateral donors and even private finance became effectively conditional on the agreement by the recipient government to implement often far-reaching economic policy reforms, along the lines of the World Bank model.”71 This, as one might imagine, drastically limited the ability of many developing states to choose economic policies at odds with the neoliberal agenda.

Many planners and theorists operating in the neoliberal milieu came to view the government’s role in the economy as simply providing the legal framework for the free-market.72 After that, the economy could be more or less left to govern itself. Law was not meant to be an instrument of state policy but was instead thought to be a check on state power and to provide the framework in which markets would perform effectively. Neoliberals conceived of the economy as a ‘market’ where individuals reacting to price signals would interact with one another to put resources to their most efficient use. From this perspective, regulation was generally considered unnecessary interference with the market and the embedded liberal period’s emphasis on macroeconomic management was considered redundant and cumbersome. For neoliberals, markets in any country would require the same “universal” legal foundations as found in the developed countries.73 Consequently, unlike under embedded liberalism, law came to be seen by planners as central to economic growth and legal reforms became part of much broader plans to make developing nations more “market friendly”.74 As Nathan Brown observes “when interest in the relationship between law and development returned in the 1980s and 1990s,

71 Ibid: 399.
72 Trebilcock and Daniels, Rule of Law Reform and Development: Charting the Fragile Path of Progress, 5-6.
73 Kennedy, “The "Rule of Law", Political Choices, and Development Common Sense,” 129.
attention centered on business and entrepreneurship rather than the poor.” 75 In this context, the failures and limitations of the L&D movement were quickly forgotten or dismissed by many neoliberal planners as the result of that movement’s lack of emphasis on the free-market. 76 Neoliberal reforms were also much more expansive tackling not just legal education, as the L&D movement had, but broader issues of judicial and institutional efficacy.

The collection of ideas and theories about laws, property rights, and efficiency that influenced neoliberal planners was the product of numerous complementary, independent, but not entirely separable intellectual movements such as monetarism, neo-institutional economics, and Coase’s transaction-cost theory. 77 This hodgepodge of ideas and assumptions about law and economics was, by the 1990s, captured by the phrase ‘the rule of law’. 78 Finding a clear conception of the rule of law as used by these neoliberal planners is, as already noted, no simple matter. This difficulty is due to the lack of theoretical clarity both in the concept of the rule of law and in that of neoliberalism. It is perhaps counterproductive to attempt to identify a single conception of the rule of law, given how many interpretations have been put forth by scholars over the years, let alone to venture a specific one that could be associated with neoliberalism. However, what can be said at a very basic level about neoliberal “rule of law” reforms is that they were all

77 Campbell and Pedersen, “The Rise of Neoliberalism and Institutional Analysis,” 1. For a historical treatment of the decline of historical specificity in economics over the course of the 19th and 20th century see: Geoffrey Hodgson, How Economics Forgot History: the problem of historical specificity in social science (New York: Routledge, 2001). Monetarism argued that the monetary expansion of the 1960s and 1970s was the root cause of the economic crisis in the 1970s. For a hisorical treatment extremely sympathetic to monetarism and neoliberalism see Yergin and Stanislaw, The Commanding Heights: the battle between government and the marketplace that is remaking the modern world.
underpinned by the assumption that a state’s laws are best when they achieve “efficiency” and low transaction-costs, and when they are enforced predictably. Such a situation, it is commonly argued, would create the ideal environment for economic growth. Frank Cross summarizes the position of neoliberal rule of law advocates well when he states that:

Considerable empirical research now informs the economic and other theories about the relationship of law and economic growth. There is substantial evidence that some major legal rules and institutions (such as democracy, property rights, and certain government regulations) have a distinctly positive effect on growth.

Such thinking became so entrenched in the minds of development planners that by the 1990s it became conventional wisdom that without a legal code clearly establishing “the rules of the game,” sustainable economic growth would not be attainable. Thus, as the World Bank, IMF, and other development agencies began to pursue structural economic reforms in the developing world during the 1980s and 1990s, law came to be seen as central to that objective, primarily as a means to foster private transactions by enforcing property rights and contracts and by protecting foreign investors.

For example, in the 1990s the World Bank’s annual World Development Reports shifted away from an emphasis on fiscal rectitude and market reforms towards a greater emphasis on a reduction of transaction costs, improvements to education systems, technology upgrades, and improvements to the rule of law. One important author of this approach at the World Bank in the late 1980s was Ibrahim Shihata, general counsel

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81 Santos, "The World Bank’s uses of the “rule of law” promise in economic development," 253.
for the World Bank. He became one of the most influential advocates of an approach to law which viewed the law as a means to foster economic development. Shihata argued that the “rule of law” or “good governance” - not to be confused with politics - should form an essential prerequisite to the World Bank’s assistance.83 The World Bank, it should be noted, is prohibited by its articles from interfering in its members’ “politics.” This prevents it from supporting judicial reform unless it is aimed at economic development. As a result of its interest in the rule of law, however, the World Bank invested roughly 2.9 billion dollars between 1990 and 1999 in legal reform programs to improve ‘governance’ in borrowing nations, particularly in Eastern Europe.84 As one World Bank report observed of this new approach:

> The massive move by developing and transition countries toward market economies necessitated the adoption of strategies for the encouragement of private investment, domestic and foreign. Naturally, there was a general realization that such an objective could not be achieved without modifying and, sometimes, completely overhauling the legal and institutional framework and firmly establishing the rule of law, thereby creating the necessary climate of stability and predictability.85

The World Bank’s 1991 “Urban Policy Report” is one work in this vein. It emphasized, among other things, “reducing constraints on urban productivity.”86 The World Bank’s Urban Report argued that an essential component of increasing urban economic growth was an improvement of the regulatory and financial services of developing cities. It was of particular importance that governments alleviate “structural constraints inhibiting the productivity and growth of the informal sector by reforming

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83 Shihata’s views are still institutionally endorsed by the World Bank.
regulations and codes that limit the access of the poor to urban services, infrastructure, credit and markets.”

This report viewed the major need for financial services as residing in the housing sector, and housing finance loans played a key role in the report’s overall strategy.

In Egypt the renewed interest in the relationship between law and economic development in the 1980s and 1990s found one of its most important explications in USAID’s Judicial Sector Report of 1994, which emphasized the role of property rights and contracts in economic growth. The report described its goal as being “to analyze and make recommendations regarding constraints in Egypt’s legal and judicial sectors which inhibit the proper functioning of a market economy.”

The government’s chief function in a market driven economy is that of an enabling agent which creates the conditions needed for the market to function properly by responding efficiently to an infinite number and variety of individual business decisions, contracts and transactions which propel the economy forward. Such conditions include appropriate macro-economic policies… In addition, a well-conceived legal and institutional framework is essential to encourage and facilitate private sector economic activity generally and foreign and domestic investment in particular. Conversely, the lack of appropriate laws and legal institutions or poorly designed laws and institutions can seriously hinder or prevent a market economy from functioning properly…

The USAID report is indicative of much of the neoliberal thinking surrounding the rule of law during the 1980s and 1990s. It emphasized limited government interference in the market as excessive regulation was thought to reduce the speed of transactions.

Egypt’s earlier “experiment with socialism” was viewed as having adversely affected

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87 Ibid, 54, 64-65.  
88 Ibid, 65, 81.  
89 Brown, The Rule of Law in the Arab World: Courts in Egypt and the Gulf, 222.  
91 Ibid, 1.  
92 Ibid, 3.
Egypt’s legal infrastructure and prejudiced laws against the free market. The report also blamed judicial difficulties on a lack of lawyers and judges, an inadequate legal education system, and a cumbersome bureaucracy. These forces acted together to create high transaction costs in all sectors of the Egyptian economy. However, new small entrepreneurs were said to suffer most, facing an absence of well functioning commercial law and a lack of credit. This situation was exacerbated by the fact that informality deterred investment by the international financial community. The recommended solution was an overhaul of Egypt’s commercial laws and court system, “modernization” of the system of legal education, appeals, data collection and registration and a general revision and “modernization” of “substantive laws to improve the legal framework for investment, job creation and economic growth.”

While there was a general shift during the 1980s and 1990s towards the use of the law to promote economic growth inspired by the rise of neoliberalism, part of the impetus for rule of law reforms also came from neoliberalism’s struggles. By the early 1990s, despite outward confidence, the World Bank and IMF were growing increasingly unsure about many of their policy prescriptions. Part of this uncertainty stemmed from the success of East Asian nations at experiments with rapid state-led development as well as the dismal economic record of sub-Saharan Africa, one of the few regions still dependent on the World Bank for most of its financing by the mid-1990s. This sense of distress was compounded by Mexico’s financial crisis of 1994-1995. In the wake of this crisis, Paul Krugman argued that the case of Mexico, a state widely regarded to have done everything

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93 Ibid, 4.
94 Ibid, 9.
95 Ibid, 10.
96 Pender, "From 'Structural Adjustment' to 'Comprehensive Development Framework': Conditionality Transformed?,” 400. Williamson, "The Washington Consensus and Beyond."
right by the standards of the Washington Consensus, exposed the shaky empirical foundations of the claim that free trade and free markets would inevitably lead to an ‘economic take-off’. The year 1995 thus marked a moment of serious existential crisis for the World Bank as criticisms mounted from both the developing world and within the Washington establishment. Some of the latter, in an ironic turn, were even calling for the privatization of the World Bank. The ultimate result of this was a shift at the World Bank away from the Washington Consensus towards a broad-based definition of what constituted development that was not centered exclusively on economic growth. This led the World Bank under the presidency of James Wolfensohn, an Australian financier who in 1995 took office in an attempt to revive the reforming zeal of Robert McNamara’s presidency, to prominently turn towards using Non-Governmental Organizations [NGOs]. The hope was that by working with NGOs and “civil society”, while bypassing kleptocratic elites, the World Bank would be able to transform the conditionality-based aid programs of “the 1980s and 1990s, which placed donor and recipient in a relationship of unequal exchange,” into a relationship of “equality and mutual benefit.” One major outcome of this shift was the development of Poverty Reduction Strategy Papers [PRSPs] that the World Bank, IMF and many other donors began to require that poor countries create and endorse before securing aid. This shift was embodied in the Comprehensive Development Framework [CDF] initiated by the bank in 1999, this policy advocates

97 Paul Krugman, "Dutch Tulips and Emerging Markets," Foreign Affairs: 74, no. 4 (1995), 32. Sebastian Edwards, one economist who Krugman cited in this article to support the shaky empirical foundations for the connection between economic openness and economic growth, later concluded that it did seem probable that there was a strong connection between economic openness and economic growth after a much more expansive study. See Sebastian Edwards, "Openness, Productivity and Growth: What do We Really Know?," The Economic Journal: 108, no. 447 (1998), 396.
99 Ibid, 184.
argued, would help the bank incorporate the financial, institutional and social components of development. The CDF is best interpreted as an attempt by the bank to “operationalise a vision of development with elevated non-economic objectives.”

However, the importance of market-led economic growth remained central to the World Bank. As the World Development Report of 2000/2001 stated “in view of the urgent need to get countries onto dynamic, job-creating development paths, it is critical that the difficulty of reform and the impossibility of compensating every loser not lead to policy paralysis.”

While critiques of the Project for Markets had been building over the course of the 1990s one of the most prominent attacks on the efficacy of the rule of law in economic development came in 2003 with the publication of “Promoting the Rule of Law Abroad: The Problem of Knowledge” an article by Thomas Carothers of the Washington D.C. based think-tank, the Carnegie Endowment for International Peace. Carothers, a leader in the field of governance studies, drew attention to the large degree of uncertainty associated with legal reform programs owing to the definitional problems associated with the rule of law and the lack of consistent empirical research by the aid agencies which attempted to implement it on the ground. As Carothers observed:

One cannot get through a foreign policy debate these days without someone proposing the rule of law as a solution to the world’s troubles… The concept is suddenly everywhere – a venerable part of western political philosophy enjoying a new run as a rising imperative of the era of globalization. Unquestionably, it is important to life in peaceful, free, and prosperous societies. Yet its sudden elevation as a panacea for the ills of countries in transition from dictatorships or statist economies should make both patients and prescribers wary. The rule of law

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100 Edwards, "Openess, Productivity and Growth: What do We Really Know?," 407.
101 Ibid, 407.
102 Ibid, 407.
promises to move countries past the first, relatively easy phase of political and economic liberalization to a deeper level of reform. But that promise is proving difficult to fulfill.\textsuperscript{104}

The charges levelled by Carothers and others in the field of development studies suggested that many of the same questions that felled the L&D movement regarding the role of law in development may have returned to haunt the Project for Markets. The themes which united most major critiques of the project for markets centered on its shaky empirical foundation, lack of theoretical clarity, idealization of Western legal systems and indifference to the social and political consequences of legal reform.

In terms of critiques, perhaps the most serious challenge facing those defending the economic benefits of introducing the ‘rule of law’ to developing nations is that they are confronted with a serious knowledge deficit in attempting to implement policy.\textsuperscript{105} A large proportion of individuals involved in legal reform programs, even those supportive of such projects, will admit that much remains unknown about the actual impact of the “rule of law” despite the large amount of capital invested in it.\textsuperscript{106} As one World Bank official put it “one can never be sure” if foreign investment “can be attributed to legal reform or not. It is very difficult to know if law reform will have an impact, but to some extent, that thought is intuitive.”\textsuperscript{107} There is a great deal of ambiguity on the subject of whether the promotion of formal legal institutions will actually encourage economic development.\textsuperscript{108} It is far from clear that a cause and effect relationship actually exists between the two. It may be that higher levels of development allow the state to spend more on an effective legal system or that economic development may itself spur judicial

\begin{footnotesize}
\begin{enumerate}
\item ———, "Promoting the Rule of Law Abroad: The Problem of Knowledge," 3.
\item Ibid: 5.
\item Perry, "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," 785.
\item Carothers, "Promoting the Rule of Law Abroad: The Problem of Knowledge," 3.
\end{enumerate}
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reforms rather than the other way around or that poverty may in fact be the primary cause of poor legal systems.\textsuperscript{109} As Trebilcock and Daniels found in their survey of obstacles to legal reform in the developing world:

> Resource constraints may in some sense be the most pervasive category of obstacle, in that there are few reform efforts in respect of which more resources would not be preferable to less. Across every institution, individual actors in many developing countries have been underpaid and undertrained. Underpaid staff tend to be more vulnerable to corrupt behaviour, a phenomenon observed particularly in the judiciary, police, prosecution, corrections and tax administration.\textsuperscript{110}

What this discourse sorely lacks, according to Frank Upham, is a detailed empirical analysis of case studies and empirical evidence from the history of development in a broad swath of both developed and developing nations as well as from legal reform projects of the last 50 years.\textsuperscript{111} As Upham bemoans, what one often finds in the place of a detailed analysis is “a series of assumed legal systems that seem to have emerged fully formed from the pages of a high school text on U.S. democracy, and not a very sophisticated text at that. Advocates of rule of law extrapolate from Weberian sociology and the imagined experiences of Western capitalism to the rest of the world.”\textsuperscript{112}

Unfortunately, acquiring knowledge about rule of law reforms is fraught with difficulties, and many aid organizations are simply not well suited to collect empirical data on their programs.\textsuperscript{113} Patrick McAuslan takes the lack of knowledge critique one step further. He contends that the problem with the current rule of law debate is not so much a lack of knowledge as an inability to reflect on the empirical data at hand which demonstrates that

\textsuperscript{110} Trebilcock and Daniels, Rule of Law Reform and Development: Charting the Fragile Path of Progress, 333.
\textsuperscript{111} Upham, "Mythmaking in the Rule of Law Orthodoxy," 8.
\textsuperscript{112} Ibid.
\textsuperscript{113} Carothers, "Promoting the Rule of Law Abroad: The Problem of Knowledge," 3.
legal reforms rest on three assumptions refuted by evidence: that development requires a modern legal framework as in the United States, that this model creates clear and predictable rules, and that this model can be easily transferred to the developing world.¹¹⁴

The problem of inadequate knowledge is further compounded, critics contend, by the fact that many “rule of law” advocates reference not the reality of law as it is practiced in developed countries but an idealized conception of Western legal systems.¹¹⁵ Law is often treated by the project for markets as little more than an invisible technology that can be analyzed to determine the best universal practices and then applied to achieve similar results in any context. Trubek and Galanter were critics of this approach in “Scholars in Self-Estrangement”. Although they were criticizing the justification for legal transplantation of the earlier L&D movement, their observations remain equally valid when discussing the project for markets. As Trubek and Galanter point out, law in Western societies rarely matches the idealized notion of our legal systems that “rule of law” theorists endorse. Many rules that compose the corpus juris in the United States, for example, find their origins not in a Platonic search for the ‘good’ but, as one might expect, in rules that were established to serve the ends of specific interest groups.¹¹⁶ In many Western countries the judiciary is also rife with rulings that violate the formalized notion of law in the name of specific political, economic or social justifications.¹¹⁷ As Upham observes the result of this idealization “is the quixotic quest for an impossible

¹¹⁷ Upham, "Mythmaking in the Rule of Law Orthodoxy," 5.
ideal where impoverished developing countries are expected to strive for a pristine rule of law that their developed counterparts have not achieved.”

The rule of law has also come under fire because some contend that it is difficult to craft effective policy, or conduct objective studies, based upon it because it lacks theoretical clarity. As Alvaro Santos observes, “the rule of law” essentially represents little more than a poorly defined agglomeration of concepts, interpretations and goals. Many scholars have even questioned the idea that a term as contested as the rule of law can ever find satisfactory definition. As Judith Shklar observes:

> It would not be very difficult to show that the phrase "the Rule of Law" has become meaningless thanks to ideological abuse and general over-use. It may well have become just another one of those self-congratulatory rhetorical devices that grace the public utterances of Anglo-American politicians. No intellectual effort need therefore be wasted on this bit of ruling-class chatter.

Definitional uncertainty naturally leads into another criticism of the Project for Markets: since there exists no satisfactory definition of the rule of law, critics contend, it makes it highly unlikely that development agencies will be able to effectively measure and study it with any great degree of certainty. Nevertheless the World Bank, for its part, seems to be confident in its ability to quantify the rule of law. Steve Radelet, of the Center for Global Development, a Washington think-tank, certainly thinks so. He believes there has been massive improvements in the World Bank’s measurement of the rule of law: “fifteen years ago, we didn’t talk about this stuff… ten years ago, there was no data,” but now the Worldwide Governance Indicators project is “one of the best kept

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118 Ibid: 8.
119 Santos, "The World Bank’s uses of the “rule of law” promise in economic development," 257.
secrets at the World Bank."\(^{121}\) World Bank governance projects essentially involve taking subjective measures of institutional quality and performance by means of polls or country surveys and then grouping them into the categories of: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption.\(^{122}\) This statistical information is then used to create a composite governance index by cross referencing governance data with more common development indicators such as the GDP or literacy rates.\(^{123}\) Based on the work of researchers associated with the World Bank, such as Daniel Kaufmann who is attempting to establish an empirical link between governance and economic growth, Dani Rodrik, Arvind Subramanian, and Francesco Trebbi argue that:

> The quality of institutions “trumps” everything else. Once institutions are controlled for, measures of geography have at best weak direct effects on incomes, although they have a strong indirect effect by influencing the quality of institutions. Similarly, once institutions are controlled for, trade is almost always insignificant, and often enters the income equation with the “wrong” (i.e., negative) sign, although trade too has a positive effect on institutional quality.\(^{124}\)

However, even Rodrik \textit{et al} have been forced to admit that while they believe there is a strong connection between effective institutions and economic growth, much remains unknown about their effective transplantation “on the ground”. This is perhaps unsurprising given the wide range of unexplained variation often displayed even in studies that find strong correlations between institutions and development.\(^{125}\) For instance, countries with weak governance indicators, such as Russia, China or Saudi

\(^{121}\) Quoted in "Order in the Jungle," \textit{The Economist} March 13, 2008.  
\(^{122}\) Trebilcock and Daniels, \textit{Rule of Law Reform and Development: Charting the Fragile Path of Progress}, 7.  
\(^{125}\) Trebilcock and Daniels, \textit{Rule of Law Reform and Development: Charting the Fragile Path of Progress}, 9.
Arabia, are still able to display high economic growth rates. This leaves open the question of how meaningful such subjective statistics actually are in accessing the rule of law’s connection to economic growth across countries and regions.

The Project for Markets has also come under attack for its close association with neoliberalism. This is notable because neoliberalism’s struggles not only encouraged development institutions, such as the World Bank, to delve deeper into the use of the rule of law, but these struggles also fueled some critics’ dissatisfaction with the Project for Markets. The 1990s witnessed a host of countries that adopted neoliberal policies experience mixed results, undesired side-effects or serious financial crises. This caused many critics to question some of neoliberalism’s most cherished maxims, such as its linear view of development, emphasis on export-led growth and support for deregulation and capital market liberalization. While critiques of neoliberalism have existed from its inception on the “left” many of these new critics of neoliberalism’s efficacy came from within organizations such as the World Bank and IMF. This general dissatisfaction with the outcome of many neoliberal policies in the 1990s led many to challenge some of its assertions regarding law and development.

One neoliberal maxim that was integral to the Project for Markets and has since come under scrutiny is the assumption that an efficient, pro-market legal order will attract foreign direct investment [FDI] and encourage economic development. The FDI argument is ultimately based on the assumption that foreign investors will behave ‘rationally’ and take all relevant information into account when making a decision and

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thus seek out a predictable institutional environment.\textsuperscript{128} However, practically, investors are incapable of doing this and are often operating in an uncertain context that taxes the “computational capacity of the human mind.”\textsuperscript{129} While there is seemingly no end to the persuasive and well reasoned arguments as to why FDI should be drawn to effective legal systems, as Amanda Perry points out, there is precious little empirical evidence in the vast literature on the subject to support this relationship and even several strong arguments that seem to challenge it. There is some anecdotal evidence to suggest that investors’ perception of a government’s credibility affects investment levels but it is not clear that an actual improvement of the legal system corresponds to this. It is far from certain that FDI will be absent if the ‘rule of law’ is not present.\textsuperscript{130} Some investors, such as East Asians, may actually prefer less formal environments for their investments.\textsuperscript{131} Pointing to recent studies of investment in ex-Communist countries in Eastern Europe, Carothers argues that a weak ‘rule of law’ will certainly factor in an investor’s decision but that it “is not a major factor in determining investment flows, and the more important causal relationship may be in the reverse direction: the presence of at least certain types of foreign investors may contribute to the development of the rule of law through their demands for legal reforms.”\textsuperscript{132} Some data seems to support the contention that investors do not necessarily regard the legal system of a nation as being terribly important.\textsuperscript{133}

While admittedly limited in scope, one survey of foreign investors in Sri Lanka found that investors had not conducted a detailed study of Sri Lanka’s legal system before

\textsuperscript{128} Perry, "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," 787.
\textsuperscript{129} Ibid, 787.
\textsuperscript{131} Perry, "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," 796-97.
\textsuperscript{133} Perry, "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence," 788.
investing there and even had they known of Sri Lanka’s legal inefficiencies, 86 percent of
respondents said they would still have invested in Sri Lanka. While this survey could
not poll companies that did not invest in Sri Lanka it still demonstrates the massive
uncertainties associated with the rule of law in development.

Excessive formalism is another characteristic of the Project for Markets that has
come under scrutiny. Many participants in the Project for Markets, like their L&D
predecessors, simply take for granted that the “state is the primary locus of social
control,” and that transplanted “rules both reflect the interests of the vast majority of
citizens and are normally internalized by them.” Such a view rests on the belief that
the law itself is an accurate guide to understanding the functioning of the rules which
govern society and that without formal laws efficient social relations are impossible.
However, an excessive emphasis on formalism ignores the extent to which informal rules
can be just as essential to economic efficiency as formal laws and just as legitimate. As
Robert Ellickson notes in *Order without Law*, informal laws can actually be essential for
people to survive the excessively formal rules that often govern economic life. Legal
systems, despite their many benefits, do not always succeed at reducing transaction costs
and can often increase them. Some studies examining a variety of instances, from
medieval Europe to modern Asia, have found that informal legal arrangements, based on
incentives from repeated dealings, are highly effective at ensuring compliance with
contracts. Some of these studies have even found that “the sudden introduction of a

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134 Ibid, 786.
135 Trubek and Galanter, "Scholars in Self-Estrangement: Reflections on the Crisis of Law and
formal mechanism to resolve legal disputes can disrupt informal mechanisms without providing offsetting gains.” 139 This is not to say that either formal or informal systems are necessarily superior, but rather that, again, much remains unknown about the actual effect of informal or formal systems and their connection to transaction costs and its effect on economic growth. Even Douglass North, an historian who is a vociferous supporter of the connection between property rights and economic growth, was forced to admit that:

Economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance. 140

Criticism has also been levelled against the Project for Markets for its aversion to politics. Despite the inherently political nature of neoliberal legal and market reforms, the Project for Market’s supporters have generally approached the rule of law in terms that essentially viewed the law as ‘good’ and politics as ‘bad’. 141 This proclivity is made worse by the fact that many members of the Project for Markets deployed the rule of law as a development strategy in and of itself. 142 In other words, assuming that once the government was ‘out of the way’ the economy would more or less take care of itself. The problem with such an approach, David Kennedy observes, is that while institutional functionality is clearly an important component of economic development this tells us

very little about what specific economic policy options to actually undertake.\footnote{David Kennedy, \textit{The Dark Sides of Virtue: reassessing international humanitarianism} (Princeton: Princeton University Press, 2004), 154.} Such an approach ignores both the complex technical side of development as well as the more political distributional choices that are involved in managing an economy. Ignoring politics is problematic for the Project for Markets because while its authors present market reforms in politically neutral terms their development strategy still makes highly politicized assumptions about how resources should be allocated in the economy, assumptions which can have profound distributive implications for a society.\footnote{Ibid, 150.} Indifference to distributional outcomes is particularly troubling for the Project for Markets given that the re-distribution of wealth towards society’s upper echelon has been a core feature of neoliberalism from its inception.

The Project for Markets has also been accused of ignoring many of the political contradictions involved in providing aid as development agencies are far from free of political entanglements. Some critics argue that the conditionality agreements which marked the era of structural adjustment from 1980-1994, and tended to fall out of favour thereafter, were simply replaced by the highly politicized concept of a “good policy environment” or the “rule of law” which became a major condition for receiving financial assistance from the World Bank.\footnote{Edwards, “Openess, Productivity and Growth: What do We Really Know?,” 409.} One of the consequence’s of this change of tack was the rising prominence in the 1990s of the Non-Governmental Organization [NGO] in the developing world.\footnote{Mike Davis, \textit{Planet of Slums} (New York: Verso, 2006), 75.} By the end of the twentieth century there were literally thousands of NGOs dependent on international donors across the developing world. However, as Jeremy Gould and Julia Ojanen argue, based on their study of poverty reduction in
Tanzania, the dominance of NGOs has not led to an ‘unleashing of civil society’ so much as it has created an ‘iron triangle’: a small but powerful group composed of key government ministries, transnational professionals and aid agencies. Since many donor agencies have less than effective oversight measures in place, Gould and Ojanen found that politico-administrative elites ‘on the ground’ could easily abuse their power over funds to enrich themselves and their associates. Furthermore, civil society’s actual demands were often crowded out by the superior organization of transnational development agencies.\footnote{Jeremy Gould and Julia Ojanen, "Merging in the Circle: The Politics of Tanzania’s Poverty Reduction Strategy," (Helsinki: 2003), 8.} This had the added side effect, some critics argue, that groups embracing a radical political agenda were sidelined or disarmed by their incorporation into the de-radicalized political framework of the NGO community. The turn towards the NGO thus represented, some contend, simply the creation of a traditional clientelist relationship between aid agencies and NGOs, amounting to little more than ‘soft-imperialism’ with NGOs captive to the agendas of international organizations.\footnote{Davis, \emph{Planet of Slums}, 76.}

In short, by the end of the twentieth century, the rule of law was ascendant in development assistance, particularly its neoliberal manifestation: the Project for Markets. This was a marked change from the rule of law’s status under embedded liberalism. But despite its widespread popularity there were mounting concerns from critics that after fifty years of development assistance very little was known about the rule of law. While the Project for Markets had come much farther than the L&D movement ever had, it still seemed to be resting on a foundation that was far from certain.
Chapter 2: Egypt’s Political Economy

While not receiving as much attention as the former Soviet Union or Latin America, owing to the absence of any profound economic or political liberalization during the 1980s and 1990s, the Middle East was still an area of interest for neoliberal rule of law reformers.\textsuperscript{149} Egypt was one state intimately involved with the Project for Markets from neoliberalism’s nascent beginnings, becoming the recipient of large amounts of Western, particularly American, aid from the 1970s on in exchange for negotiating peace with Israel and embarking on market oriented reforms. For neoliberals Egypt seemed to embody many of the problems they eagerly sought to reform: a massive state apparatus, fiscal indiscipline, and a dysfunctional institutional environment. However, Egypt also seems to provide a case in point that legal reforms alone might not be enough to bring prosperity to an economic system whose primary difficulty might be more political than technical in nature.

Following the Second World War, states across the Middle East entered a period of drastic reorganization.\textsuperscript{150} Newly independent governments undertook policies aimed at rapidly modernizing their economies and state structures. In pursuing these goals Middle Eastern governments were all faced, to varying degrees, with similar developmental challenges stemming from their colonial or semi-colonial past: weak state apparatuses, commodity dependent economies, predominantly unskilled workforces, massive social inequality, and a dangerous regional environment which necessitated large

\textsuperscript{149} Carothers, "The Rule-of-Law Revival," 11.

\textsuperscript{150} The Middle East is admittedly an amorphous and ill defined term. This study considers the Middle East to include the states of the Arab League (excluding Somalia and Mauritania) as well as Iran, Israel and Turkey.
military expenditures. While there was variation from case to case, most Middle Eastern nations chose to pursue a strategy of state-led development as their means to foster rapid economic growth. The state-led development model dominated the region from roughly the 1950s to the mid-1970s after which the consensus on the efficacy of the state-led economic model began to break down as many Middle Eastern economies faltered and states found themselves unable to bear the fiscal burden which this model entailed.151

From the mid-1970s on, many regimes began unevenly and cautiously to introduce economic reforms aimed at liberalizing their economies. In this context liberalization generally refers to reforms aimed at shrinking the public sector, curtailing subsidies and privatizing state-owned enterprises. Israel, Egypt, and Turkey were the most prominent states to start down this path in the 1970s and early 1980s. While the supposed aim of liberalization was to remove governments from “the commanding heights” of the national economy, in practice this rarely occurred. Most regimes in the region have retained control over state enterprises, avoided deregulation and have refused to drastically shrink the public sector. Such generalizations, however, must not be pushed too far as it is difficult to neatly summarize the region’s experience with liberalization.152 Egypt, for example, has dragged its heels for decades despite its highly publicized infitah, or economic opening, in 1974. Iraq only experienced substantive liberalizing reforms in

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151 This is certainly not meant to be an absolute indictment of state-led growth as a model for development as many countries in East Asia have been successful with this strategy. However, in the Middle East this model has not been able to deliver the desired results. Some states, such as Turkey and Israel, have had more success with this model than others but even they pursued liberalizing reforms in the latter quarter of the twentieth century. For more on a comparison between the East Asian and Middle Eastern models of state-led economic development see Byron Gangnes and Seiji Naya, "Why East Asian Economies Have Been Successful: Some Lessons for Other Developing Countries," in Economic Transition in the Middle East: Global Challenges and Adjustment Strategies, ed. Heba Handoussa (Cairo: The American University in Cairo Press, 1997).

2003 as a result of US occupation, and Syria has yet to undertake any serious economic restructuring.¹⁵³

The first developmental moment in the Middle East ran from roughly the early 1950s to the mid-1970s. During this period many Middle Eastern states chose to develop along socialist lines: Egypt in 1957-1974, Algeria in 1962-1989, Syria from 1963 to the present, Iraq in 1963-2003, Tunisia in 1962-1969, the Sudan in 1969-1972 and Libya from 1969 to the present.¹⁵⁴ Even conservative states, such as Jordan and Saudi Arabia, which claimed to pursue a more “capitalist” road to development, still ended up heavily involved in their economies in the post-war decades.¹⁵⁵ Consequently many of the region’s regimes shared a similar outlook in terms of their approach to development regardless of their avowed ideological stance. This study will therefore use state-led development as a generic phrase to refer to the various attempts at Arab socialism or state capitalism undertaken by the region’s governments at this time.

In terms of organization, planners in this period often created economic structures which mimicked characteristics of embedded liberalism in the West such as state-owned enterprises and price controls.¹⁵⁶ In the Middle East these economic policies were also profoundly enmeshed in political and cultural issues such as nationalism, anti-imperialism and populist politics.¹⁵⁷ One assumption underlying many of this period’s

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¹⁵³ Iraq under Saddam Hussein did attempt to encourage the private sector from 1987-1990 but the impact of these reforms were limited and their ultimate outcome is hard to access as the reforms were cut short by the First Gulf War and the strict international sanctions which followed.
¹⁵⁶ Ayubi, *Over-Stating the Arab State: Politics and Society in the Middle East*, 291.
experiments with state-led growth was that profitability should not be the main criteria for measuring the performance of individual public sector enterprises. Instead, it was thought more important by government planners that public sector enterprises fulfill aims such as fostering social justice, promoting full employment, and producing cheap consumer goods. Such thinking generally assumed that the “forces” of supply and demand should be subordinated to government administered prices, and governments found nothing inherently wrong with state monopolies in certain sectors of the economy. For the most part, Middle Eastern governments during this period distrusted both the domestic private sector and foreign investment due to their past association with European imperialism. Both became victims of tight regulation, persecution or outright nationalization. Industry was also generally favoured over agriculture, as industrialization was believed to reduce import dependence. Thus, many of the region’s states adopted an industrial development strategy centered around import substitution in the 1950s and 1960s.

While the ideological proclivities of regimes differed, few government planners in the Middle East during this period disagreed that the state should be the primary agent in guiding the transformation of society. The general consensus that existed on the issue of state direction of the economy rested on several shared historical circumstances and beliefs. Middle Eastern governments were all faced, some more so than others, with the herculean task of lifting their nations out of poverty and overcoming decades, even

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centuries, of humiliation at the hands of European powers. It was accepted that this task would require a massive and efficient mobilization of resources, a mobilization which many planners felt only the government could effectively manage. This view was reinforced by the perceived failure of the private sector to advance national economic independence in many states during the inter-war years, and its complicity in the colonial enterprise.\footnote{Owen, \textit{State, Power and Politics in the Making of the Modern Middle East}, 23.}

After the Second World War Middle Eastern states went through a period of rapid growth both in terms of the size and number of functions carried out by their bureaucracies. This expansion was necessary not only so that ruling parties could exercise greater control over their national economies but so they could provide a wide range of new social services to their populations, such as national health and education programs.\footnote{Ibid, 25.} Military expansion and modernization also necessitated massive state expenditures. A study by Yusif Sayigh quantifying the growth which occurred during this period paints a dramatic portrait of the scale of state expansion. For the eight countries for which figures were available Sayigh found a steep rise in government expenditures in Arab states between 1930 and 1980. At the minimum he found the budget to be more than 40 times larger in 1980 than it had been in 1930 and at the high end he found it to be 2,400 times larger.\footnote{Ayubi, \textit{Over-States the Arab State: Politics and Society in the Middle East}, 292.} The growth in the size of the state was accompanied by the expansion of the public sector. For example, in most Middle Eastern states prior to the 1940s public ownership was generally confined to utilities and irrigation. By the 1960s the public sector in Egypt, Iraq and Syria came to dominate in

\textit{\[\text{References}\]}

\begin{itemize}
\item Owen, \textit{State, Power and Politics in the Making of the Modern Middle East}, 23.
\item Ibid, 25.
\item Ayubi, \textit{Over-Stating the Arab State: Politics and Society in the Middle East}, 292.
\end{itemize}
all areas of the economy outside agriculture. However, this pattern was not only the case in ‘socialist’ experiments. Saudi Arabia and Iran, two very conservative, ‘capitalist’, and oil-rich nations, both developed public sectors of similar size and function to those of ‘socialist’ states.

In terms of results, state-led development in the Middle East achieved some impressive short-term GDP growth rates as well as an impressive extension of social services (even before the oil boom of the 1970s is taken into account). However, while being mindful of the region’s many disadvantages - such as high population growth, heavy defense expenditures, limited resources save oil, initially low literacy rates and political instability - many scholars still consider these state-led experiments a failure. The goals of social justice and national economic independence, the ultimate aim of state-led development, remained elusive. Part of the problem was that public industries established in this period were rarely internationally competitive and domestic price distortions led to massive misallocations of resources. The often conflicting economic and political goals of state enterprises meant that there was little incentive for managers to reduce costs, especially in terms of excess labour which could lead to huge cost overruns. In these circumstances many countries in the region accumulated massive foreign debts in attempts to prop-up failing state enterprises with loans during this period. Unemployment also remained a serious problem for many Middle Eastern countries and equity gains were often attained at the cost of great inefficiency. This was certainly so in the case of expensive consumer subsidy programs or the swollen rolls of public sector

164 Ibid.
165 Issawi, "De-Industrialization and Re-Industrialization in the Middle East since 1800," 477.
166 Richards and Waterbury, A Political Economy of the Middle East, 206.
employees. Attempts at import substitution were also detrimental for many economies in the region. Far from discouraging import dependence, it forced many states to import intermediate goods that they could not produce themselves simply to sustain their domestic industries, further exacerbating their fiscal woes.

In the mid-1970s, as their fiscal situations became increasingly dire, Middle Eastern countries were forced to grapple with the idea of abandoning the state-led model, dismantling their sizeable public sectors and reversing social entitlement schemes. Major impetus for these reforms came from the West. As embedded liberalism lost ground to the emerging philosophy of neoliberalism, international institutions such as the World Bank and IMF, multinational corporations and domestic elites in the Middle East all began encouraging Middle Eastern governments to “liberalize” their economies. Thus, liberalization was spurred domestically by the fiscal crisis of the state and internationally by the rise of the ‘Washington Consensus’ or neoliberalism. Roger Owen argues that this shift was also encouraged in the 1970s by changes in the regional environment which witnessed the rising economic power of Saudi Arabia and the United States as well as the declining fortunes of Egypt. The latter having been a powerful proponent of state-led development in the region and the developing world generally, Egypt’s sagging economy did little to recommend such economic policies. For most regimes in the Middle East, undertaking liberalizing reforms generally meant reducing government spending, shifting investment resources from the urban to rural sector, and from the public to private sector, as well as a move away from a planned economy

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167 Ibid, 208.
169 Ayubi, Over-Stating the Arab State: Politics and Society in the Middle East, 385.
towards one where social goals would have to be sacrificed for efficiency. The shift away from the public sector was driven by neoliberal’s general belief that public enterprises were less efficient than private ones, since efficiency was thought to grow with competition.¹⁷¹

Yet, there was little public enthusiasm for structural economic reforms - quite the opposite. Planners at the World Bank and IMF were disappointed in their hope that the failure of left wing policies in the Middle East would signal an embrace of the free market by the region’s inhabitants. Liberalization was, in the words of Nazih Ayubi, “mainly a public policy, carried out in response to the ‘fiscal crisis of the state’ and under pressure/temptation from globalized capitalism and from its international institutions.”¹⁷²

Much as in the nineteenth century, the Middle East found itself intellectually dependent on the West, forced to rely on Western “experts” to liberalize their economies.¹⁷³ Far from embracing free market economics, many in the Middle East viewed the failure of socialist development as part of the call for a return to Islam.¹⁷⁴ Since few Middle Eastern states had been able to peacefully incorporate Islamists into their existing political systems, many Middle Eastern states faced a significant upsurge in violent political opposition during the 1970s, 1980s and 1990s.¹⁷⁵ Two notable examples of this

¹⁷² Ibid, 329.
¹⁷³ Ibid, 332.
¹⁷⁴ Carrie Rosefsky Wickham, *Mobilizing Islam: religion, activism, and political change in Egypt* (New York: Columbia University Press, 2002), 33-35. While grievances with the economic failures of authoritarian states played a major role in Islamist resistance in the Middle East, Wickham points out in her work on Egypt that Islamism should not simply be understood as being solely motivated by political and economic grievances. Part of Islamism’s strength as a political movement in Egypt, she concludes, is that it has been able to not only provide a vehicle for the articulation of grievances but that it has been able to create new political demands and motivations for mobilization.
¹⁷⁵ For more on the rise and fall of militant Islam see Gilles Kepel, *Jihad: the Trail of Political Islam* (Cambridge: Harvard University Press, 2002), ———, *The War for Muslim Minds: Islam and the West* (Cambridge: The Belknap Press of Harvard University Press, 2004). For more on how the barbaric repression suffered by members of the Muslim Brotherhood, such as Sayyid Qutb, under Nasser...
were Egypt and Algeria. Both states had embraced a socialist path to development, during the 1950s and 1960s respectively, but both had failed by the 1970s and 1980s to deliver the economic and social gains the regimes promised their populations. Egypt, for example, faced a terrorist campaign aimed at destabilizing the regime, resulting most notably in Anwar Sadat’s assassination in October of 1981 and the Luxor massacre of 1997 in which more than 50 tourists were executed by militant Islamists. Algeria, on the other hand, fought a brutal civil war against Islamist insurgents after the FLN’s generals refused to accept the victory of the Islamic Salvation Front [FIS] in the first round of elections in late 1991.176

While the 1970s witnessed both a serious fiscal crisis for many Middle Eastern states and a growing sense of empowerment for political Islam, they also witnessed a boom in world oil prices which created a massive monetary windfall for many oil producing states in the Gulf. Non-Oil producing countries in the region, including Egypt, which had large numbers of expatriate workers sending cash home from the Gulf also benefited from this boom. This infusion of capital had the effect of allowing many governments in the region to delay or postpone painful structural economic reforms. But this state of affairs was not to last. When oil prices collapsed in the early-1980s many states found themselves facing a massive reduction in oil-rents which meant they were no longer be able to conceal their fiscal woes.177 However, after almost 30 years of state intervention in the economy, powerful bureaucratic and political interests hampered

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177 Wickham, Mobilizing Islam: religion, activism, and political change in Egypt, 41. Richards and Waterbury, A Political Economy of the Middle East, 220.
attempts to diminish the role of the state in economic activities, making substantive reform difficult. In the 1990s the state remained the largest employer in the region, and public employment, was higher in the 1990s than the 1980s as a percentage of the labour force.  

As a case study, Egypt exemplifies many of the aforementioned trends in the Middle East’s economic and political development in the latter half of the twentieth century. Egypt was both on the leading edge of the 1950s movement towards “Arab socialism” and at the forefront of developing nations hesitantly liberalizing in the 1970s. As the most populous and arguably most influential Arab state in the region, its development powerfully influenced the choices of many of its neighbours.

After the Second World War Egypt had been the first state in the Middle East to adopt a policy of state-led economic development. This occurred under the direction of the Free Officers Movement, a group of military officers who seized power from King Faruk in July 1952. The officers, and their socialist and Islamist allies, were incensed by many of the Monarchy’s failings including Egypt’s economic mismanagement, parliamentary corruption, the lingering British imperial presence and defeat at Israeli hands. However, Egypt’s economic woes were a central reason for the Free Officers’ seizure of power. Despite the centrality of economics to their ruling platform the Revolutionary Command Council [RCC], the Free Officers’ Executive Committee, had very little to offer upon assuming power in the way of a clear economic policy other than

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an opposition to ‘feudalism’ and a commitment to ‘social justice’. Consequently the RCC’s drift towards a “socialist” economy under the leadership of Gamal Nasser was a gradual one over the course of the 1950s and 1960s. During this period the Egyptian state became highly centralized and its powers increasingly expansive. The state’s central role in development was reinforced by the so-called “Nasserite social contract” by which the government provided goods and services as well as increased opportunities for employment, education and social mobility in exchange for an acceptance of authoritarian rule on the part of the Egyptian populace.

In the early period of Nasser’s rule, 1952-1956, Egypt’s revolutionary government encouraged the growth of the public sector, but the government did so out of a desire to assist the private sector or, as in the case of the Aswan Dam, to undertake projects that the private sector was thought unable to handle. This changed after the Suez War of 1956 as the public sector was increasingly to expand at the expense of the private sector. The late 1950s witnessed a host of nationalizations of both foreign and domestic holdings. By the 1960s the failure of the private sector to meet the regime’s developmental expectations led to a wave of nationalizations in 1961. As Richards and Waterbury observe, “in one fell swoop, the Egyptian state took over most large-scale industry, all banking, insurance, and foreign trade, all utilities, marine transport, and airlines, and many hotels and department stores,” although most agricultural property remained privately owned. The 1960s then witnessed the flight of much of Egypt’s

184 Ibid, 183. In the financial sector one notable nationalization in 1960 was that of the privately owned Bank Misr founded by the Egyptian industrialist Talaat Harb in 1920.
European, khedivial and domestic business communities as a consequence of Nasser’s mass expropriations of private property.\textsuperscript{185} One of the main problems stemming from this exodus was that it left Egypt without an experienced capitalist class. Instead Egypt’s economy came to be dominated by inexperienced managers who were weak and heavily dependent upon the regime’s patronage for survival.\textsuperscript{186}

Prior to the Revolution of 1952 the Egyptian state had been very limited in size and scope. Under the rule of Muhammad Ali, his successors, and subsequently British colonial administrators, the Egyptian state only witnessed growth in the realms of finance (tax collection) and irrigation (ensuring the cotton harvest).\textsuperscript{187} It was not until the time of Nasser that the state rapidly expanded. This growth was essential to Nasser’s schemes for economic development, as many of his social and economic goals were heavily reliant on an interventionist state apparatus.\textsuperscript{188} Bureaucratic expansion under Nasser was also driven by the regime’s political concern with maintaining full employment. One particularly significant decision in this regard, aimed in part at co-opting the educated middle class, was Nasser’s 1964 promise of state employment to every university graduate. This drastically increased the size and cost of maintaining the civil service.\textsuperscript{189} Thus, much of the bureaucracy’s quantitative growth occurred in the 1960s and far outstripped the Egyptian economy’s ability to support it. Ayubi observes that:

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The most notable changes followed the beginning of the sixties, and can be summarized thus: from 1962/63 to 1969/70 the national income of Egypt increased by 68 per cent, resting on an increase in the labour force of no more than 20 per cent. Yet at the same time, posts in the public bureaucracy had
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\textsuperscript{185} Clement and Springborg, \textit{Globalization and the Politics of Development in the Middle East}, 23.
\textsuperscript{186} Ibid, 138-39.
\textsuperscript{189} Wickham, \textit{Mobilizing Islam: religion, activism, and political change in Egypt}, 24.
increased by 70 per cent, and salaries by 123 per cent. Thus far, the rate of bureaucratic growth had quite exceeded the rate of growth in population, employment and production.\(^{190}\)

After the revolution the Egyptian bureaucracy came to be plagued by serious issues of underperformance. While far from perfect in the monarchical period, Egypt’s bureaucratic performance underwent a marked decline in the revolutionary era as it expanded faster than the regime was able to effectively manage or support it.\(^{191}\) By the 1970s, these trends of bureaucratic inflation combined with qualitative decline had come to produce a severely dysfunctional civil service.\(^{192}\) State administration was plagued by massive amounts of red-tape, poorly designed work-flow, inadequate office space and equipment as well as mass absenteeism. For example, one study from the early 1980s estimated that an average Egyptian civil servant “worked” between 20 minutes and 2 hours a day.\(^{193}\)

Public sector enterprises also faced serious difficulties under Nasser. Few state enterprises established under his rule were profitable, and their employment rolls were padded. As a result the regime had to run massive deficits to keep these enterprises afloat and maintain its patron-client relationships.\(^{194}\) The excess labour dumped on state companies took a serious toll on economic efficiency. Since many of these companies were already protected by government tariffs, there was little incentive for managers to

\[^{190}\text{Nazih Ayubi, "Withered Socialism or Whether Socialism? The Radical Arab States as Populist-Corporatist Regimes," Third World Quarterly: 13, no. 1 (1992): 286-88.}\]
\[^{192}\text{Ayubi, "Withered Socialism or Whether Socialism? The Radical Arab States as Populist-Corporatist Regimes," 286.}\]
\[^{193}\text{———, "Bureaucratic Inflation and Administrative Inefficiency: The Deadlock in Egyptian Administration," 293.}\]
\[^{194}\text{Richards and Waterbury, A Political Economy of the Middle East, 184.}\]
protest. Waterbury argues that most of these enterprises were run as political vehicles for the regime and consequently they suffered from malaise, poorly administered pricing and idle capacity. Efficiency was also harmed by the patronage function served by the public sector. Clement and Springborg argue that Nasser’s Arab socialism was underpinned by a class of public-sector crony managers with minimal business experience, who supported the regime but helped create a deeply dysfunctional commercial and financial system.

Perhaps the most serious factor harming Nasser’s development schemes was Egypt’s inability to earn foreign exchange and hence pay for his expanding state apparatus. Nasser’s Egypt became heavily dependent on the Soviet Union for aid. To service its debt stemming from this aid Egypt was forced to barter raw materials with the Eastern Bloc. However, Egypt’s positive trade balance with the East was offset by its negative trade balance with the West which drove Egypt deeply into debt. The difficulty that Egypt faced was that its new industries offset imports of one kind, finished industrial goods, with the need for intermediate goods to support them, for which it was forced to turn to the West. Unlike oil producing states such as Iraq, for example, Egypt was unable to make up for this situation with foreign exchange generated from oil sales. With Egyptian exports flagging or struggling to find markets and with domestic savings and investment at very low levels the Egyptian state was forced to borrow so heavily that in 1962 and again in 1965 it was faced with serious payment crises. This has been a

195 Waterbury, The Egypt of Nasser and Sadat: the Political Economy of Two Regimes, 93.
197 Clement and Springborg, Globalization and the Politics of Development in the Middle East, 139.
198 Richards and Waterbury, A Political Economy of the Middle East, 183.
200 Waterbury, The Egypt of Nasser and Sadat: the Political Economy of Two Regimes, 93.
persistent problem throughout Egypt’s post-revolutionary era: even during the oil boom, growth in state expenditure exceeded that of revenues, causing a massive growth in the national debt.201

By the beginning of the Second Five-Year Plan in 1965, Egypt was forced to borrow heavily from abroad to sustain its economic development. It was not very successful, even with the assistance of the Soviet Union. The Egyptian state thus faced an increasing domestic and external fiscal crisis. The Second Five-Year Plan eventually had to be abandoned as a result of lack of financing. With the War of 1967 Egypt lost both the Sinai Peninsula to Israel, costing Egypt its oil fields, and control of Suez traffic; without these Egypt entered recession. Though Nasser did not attempt to reform Egypt’s socialist economic system prior to his death in 1970, it had become clear by that time that Egypt’s socialist experiment had come to an end. The state’s fiscal troubles forced Nasser to put his future plans for a socialist Egypt on hold in his last years. While the Egyptian economy did experience sizeable growth under Nasser, this growth was mostly the result of production increases and the inflation of public sector payrolls, neither of which proved sustainable.202

After the death of Nasser in 1970, Anwar Sadat assumed the presidency. In 1974 Sadat adopted a course of economic liberalization, known as infitah, which sought to streamline the public sector, attract foreign capital, and promote exports.203 To this end, Sadat reengaged with Western powers and shifted away from the Soviet Union in his search for credit, technical and diplomatic assistance. As Ayubi explains, infitah meant

201 Wickham, Mobilizing Islam: religion, activism, and political change in Egypt, 38.
202 Waterbury, The Egypt of Nasser and Sadat: the Political Economy of Two Regimes, 89.
that the public sector was to be slowly weaned from the ‘commanding heights’ of the economy as private capital was allowed to penetrate the areas of finance, industry and foreign trade. Comprehensive national planning was to be abandoned freeing the public sector from many of the political considerations which had previously circumscribed its behaviour. However, the continuities between Nasser’s and Sadat’s regimes were far more than their differences. Under Sadat Egypt’s expensive social welfare programs, bloated bureaucracy and poorly run state enterprises continued to be paid for with deficit financing and external aid. These problems were combined with continued microeconomic price distortions of products and a regulatory system that was cumbersome, arbitrarily enforced and lacking in transparency.

Foreign planning models played an important role in guiding infitah’s policies. Sadat’s economic program was initially quite vague and there was no elite consensus on precisely which policies should be pursued. During the 1970s Egypt faced serious pressure from its international creditors who forced Sadat to accept foreign oversight if he wished to receive foreign credit. The year 1974 witnessed a stream of powerful foreigners visiting Egypt to influence policy; for example David Rockefeller (chairman of the Chase Manhattan Bank), Robert McNamara (president of the World Bank) and William Simon (United States Secretary of the Treasury), all visited Cairo for meetings with Sadat and other Egyptian government officials. In the words of Mr. Rockefeller:

I think that Egypt has come to realize that socialism and extreme Arab nationalism… have not helped the lot of the 37 million people they have in Egypt.

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204 Ayubi, *Over-Stating the Arab State: Politics and Society in the Middle East*, 342.
And if President Sadat wants to help them, he has got to look to private enterprise and to assistance.\textsuperscript{208}

Egypt’s creditors, such as the United States and Saudi Arabia, as well as international financial institutions, particularly the International Monetary Fund, played an important role in guiding Egyptian policy in the mid-1970s. New policies included opening markets to foreign capital by decentralizing or dismantling the public sector, devaluing the currency, and reducing subsidies. Many of these policies, particularly subsidy reduction, were to cause a great deal of dissension within Egypt and it was not until 1976 that Sadat finally bowed to the pressure of his foreign financiers and slashed government subsidies on a variety of commodities. In January 1977 this precipitated a massive uprising by hundreds of thousands of working class Egyptians hardest hit by reductions in consumer subsidies on basic food stuffs. The riots concluded when the state restored the subsidies.

During \textit{infitah} (1974-1981) Egypt experienced its best real growth of the twentieth century. From 1974 to 1982 Egypt’s GDP grew at 9.1% per annum on average.\textsuperscript{209} This was primarily driven by petroleum exports, Suez canal revenues, workers’ remittances and tourism. Oil exports grew at 45% per annum over this period while the other sources grew at about 12%.\textsuperscript{210} This meant that by 1983 these four sources of income were worth US $7.5 billion, up from $600 million in 1974.\textsuperscript{211} Despite the foreign capital pouring into the coffers of the Egyptian government the state’s fiscal situation became increasingly dire under \textit{infitah}. As John Waterbury observers:

\begin{itemize}
  \item \textsuperscript{208} Ibid: 413.
  \item \textsuperscript{209} Waterbury, "The “Soft State” and the Open Door: Egypt’s Experience with Economic Liberalization, 1974-1984," 73.
  \item \textsuperscript{210} Ibid.
  \item \textsuperscript{211} Ibid.
\end{itemize}
Under Nasser there was redistribution of income in favor of the rural and urban lower middle classes while the upper bourgeois paid for the redistribution and the middle classes found their consumerist proclivities thwarted. In the early 1970s, under Sadat, everyone was allowed to consume. While levels of production remained low, the *laisser aller* of the new Egypt could be paid for only by foreign credits and deficit financing.\(^{212}\)

Consequently Egypt’s foreign debt, which was under 3 billion dollars in 1973, was close to $22 billion in 1982.\(^ {213}\) By the mid-1980s Egypt was crippled by over $38 billion of foreign debt requiring a debt service of $4 billion per year.\(^ {214}\)

*Infitah’s* inability to foster substantive reform meant that by the late 1970s Egypt became even more dependent on foreign aid and investment for its economic survival than it had been at the beginning of the program in 1974. Even with its high deficit Egypt was able to postpone reform during the 1970s and 1980s as high oil-rents and strategic rents (especially dividends from peace with Israel) in the form of aid from the US, EEC and international aid agencies such the IMF and World Bank, allowed Egypt to procrastinate or abandon earlier reforms altogether. Rather than using the new found foreign exchange on a long term basis to ease the structural adjustment program, as attempted in 1976 and abandoned in 1977, it was used for increased consumption and subsidies. By the mid-1980s, when the bottom fell out of the oil market, Egypt was in poor economic shape. Foreign remittances fell to a trickle and a series of terrorist attacks caused a marked decline in tourist revenue. The cost of oil revenues, Suez canal tolls and worker remittances on which the state had relied to sustain the national economy were all in decline during the 1980s.\(^ {215}\) It was at this moment that the extent to which the benefits

\(^{212}\) ___, *The Egypt of Nasser and Sadat: the Political Economy of Two Regimes*, 113.


enjoyed by the working class under infitah were solely attributable to external sources became acutely apparent.\textsuperscript{216}

Infitah, a policy associated closely with Sadat, came to an official end after his assassination at the hands of Islamist militants in 1981. Sadat’s successor, Hosni Mubarak (who was standing mere feet from Sadat during his assassination and was extremely fortunate to have survived the hail of bullets), faced an economic situation in the 1980s that was becoming increasingly desperate, such that by the late 1980s Egyptian growth had turned negative and by the beginning of the First Gulf War in 1991 the Egyptian economy was in ruins. As of 1990 Egypt had an international debt of US $50 billion and its debt to GNP ratio of 150% was perhaps the highest in the world.\textsuperscript{217} Egyptian wages plummeted and unemployment soared.\textsuperscript{218} Richards and Waterbury argue that at the core of this macroeconomic crisis were three major imbalances in the Egyptian economy: gaps between domestic savings and investment, between imports and exports, and between government revenues and spending.\textsuperscript{219} Collapsing oil revenues combined with the losses of public sector companies to harm public savings, while private savings were undermined by negative real interest rates on Egyptian deposits and by great uncertainty on the part of potential investors as to the credibility of macro-economic policy.\textsuperscript{220}


\textsuperscript{217} Richards and Waterbury, \textit{A Political Economy of the Middle East}, 225.

\textsuperscript{218} Abdalla, "Mubarak's Gamble," 19.

\textsuperscript{219} Richards and Waterbury, \textit{A Political Economy of the Middle East}, 225.

\textsuperscript{220} Egypt’s public sector in the 1990s included a wide array of different entities and activities. These included the central government, service authorities, economic authorities, roughly 314 nonfinancial public companies governed by Law 203, the banking sector, the insurance sector, the public pension fund, social security systems, and the National Investment Bank. For more on the composition and operation of the Egyptian public sector during the 1990s see "Egypt: Beyond Stabilization, Toward a Dynamic Market
Only Egypt’s ability to reap strategic rents, in the end, saved its economy from total collapse. Mubarak successfully secured $25 billion in debt relief in return for supporting the US in the First Gulf War (the United States being one of Egypt’s major creditors). Still, with this debt forgiveness came the imposition of a massive IMF structural adjustment package which included fiscal reform, trade liberalization and privatization of financial and real goods. Debt relief and banking reforms were central to this package. The banking reforms advocated by the IMF were quite successful at encouraging Egyptians to convert dollar holdings into Egyptian pounds a move that helped to create a current account surplus. Fiscal discipline and a tight monetary policy cut inflation from 25% in 1990 to 8% in 1994. By 1998 Egypt’s debt service was only 9% of exports. However, the relative success of many of Egypt’s banking and fiscal reforms removed some of the pressure on the regime to reform in other areas. So, while the debt was relieved and the budget cut, a heavy negative balance of trade remained. While the state did privatize 119 of 314 state-owned enterprises between 1993 and 1999, this generally took the form of sales to regime cronies or consisted of phony privatizations in which the state remained the largest shareholder, thus keeping the businesses firmly under the regime’s control. As Timothy Mitchell observed of the

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221 Clement and Springborg, *Globalization and the Politics of Development in the Middle East*, 140.
222 A country’s balance of payments records all debit and credit transactions with foreign countries and international institutions. The balance of payments is composed of the current account and the capital account. The current account includes all transactions relating to a country’s current expenditures and national income. The capital account is composed of all transactions related to in-flows and out-flows of financial capital. For a general background on the international political economy see Theodore Cohn, *Global Political Economy: Theory and Practice* (New York: Addison Wesley Longman, 2000).
aggressive privatizations of 1996, they were “not a switch from state-run enterprise to a
reborn private sector. It was a complicated adjustment of existing relations between
public-sector business barons and their partners in the private sector.”

Since 1991, Egypt’s economic reforms have thus been a slow process in line with
Mubarak’s gradualist approach to politics and economics. The regime has opted to
publicly reject calls for structural reforms while quietly pursuing them; to do otherwise
was viewed as too politically dangerous by a regime whose revolutionary legitimacy has
long since been eroded. Consequently, Egypt’s stabilization in the 1990s progressed
quite well, but the regime successfully managed to retain a stranglehold over economic
life.

In fact, under Mubarak the Egyptian military has, with the help of American aid,
expanded its role in the economy to control large interests in the manufacturing,
agriculture and construction industries as well as retail stores and even hotels. The
military’s dominance of the economy is essential to the regime’s survival as it ensures
Mubarak has the power to provide largesse to its members as well as perks like stylish
condos in suburban Cairo and membership in posh officers’ clubs. Simply no other
profession in Egypt enjoys the massive level of regime favouritism that Egypt’s officers
do. The economic dominance of Egypt’s officer class is decried by many Egyptian
business people who claim that competing with firms controlled by the military is both

227 Harik, Economic Policy Reform in Egypt, 22, 199.
228 Richards and Waterbury, A Political Economy of the Middle East, 216.
229 Ibid, 228.
difficult and dangerous. To even publicly discuss the military’s control of economic life in Egypt risks brutal reprisals as Egyptian journalists who have dared to write about the topic quickly discover.

Thus, for Mubarak’s regime fear of losing power meant deficit spending and continued foreign borrowing to preserve the status quo. To a great extent this has been equally true for all the regimes examined in this chapter: under Nasser, Sadat and Mubarak, regime survival has been the ultimate measure by which policies were judged. Herein, Clement and Springborg argue, lies the explanation for Egypt’s poor economic performance and the government’s unwillingness to liberalize: elite resistance. The power of Egypt’s rulers, particularly Sadat and Mubarak who lacked Nasser’s popular legitimacy, rests primarily on the institutional power conferred by control of the military, state and party apparatus. The consequence of this is that neither Sadat’s nor Mubarak’s regimes have been willing to reform failing state enterprises or the bloated civil service. In the words of Richards and Waterbury “the economic risks of inefficient public sector enterprise may not outweigh the political risks of giving up the leverage over resources and people that public enterprise provides.” Or as Harik observes, radical economic reform in Egypt seems unlikely unless Mubarak and his NDP are removed from power.

232 Ibid.
236 Ibid, 135.
Chapter 3: Two Views on Informal Housing in Cairo

It was in the context of the rise of neoliberalism in the West and the reorganization of the Egyptian state and economy that the Project for Markets first arrived in Egypt in the form of development assistance programs designed by the World Bank, IMF and USAID. While the importance of clear, legible property rights to economic growth had been a vital component of the Project for Markets since its beginnings, one author who played a central role in popularizing property formalization schemes in the framework of development assistance was Hernando de Soto. De Soto’s *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (2000), elaborated on an earlier work *The Other Path: the Invisible Revolution in the Third World* (1986); both were highly effective in getting out the new message. These works examined the ‘informal sector’ and the detrimental effect of high transaction costs on economic growth in developing countries. Since the publication of these two works, de Soto’s star has been ascendant: he courts and is courted by presidents and dictators alike. De Soto has been covered in a host of prominent publications: *The Financial Times, The Economist, Fortune, Business Week, Forbes, The Wall Street Journal, The New York Times, The Washington Post, and The Los Angeles Times* and has received the praise of Ronald Reagan, George H.W. Bush., Milton Friedman, Margaret Thatcher and Bill Clinton.239 At the 2004 World Economic Forum, Bill Clinton even referred to de Soto as “probably the world's most important living economist.”240

The Mystery of Capital has become one of the most cited Latin American economic studies on development in decades, and Hernando de Soto’s Institute for Liberty and Democracy [ILD], based in Peru, has been ranked among the most influential think tanks in the world by The Economist. 241 De Soto’s greatest acclaim has come from USAID, the international financial community and from conservative groups in the United States. 242 Yet de Soto was far from the originator of the concept of informality nor was his Institute for Liberty and Democracy the only organization researching informality in the developing world. However, his role in the informality debate is still worthy of examination primarily because de Soto was and is a major celebrity and a vociferous advocate for property formalization schemes in the developing world. 243 He is also worthy of examination because his arguments are indicative of many of the Project for Markets’ general assumptions about the functioning of informal property markets. However, an examination of his work on Cairo also reveals how his arguments exemplify many of the Project for Markets’ shortcomings. One particularly useful source which provides a basis with which to question de Soto’s work is furnished by USAID’s Informal Housing in Egypt [IHE] survey of 1980. The IHE survey delivers a far different picture of the functioning of informal housing in Cairo than de Soto’s The Mystery of Capital does and in so doing provides a useful starting point for a more general critique of de Soto’s work.


While de Soto is credited with playing a central role in popularizing the idea of informality during the 1980s and 1990s, he was not the originator of the concept. Conceptually the dualistic model of economic life implicit in the notion of informality has its roots in a long tradition of political economic literature, dating back to the European enlightenment, dealing with the subject of complex urban societies. The direct antecedents of the contemporary debate on informality can be traced to the immediate post-war period when the ground-work for a general theoretical approach to informality was formed. A seminal article in this regard was J.H. Boeke’s *Economics and Economic Policy of Dual Societies as Exemplified by Indonesia* (1953) in which the author introduced the concept of the ‘dual economy’ when he posited a distinction between the capitalist Dutch colonial economy and the more “traditional” sectors of economic life in Indonesia. In the 1970s this general approach to thinking about development, which viewed the economy as bifurcated between the “traditional” and the “modern”, received a new lease on life with the assertion that the capitalist economy was surrounded by a clearly delineated non-capitalist and non-market realm of economic activity.

This new-lease on life is widely seen as having come from two studies, one by Keith Hart, an anthropologist studying Ghana, and the other by the International Labour

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244 “Getting it right on the money,” *The Economist* April 3rd 2008.
Both studies researched employment patterns in urban Africa during the 1970s. They concluded that most people working in Accra and Nairobi managed to make a living by a variety of economic activities that fell into what was termed the “informal sector”, defined as economic activity that took place outside the view of official employment data. The interest in informality sparked by the simultaneous publication of these two articles was in part driven by the desire of researchers to find new approaches to the question of economic development, primarily because of the perceived failure of the large-scale industrial-development strategies that had been previously promoted in the developing world. Almost immediately the concept of informality had a powerful impact on development theory and was incorporated into the research of various United Nations organizations including the World Bank & IMF as well as that of USAID and many of the world’s other foreign aid organizations. Part of the reason informality was so appealing to theoreticians and policy makers at this time was that it seemed to provide a solid means for combating poverty. Moreover, as Axel Klein argues, it also substantiated many planners’ previously held ideological positions. For supporters of “free markets”, for example, the “informal sector” came to be seen as an exemplar of a spirit of entrepreneurship manifesting itself even in the most dire circumstances.

251 Klein, "The Barracuda's Tale: Trawlers, the Informal Sector and a State of Classificatory Disorder off the Nigerian Coast," 555-56.
253 ———, "The Barracuda's Tale: Trawlers, the Informal Sector and a State of Classificatory Disorder off the Nigerian Coast," 556.
Another cause for the renewed interest in informality was provided by early neoliberal interest in the role which institutions and property might play in the development process. While finding clear lines of causation in the use of informality by the Project for Markets authors is difficult, it is clear that the work of Ronald Coase of the University of Chicago, and the Law and Economics [L&E] movement he spawned, have both had a profound impact on neoliberal legal reform projects. 254 Coase’s seminal work in this regard was his 1960 article “The Problem of Social Cost.” 255 Coase argued two major points in this paper. First, in the absence of high transaction costs formal property rights would underlie the most efficient system of property law. 256 This is because owners are guaranteed future income from their property and will therefore not fear to invest in or develop their property. The second point of Coase’s theorem is that the law often acts to give property to the most efficient user or those least fettered by transaction costs and thus “the market will eventually establish the most efficient use.” 257 The central unit of L&E is the individual human being, assumed to be a rational efficiency-maximizing agent (rationality for L&E is tied to efficiency). 258 According to Edelman:

The interaction of rational individuals will (at least under perfect conditions) produce an efficient equilibrium or steady state. Markets, under perfect conditions, constitute efficient equilibrium among rational actors… But L&E scholars recognize (as did Coase) that bargaining almost always involves "transaction costs"; parties to a dispute, for example, incur costs when they hire

254 Charles Rowley, "An intellectual history of law and economics: 1739-2003," in The Origin of Law and Economics: Essays by the Founding Fathers, ed. Fracesco Parisi and Charles Rowley (Northampton, MA: Edward Elgar, 2005), 12. The law and economics movement arose at the law school of the University of Chicago, which Coase joined in 1964. The University of Chicago’s Law School shared many of the free-market sentiments of other faculties at the university and many of the early members of the law and economics movement were resistant to the interventionist approaches of earlier economic models. Milton Friedman’s writings, as one might suppose, greatly influenced their early work on law and economics.
255 Ibid., 3.
256 Getzler, "Theories of Property and Economic Development," 659.
257 Ibid., 660.
lawyers or consultants, when they travel to negotiation sites or miss work, when there are costs to discovering information, and so on. Transaction costs are but one type of "market imperfection" that can produce "market failure" or inefficient markets. L&E scholarship offers a theoretically informed set of principles for identifying legal rules that can restore efficiency to the market by influencing the behavior of market actors (individuals or corporations).259

L&E theory found its way into a variety of related disciplines. In economics, much of the broader thinking on the role of laws and property rights in neoclassical and neoinstitutional economics stems from the collection of theories and theorists who have followed Coase’s work on transaction costs.260 In the field of history, Coase’s writings were picked up by Douglass North whose work stressed the historical importance of formal property rights to economic development in the West.261 North even goes so far as to argue that the lack of a low-cost method of enforcing contracts is the primary source of historical stagnation and underdevelopment in the developing world.262 North in turn provided much of the intellectual underpinnings for de Soto’s supposition that secure property rights had been one of the major economic determinants of the West’s economic success.263

For his part in this debate, Hernando de Soto, first gained notoriety in the intellectual community in 1979 during Peru’s transition to civilian rule when he helped organize a conference in Lima on “Democracy and the Market Economy.” This conference was an attempt to introduce Friedrich Hayek’s ideas to the Peruvian intellectual community, and it led in 1980 to the foundation of the Institute for Liberty

259 Ibid, 185.
and Democracy, an organization captained by de Soto but run in association with many of Peru’s leading right-wing intellectuals and politicians. Initially a tiny organization that operated out of de Soto’s garage, by the mid-1980s the ILD had achieved a stature sufficient to earn it the largesse of USAID, the Inter-American Foundation and the Liberty Fund. USAID supported de Soto strongly in the late 1980s because he provided USAID with local credibility and also because the issue of titles and credit had long been central to many USAID programs. With this inflow of American funds, by the mid-1990s the ILD had expanded to include 75 full-time staff and an annual budget of $1.5 million. However, the ILD’s overall academic contributions remained modest. It has produced very few articles or studies, the only two major monographs it has produced are \textit{The Other Path} and \textit{The Mystery of Capital}, both of which were aimed at a general audience.

When the ILD finally decided in 1986 to publish its work \textit{The Other Path} Hernando de Soto, as the lead author, bought a gun and a bulletproof car. He was certain that the Shining Path, a group of Maoist guerrillas, would make an attempt on his life in an a bid to eliminate his unique brand of neoliberal populism. De Soto was right. After \textit{The Other Path} was published, both he and the ILD were indeed targeted: his car was machine-gunned and the ILD’s offices bombed. The “revolutionary” idea at the

\begin{itemize}
\item[265] Bromley, "A New Path to Development? The Significance and Impact of Hernando De Soto's Ideas on Underdevelopment, Production, and Reproduction," 333.
\item[266] Ibid: 332.
\item[267] Mathew Miller, "The Poor Man's Capitalist," \textit{New York Times} July 1, 2001. De Soto and his wife were so concerned about the possibility of being assassinated that they said they had put off having children for fear they might leave them orphans.
\item[268] Bromley, "A New Path to Development? The Significance and Impact of Hernando De Soto's Ideas on Underdevelopment, Production, and Reproduction," 333. Major sections of \textit{the Other Path} were written by Enrique Ghersi, and other Peruvian and US reaserchers associated with the ILD.
\end{itemize}
core of de Soto’s work, which the Shining Path wished to silence, was a remarkably straightforward one: the poor in the developing world were not really poor. In fact, they were richer than they had ever imagined. The reason they remained poor, de Soto argued, was that their property was held in defective forms. In vast swaths of the developing world, owners were unable to obtain the formal property rights recognized by the state or the international financial system. Consequently, such owners were denied the ability to use their property as collateral to raise capital and become successful entrepreneurs. This consigned the balance of humanity to the informal economy: a world of insecurity and poverty. De Soto believed the “informal sector” — a term open to loose and varied interpretations - constituted an area of economic life defined by economic activity that contravened laws but did not involve murder, theft or other criminal acts. His definition of property rights was fairly broad, encompassing “all those rights, both personal and real, which confer on their holders inalienable and exclusive entitlement to them - in other words, the power to enjoy them freely, to dispose of them freely, or to use them to the exclusion of all others.”

In The Other Path the type of informal property which De Soto elaborated on in greatest detail was informal housing. His analysis of informal housing was based on the ILD’s case study of Lima during the early 1980s. The ILD found that far from being anarchic, informal settlements were in fact well organized in line with extralegal social codes.

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269 de Soto, The Other Path: the Invisible Revolution in the Third World, 189-99. The Other Path was first published in Spanish in 1986. It was published in English in 1989.
norms. The ILD also found that buyers and sellers in the informal market found various ways of brokering deals, finalizing land sales and generally creating a parallel system which was able to respect a minimum of their essential property rights. The Other Path also commended informal housing for creating a highly preferable alternative to slums both for the urban poor and for the struggling middle class. The major cause of informality de Soto identified in The Other Path was the high price and time involved in gaining access to the formal system: in other words, the high transaction costs associated with gaining entry to the formal sector.

Despite the high costs associated with entering the formal system, The Other Path concluded that remaining outside the system was far from desirable as informal tenure was uncertain, and informal property markets were far less efficient than the formal market. The Other Path contended that informal property rights caused three main problems. First, informality prevented the efficient use of resources as insecurity of tenure decreases the incentive to invest in property. Second, informal property cannot be easily used as collateral to secure credit: this reduces “property’s mobility as a factor of production and reduces its productivity.” The book’s third conclusion was that informality incurs substantial costs because it forces its owners to create parallel organizations to manage their property relations. This problem was compounded by the inability of individuals operating in the informal sector to have contracts enforced or adjudicated by the formal legal system which again hinders investment and adds costs.

273 Ibid, 19.
274 Ibid, 30, 55.
276 de Soto, The Other Path: the Invisible Revolution in the Third World, 159.
277 Ibid, 160.
278 Ibid.
associated with risk mitigation for buyers and sellers. Lack of an extra-contractual legal system also impacts the informal sector: this cost relates to the lack of formal but non-contractual regulation. Safety regulations in building codes would be one example of this. Consequently, The Other Path concluded that the informal sector’s separation from the formal sector had a detrimental affect on Peru’s macro economy that reduced both its productivity and its overall investment levels.

The conclusions which de Soto reached regarding how to respond to informal property arrangements were far different than the ILO’s. Whereas the ILO advocated increased public sector investment and assistance for the informal sector, de Soto recommended a reduction of the public sector to remove unfair competition as well as to reduce the state’s regulatory role. This conclusion was partially based on de Soto’s reading of world history which viewed Peru and other developing nations as trapped in a mercantilist stage of economic development, a stage de Soto believed to be simply a transition stage between feudalism and a market economy. The mercantilist stage of development was primarily marked by the manipulation of the economy by vested interests which hamper the creation of a truly free market. De Soto thus advocated removing the government from “the commanding heights” of the economy as the key to beginning Peru’s transformation into a “modern” market economy.

De Soto and the ILD’s second major work, The Mystery of Capital, expanded on the studies done in The Other Path to include four other major cities in the developing world, one of which was Cairo. But The Mystery of Capital was far less circumscribed in

279 Ibid, 171.
280 Ibid, 173.
its aims than *The Other Path* had been, its goal being, in the words of Alan Gilibert,
essentially to “solve the problems of every poor person in the Third World.”283 Based on
the ILD’s research, de Soto argued that wealth - in the form of real-estate - accumulated
by the poor in Egypt was “worth fifty-five times as much as the sum of all direct foreign
investment ever recorded there, including the Suez canal and the Aswan Dam.”284
According to de Soto, Egypt’s “dead-capital housing” accounted for 92% of the homes of
city dwellers and 83% of those of landowners in the rural areas.285 The value of the
“dead capital” sunk in Egyptian real-estate was estimated by the ILD to be approximately
240 billion dollars.286 For de Soto the ‘informal sector’ existed in stark contrast to the
‘Westernized formal sector’:

> When you step out of the door of the Nile Hilton, what you are leaving behind is
> not the high-technology world of fax machines and ice makers, televisions and
> antibiotics. The people of Cairo have access to all those things. What you are
> really leaving behind is the world of legally enforceable transactions on property
> rights. Mortgages and accountable addresses to generate additional wealth are
> unavailable even to those people in Cairo who would probably strike you as quite
> rich… The institutions that give life to capital – that allow one to secure the
> interests of third parties with work and assets – do not exist here.287

*The Mystery of Capital* painted a picture of Egypt as a country where the Egyptian
entrepreneurial spirit was stifled by Kafkaesque bureaucracies that made property
registration impossible and discouraged Egyptians from investing in their own property
due to a lack of secure tenure.

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283 Gilbert, "On the Mystery of Capital and the Myths of Hernando de Soto: What Difference Does Legal
Title Make?," 3.
286 Ibid, 34. Institute For Liberty and Democracy (ILD) and Egyptian Center for Economic Studies
(ECES), "Formalization of Egypt's Urban Informal Real Estate Sector: Institutional Reengineering Stage.,"
(Cairo: 2000), 20.
However, while de Soto’s arguments were premised on how rational actors (should) behave in informal property markets, a very different picture of how informal housing actually functions in Cairo was provided by USAID’s Informal Housing in Egypt survey of 1980. Before examining this source in detail, a brief discussion of Cairo’s recent urban development is necessary.²⁸⁸ It should be noted that informal housing is a highly mutable category, it encompasses apartment blocks that have been illegally constructed on agricultural land through to vertical additions to existing housing stock that have not received building permits. Thus there exists a sliding gradient of informality ranging from buildings that are completely illegible to the government to buildings that might only be lacking a few building permits - this makes informal housing a tricky category to pin down. Generally the works referred to here regard as informal any building for which the owners lack a property title recognized by the government of Egypt.

Over the course of the twentieth century the population of Cairo has soared, from approximately 1 million in 1930 to 6 million in 1965, 8 million in 1976, 10.6 million in 1986 and 13 million by 1996.²⁸⁹ This expansion has been the result of both high growth rates and heavy in-migration, although the latter phenomenon has declined in importance...

²⁸⁸ Diane Singerman and Paul Amar, "Contesting Myths, Critiquing Cosmopolitanism, and Creating the New Cairo School of Urban Studies," in Cairo Cosmopolitan: Politics, Culture, and Urban Space in the New Globalized Middle East, ed. Diane Singerman and Paul Amar (Cairo: The American University in Cairo Press, 2006), 20. Although there have been numerous micro-studies published on Cairo the historian of the modern mega-city has few comprehensive works dealing with the city’s urban landscape to rely on. The most recent comprehensive study of Cairo was published in the 1960s by Janet Abu-Lughod, see Janet Abu-Lughod, Cairo: 1001 Years of the City Victorious (Princeton: Princeton University Press, 1971).

in recent years. They rapid growth has led to a serious problem of overcrowding as many migrants to the rapidly expanding metropolis were unable to find affordable housing. Consequently, the poor who flocked to post-war Cairo were faced with cramped and sub-standard housing and generally had to make do with whatever dwellings they could find in the tight quarters of the old city in eastern Cairo.

In the period 1947-1967 Cairo’s expansion was mostly at the expense of agricultural land. The majority of this was legal expansion undertaken by the government or private land development companies. It was near the end of this period that the first informal settlements started to appear around Cairo. As early as the Second World War the formal market had been unable to meet Cairenes’ demand for housing, and war shortages in housing carried on into the post-War era; they were then magnified as the population grew and the Egyptian government’s urban policies struggled to keep pace. Were it not for the informal sector, housing stock would have fallen far short of Cairenes’ demand during this period. While many of these settlements were created in clear violation of subdivision and construction laws, the Egyptian government generally opted to ignore the infractions. As a result of the lack of government or academic interest in these developments there is practically no recorded history of the creation of

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292 Ibid, 11.
293 Abu-Lughod, Cairo: 1001 Years of the City Victorious, 230.
informal settlements during this period.\textsuperscript{296} However, by piecing together evidence from maps and oral histories, David Sims, a city planner who has extensively studied the issue of informal settlements in Cairo, has determined that informal areas had their nascent beginnings in the mid-1960s.\textsuperscript{297} The 1967 War, the subsequent War of Attrition and the 1973 War all placed severe constraints on formal development in Cairo. The nation’s public funds were put towards the war efforts, and urban infrastructure plans were set aside. While formal growth halted in the period of 1967-1974, Cairo’s informal development continued its gradual expansion.\textsuperscript{298}

The attempted economic liberalization of Egypt’s state-run economy, \textit{infitah} (1974-1981) and Egypt’s political opening to the West combined with the effects of increased revenue from external sources to make the period 1974-1985 one of sizeable GDP growth. Infrastructure financing resumed and construction of informal housing developments boomed. Economic growth caused Cairo’s real estate prices to soar, driving housing costs beyond the reach of much of Cairo’s working and middle class.\textsuperscript{299} Cairo’s population managed to cope with this crisis by investing in informal housing that was outside of central Cairo.\textsuperscript{300} This helped make housing affordable for the working class and allowed them to upgrade their homes, as funds became available, rather than having to make the large initial capital outlays that were required for entry into the formal

\textsuperscript{296} Ibid.
\textsuperscript{297} Ibid.
\textsuperscript{298} Ibid.
\textsuperscript{299} El-Batran and Arandel, "A Shelter of their Own: Informal Settlement Expansion in Greater Cairo and Government Responses," 220. Worker remittances from abroad, which were estimated to be 1.6 billion Egyptian Pounds in 1979 and represented an increase of 1000\% on 1974, were to be the primary force behind informal housing’s expansion during \textit{infitah} as Egyptians working abroad during the oil boom were finally given access to the capital they needed to invest in housing.
\textsuperscript{300} Ibid, 221.
housing market. By the 1980s informality in Cairo was simply inescapable. Approximately 84% of buildings constructed in Cairo between 1975 and 1990 were informal, and large swaths of the city were now covered in its characteristic redbrick apartment blocks.

The Egyptian government’s policies also played a role in decreasing both public and private investment in housing. Manal El-Batran and Christian Arandel argue that the decline in affordable public housing that occurred from 1965 to 1975, partially as a result of hostilities with Israel and the resulting diversion of public funds, led to an increasing gulf between demand and supply in both the public and private housing sectors. Under infitah, Sadat disengaged the state from the provision of public housing altogether, save for in the low-income bracket. Despite this, public housing rents remained far too high for many Cairenes and thus the informal housing sector was the only affordable alternative for low or middle income residents seeking to rent. This problem was further aggravated by rent-controls which made it exceedingly costly for new households to enter the formal housing market and discouraged landlords from investing in the formal sector.

As a result of the massive growth in the informal sector since the 1970s many came to believe that informal housing, far from being a problem, might actually provide

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302 Elyachar, Markets of Dispossession: NGOs, Economic Development, and the State in Cairo, 70, 71. Real estate assumed a prominent role in Egypt’s economy, during the 1980s and 1990s it became the country’s fourth largest investment sector.
304 Ibid.
305 Ibid.
the solution to Cairo’s housing problems.\textsuperscript{307} For Mubarak’s government, however, informal housing had gained a pejorative association in relation to Islamic ‘fundamentalism’. Informal settlements were thought to be a potential den of anti-government resistance, especially as clashes between Islamists and the security forces caused Cairo’s informal neighbourhoods to be portrayed in official state discourse as a cancer on Egypt’s body politic. Nonetheless, in terms of the broader economy, informal housing gained a positive connotation.\textsuperscript{308} The informal sector was seen by organizations that were supervising the liberalization and reorganization of the Egyptian state, such as the World Bank and the International Monetary Fund, not simply as a means to foster economic growth but as a way to provide a safety net of sorts to those suffering from neoliberal structural adjustment policies.\textsuperscript{309}

One aid agency that was heavily involved in researching urban development in Egypt was USAID. USAID is a US federal agency, which receives its operational direction from the Secretary of State, who has primary responsibility for the US’s non-military foreign aid programs. From 1974 on, Egypt became a recipient of large amounts of American largesse, receiving more American funds than any of America’s other aid recipients, save for Israel. From 1975 to 2007 USAID gave 28 billion dollars to Egypt, and the American government provided a further 33 billion dollars of military aid to Egypt over the same period.\textsuperscript{310} Egypt also received technical assistance and assistance with large capital projects and transfers of commodities and finished goods from the

\textsuperscript{308} Ibid, 74.
\textsuperscript{309} Ibid.
US.\textsuperscript{311} USAID’s programs affected every sector of the Egyptian economy from industry, agriculture and commerce to basic human services and local government. In this context, Egypt became a test case for American economic theory and development policy. The US had a serious stake in the success of Egypt’s economic policies as *infitah*’s affinity with Western economic principles meant that the US would be held responsible for Egypt’s economic success or failure regardless of the actual US role in setting Egyptian policy.\textsuperscript{312} The US also had broader strategic interests at stake in providing aid to Egypt. The Whitehouse hoped that ensuring Sadat could stabilize Egypt’s domestic economy would make it much more likely that he would have the domestic political capital necessary to disengage Egyptian forces from the conflict with Israel and perhaps pursue a broader regional peace.\textsuperscript{313}

During the late 1970s USAID sought to increase its knowledge of urban problems in Egypt; it primarily accomplished this by commissioning four complementary studies: the National Urban Policy Studies [NUPS] on Informal Housing, Housing Finance, Land and Infrastructure. USAID was concerned that “although the vast majority of Egyptians may be financially better off than they were before the open door policy,” urban areas still had a large amount of social inequality that planners felt could prove “politically destabilizing.”\textsuperscript{314} One of the most important problems that USAID identified with informal housing was that it did not “expand the pool of resources available to the general field of housing mortgage and finance since household savings are maintained

\begin{footnotes}
\item[312] Ibid, 35.
\item[313] Ibid, 32.
\end{footnotes}
outside of the banking system.” USAID viewed informal housing as a “positive market response,” to be supported in a constructive manner to meet Egypt’s housing needs. Short term recommendations included: building permit reforms to halt delays, increased financing for housing, and a general attempt to make informal housing more legible and integrated with the formal market, e.g. through increased enforcement and taxation mechanisms.

One work produced by USAID’s urban researchers in this period was the *Informal Housing in Egypt* (IHE) study of 1980. The IHE study was conducted by several research firms contracted by USAID - Abt Associates Inc. and Dames & Moore Inc., as well as the Egyptian General Organization for Housing, Building, and Planning Research (GOHBPR) with assistance from the Central Agency for Mobilization and Statistics (CAPMAS) in Egypt. The primary goal of this study was to collect data on the general composition of Cairo’s housing stock. This study is particularly valuable in relation to de Soto’s work because it provides empirical grounds upon which to critically assess many of his assertions relating to the functioning of Cairo’s informal property market.

Prior to the IHE study very little was known about the qualitative or quantitative characteristics of Cairo’s informal housing. In fact, USAID’s first study dealing with urban housing in Egypt, conducted in 1976, admitted to having been hamstrung in many of its conclusions because it had “no firm figures” on the extent of informality in Egypt.

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315 Ibid, 4.
316 Ibid, 5.
318 Abt Associates is a for-profit government - and business - research consulting firm. Dames & Moore was an engineering firm until its acquisition in 1999 by URS corp. The GOHBPR is a state run research organization in Egypt. CAPMAS the Central Agency for Public Mobilization and Statistics, is the official statistics office for Egypt.
although it estimated informal construction to be occurring at a rate of perhaps 50,000 units per year.\textsuperscript{319} Save for data collected by a World Bank and GOHBPR study of the construction industry in Egypt, no hard data had been collected on informal housing in Cairo prior to the 1980 IHE survey.\textsuperscript{320} The IHE’s study of Cairo and the smaller municipality of Beni Suef consisted of a scanning survey of 13,000 dwellings plus 500 detailed household surveys in Cairo, as well as 215 interviews with individuals familiar with the provision of housing in Egypt.\textsuperscript{321} The IHE study not only examined informal housing but, wherever possible, it also surveyed formal housing in order to draw comparisons between the formal and informal sectors. The IHE study relied on legal status to provide its definition of informality: It considered any building that was “built in contravention of either zoning laws or building codes” to be informal as this generally excluded it from the formal registration process. (Such an exclusion prevented informal owners from using their property as collateral for loans in the formal financial system).\textsuperscript{322}

In terms of the incidence of informality, the IHE estimated that the majority of housing supplied in Cairo between 1970 and 1981, i.e. 84 percent, was informal, and of all housing built nation-wide between 1966 and 1976 81 percent was informal in urban areas.\textsuperscript{323} This massive informal construction boom, the study concluded, was largely responsible for Cairo’s low vacancy rate of 5.5 percent, as of 1981, despite its burgeoning population and earlier government projections of housing shortfalls.\textsuperscript{324} Most of this informal construction was composed of the vertical expansion of existing housing, which

\textsuperscript{319} USAID, Ministry of Housing and Reconstruction and Ministry of Planning, "Immediate Action Proposals for Housing in Egypt," (USAID, 1976), 12.
\textsuperscript{320} Mayo and Katz, "Informal Housing in Egypt," xvi.
\textsuperscript{321} Ibid, 1, 2, 12.
\textsuperscript{322} Ibid, xv.
\textsuperscript{323} Ibid, xvi, 26.
\textsuperscript{324} Ibid, xvii, 113.
between 1976 and 1981, was thought to have accounted for two-thirds of additions to the housing stock.\textsuperscript{325} Informality was fairly common in central Cairo during the 1970s, but most informal housing was concentrated geographically in areas such as Dar as-Salaam and Helwan in the South, Giza in the West, and in Shubra al-Kheima in the North.\textsuperscript{326}

### Incidence of Formal and Informal Housing by Time Of Construction (Sample Size in Parentheses)\textsuperscript{327}

\textbf{Figure 1.}

<table>
<thead>
<tr>
<th>Time of Construction</th>
<th>Informal</th>
<th>Formal</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1960</td>
<td>43.7%</td>
<td>56.3%</td>
<td>(212)</td>
</tr>
<tr>
<td>1960-1970</td>
<td>72.2%</td>
<td>27.8%</td>
<td>(133)</td>
</tr>
<tr>
<td>1971-1976</td>
<td>88.8%</td>
<td>11.3%</td>
<td>(76)</td>
</tr>
<tr>
<td>After 1976</td>
<td>75.0%</td>
<td>25.0%</td>
<td>(36)</td>
</tr>
</tbody>
</table>

Numerous factors led builders and home buyers to choose to opt-out of the formal property system in Cairo.\textsuperscript{328} Several of the most salient causes identified by the IHE were: rapid population growth, inappropriate legislation, lax legal enforcement, poorly designed housing policies, ignorance of the law, and the influx of capital as a consequence of the oil boom.

The rapid growth of housing in Cairo, caused by its post-war population boom, created a situation in which Egyptian authorities simply lacked the resources to enforce the laws on the books. Lax enforcement of subdivision laws and other building codes, for example, were rife. Such laws proved nearly impossible to enforce as inspectors were overwhelmed by the sheer number of buildings being constructed. Regulators were also

\textsuperscript{325} Ibid, 22.  
\textsuperscript{326} Ibid, 31.  
\textsuperscript{327} Ibid, 32.  
\textsuperscript{328} Ibid, 34.
hamstrung by their weak legal position as the punishments they could mete out to informal builders were fairly limited. Violators of building regulations would generally only receive a modest fine, if they were fined at all. Further, no informal settlement on private land (as opposed to government land) had ever been forcibly removed as the Egyptian government generally seemed loathe to anger the urban poor. The IHE survey concluded that “denial of infrastructure to informal areas, fines, harassment by authorities, and occasional demolition,” had not remotely hampered the expansion of informal housing. In fact, an added bonus of avoiding the formal legal system was that it increased a builder’s chance of evading harassment by the authorities. Only 27 percent of informal builders reported being visited by the authorities, and none mentioned being “hassled” by the authorities as a major hindrance during construction. On the other hand, 86 percent of formal builders were visited by officials, and 9 percent claimed that being “hassled” by such officials was their major construction problem.

A large proportion of informality resulted from legislation that was simply too expensive or troublesome for builders and those entering the housing market to comply with. Respondents to the IHE survey reported that for both agricultural and non-agricultural land it was simply too time consuming and costly to justify registration. While registration did qualify builders to receive subsidized materials, it was generally

329 Ibid, 46.
330 Ibid.
332 Mayo and Katz, "Informal Housing in Egypt,", xviii.
333 Ibid, 46.
334 Ibid, 46.
335 Ibid, 40.
felt by many Cairenes that such benefits did not offset the cost of complying with permit requirements.  

Ignorance of the law was another cause of non-compliance. As one mason told IHE investigators “I do not know anything of legal matters or building codes and I do not think that any other masons or owners have such knowledge.” Cultural attitudes towards property law likely played a role in this. Rural migrants, for example, seemed unaccustomed to formal tenure arrangements and were much more likely than native urbanites to establish informal dwellings. Poor education among many of the rural migrants and hence, ignorance of the law, was another possible explanation for the higher incidence of informality in the rural migrant community. Overall, lower education seemed to correlate with informality. 21 percent of formal owners were illiterate and 20 percent were university graduates, while the percentages for informal owners was 43 percent and 3 percent respectively. The IHE survey also found that a much larger proportion of informal owners, 94 percent versus 35 percent, knew little to nothing about laws governing construction on vacant land. Ignorance of the law was likely a function of the fact that many informal households saw the laws as irrelevant to their activities, and hence not worth learning, according to the report.

The oil boom of the 1970s and infitah were major catalysts for informal construction. One consequence of these events was that Egypt’s improved economic fortunes during the 1970s caused development firms to take a greater interest in central

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336 Ibid, 46.
337 Ibid, 46.
338 Ibid, 47.
Cairo, thus sharply raising prices for inner city land and housing. High home and land prices placed ownership out of the reach of many Cairenes forming new households. This forced many to the periphery of the city in an attempt to avoid the high prices in central Cairo. Furthermore, as residential land prices increased during the 1970s, prices for agricultural land stagnated or fell. The result was that potential returns from residential land sales far outweighed what landowners could hope to receive for keeping land for agricultural uses, if such land bordered an urban area. Thus, speculators invested heavily in agricultural land that could be illegally urbanized in hopes of reaping a quick return on the land’s sale. Workers’ remittances from abroad allowed many investors with working class backgrounds to participate in this development boom as well – as they considering land to be a very sound investment during the 1970s.

It is undeniable that the majority of Cairo’s residents were faced with numerous housing difficulties in the 1970s. However, these problems were not unique to people living in informal dwellings. In almost all respects, the IHE survey found, informal housing was identical to formal housing, save for legal status. In terms of building quality, the IHE survey concluded that informal housing was not only equal to formal housing in terms of quality but was, on average, in better structural condition than its formal counterparts. The IHE survey states that “building designs, building materials, and interior amenities such as kitchens, toilets, and number of rooms are similar for many

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343 Ibid.
344 Ibid.
345 Ibid.
informal and formal households.” While crowding was a serious problem among low income households, its rates were equally acute for formal and informal occupants. Units classified “about to collapse” in the formal sector outnumbered those in the informal sector by 2 to 1. This was primarily the result of the relative youth of many informal structures. More materials were also expended on informal housing as compared to formal housing, since generally no engineers or architects were involved in its construction, and thus informal builders lacked the expertise required to safely cut back on materials.

Informal housing also had fairly similar rates of utility connection as compared to formal housing, and it seems that utility connection was more closely related to building size than to legality. While utility connection rates for Cairo’s informal housing was slightly lower than for its formal areas, as informal structures were often built on land with no utility connections, this difference generally disappeared over time as residents found ways to connect their buildings to utilities through various means. Residents of informal areas generally felt that infrastructure provision took time and were willing to wait for the process to run its course. The IHE survey concluded that proximity to infrastructure, age of the building and number of units in the dwelling were far more likely to increase the chances that said building would be connected to infrastructure than the building’s legality. Legal difficulties aside, developers and residents could

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347 Ibid, xvii.
348 Ibid, 121-23.
349 Ibid, 128.
350 Ibid
351 Ibid, 103.
352 Ibid, 55.
353 Ibid, 60.
354 Ibid, 146.
355 Ibid, 55.
generally rely on the government to eventually provide services and public facilities since residents of informal buildings proved quite adept at petitioning the government once construction was a *fait accompli*.356

Formal and informal buildings also overlapped considerably in terms of their residents’ social and economic backgrounds.357 The IHE study found that formal and informal residents did not differ in a statistically significant way in “sex or age of the household head, household structure, or income relative to expenditures.”358 One important difference that did exist between these populations was that one’s birth in a rural area increased the chances of living in informal housing by 41 percent.359 It was found that “among formal owners 89 percent were born in an urban area and 88 percent had spent most of their lives in an urban area,” whereas for informal owners those percentages were 53 and 70 percent respectively.360

In terms of owner satisfaction there was little statistical difference between formal and informal residents. For residents of formal housing the percentage of individuals who were “satisfied” with their housing was 70.9 percent, while for informal residents it was 70.3 percent.361 Moreover formal and informal housing shared many of the same objective features with one another and thus the IHE study concluded that it was unsurprising that residents of both groups shared similar levels of housing satisfaction.362

In terms of satisfaction with neighborhoods, however, informal residents were more

357 Ibid, 47.
358 Ibid.
359 Ibid.
360 Ibid.
361 Ibid, 133.
362 Ibid, 134.
The problems that informal residents most often identified when asked about their neighbourhoods were related to inadequate infrastructure and inadequate public buildings such as schools, hospitals or mosques. Environmental problems such as inadequate garbage collection and insect infestation were also a concern. However most Cairo residents felt that neighborhood conditions had remained stable or improved. Furthermore, the IHE study found that informal areas were more likely to have been improved recently than formal areas, by a margin of 53 to 35 percent.

Nor was insecurity of tenure a major concern for Cairo’s informal owners. The IHE study discovered that the informal sector was in several respects more “willing to invest in housing than the formal sector.” The informal sector actually possessed a slightly higher proportion of owners than the formal sector and a greater percentage of houses with recent additions. When Cairenes were asked whether they had not improved their property because of fear of dispossession not a single one mentioned concern with “any aspect of security of tenure.” Anecdotal evidence suggested that once households were established it was virtually impossible to dispossess them and that “households do not appear to be concerned about failure to register land or buildings or to obtain building permits.” Land registration was possible in the informal sector through a variety of inventive means. One way large landholders registered transactions was by taking their buyer to court for partial non-payment, with the result that the court would charge in

363 Ibid.
364 Ibid, 139.
365 Ibid, 143.
366 Ibid, 146.
367 Ibid, 206.
368 Ibid.
369 Ibid.
writing that the buyer had to pay the stated amount. Once it was paid, the buyer would receive a receipt from the seller; and this, for many, was an adequately secure form of registration. For smaller landholders written and dated citations by government officials for illegal construction were often used as proof of ownership.

Nor was Cairo’s informal housing market starved of capital in the 1970s. The IHE study found that “formal financial institutions in Egypt have a limited reach. Despite overall economic growth, as measured by real household incomes, household savings, asset formation and activities of the general banking system—all of which register increases, the level of formal, home mortgage funds has remained stagnant.” Cairenes in the 1970s were nevertheless able to find an abundance of credit by using their earnings from working abroad, sales of property, “sales of jewelry, and savings in informal credit associations,” to finance land purchases and construction. Informal credit could take many forms and while few respondents complained about a lack of access to capital, it seemed clear to the IHE researchers that capital availability was on a transitory basis and it was this factor which determined the rate at which land could be developed. Informal contractors rarely dealt with banks, as many did not trust or understand financial institutions and banks would in most cases only extend credit to the informal sector at high interest rates. Another problem with formal financial institutions in the eyes of many Cairenes was that formal institutions were too inflexible for borrowers’ erratic income and would foreclose on them at the first missed payment.

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370 Ibid, 41.
371 Ibid, 42.
372 Ibid.
374 Ibid, 104. Landowners were one frequent source of credit to purchasers.
375 Ibid, 105.
Further, since many activities people partook in were illegal anyway it seemed only prudent not to document them.

By comparing the IHE’s findings with those of de Soto, one can see many of the aforementioned difficulties with the Project for Markets on display: a lack of empirical evidence, definitional difficulties, myth-making and an aversion to politics. Take for example, one of de Soto’s central arguments in *The Mystery of Capital*: that informal housing suffers from low levels of investment due to the owner’s fear of dispossession. While de Soto is right to emphasize that informal property arrangements can complicate life for the poor, his supposition that formal title is a fundamental prerequisite for security of tenure runs counter to the IHE findings which recognize that security of tenure does not necessarily require full legal title. What seems more decisive in encouraging investment, as many other studies have found, is the perception that the chances of eviction are low. This was certainly the situation in Cairo: Cairenes living in informal housing were not even remotely concerned about being dispossessed, and Cairo’s informal sector actually received more investment in the 1970s than the formal sector. Thus, far from discouraging investment, Cairo’s informal housing was the recipient of a massive influx of capital as many Egyptians working abroad regarded informal property as a sound long term investment. In fact, without such heavy investment informal housing would not have experienced such a high growth rate in the 1970s.

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376 Ibid.
A second claim central to *The Mystery of Capital* is that informal tenure arrangements limit credit access. However, again, there seems to be little evidence that formalization actually increases the poor’s access to credit. Here too, the IHE survey, like other studies in the field of informal settlement upgrading, found formalization programs to be of little utility.\(^{380}\) Property formalization turns out to be less of a silver bullet than de Soto supposes, for a variety of reasons. For one, banks are hesitant to lend money to low-income settlements because the actual value of the property may be questionable due to its location and quality.\(^{381}\) For another, it seems that in many developing countries the poor are just as mistrustful of the formal banking system as it is of them, another finding of the IHE study in Cairo. The poor are often hesitant to accept loans from formal banking institutions as many fear dispossessment as well as the crippling effect that debt repayment may have on their household.\(^{382}\) Nor does de Soto convincingly explain how the poor would be persuaded to use their newfound credit from formal banks (if it materialized at all) to finance investment, not consumption, under his scheme.\(^{383}\) In fact, many microfinance institutions [MFIs] which specialize in lending to the poor in hopes of encouraging them to start small businesses have found precisely this problem - that it is very hard to know for certain if credit will be used for an entrepreneurial venture or simply to temporarily make ends meet.\(^{384}\) Furthermore, de Soto’s argument that the informal sector’s economic performance will be improved by


\(^{381}\) Ibid: 16.

\(^{382}\) Ibid: 17.


\(^{384}\) One of the best known advocates of microfinance is Muhammad Yunus, a Bangladeshi, who won the Nobel Peace Prize in 2006. For more on Yunus’ approach to micro-lending see Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty* (New York: Public Affairs, 1999).
greater credit has come under scrutiny as most informal residents the world over already have access to basic levels of informal credit.\footnote{Gilbert, “On the Mystery of Capital and the Myths of Hernando de Soto: What Difference Does Legal Title Make?,” 17.} While informal credit availability may fluctuate, it allows for far more flexible borrowing and repayment plans than in the formal sector.

This leads into another criticism of de Soto: that he ignores the extent to which poverty more than legal title may be the primary impediment to informal residents’ access to the formal financial system. The IHE survey found, for example, that many Cairenes preferred informal lending because they were too poor to seek formal credit even if they had had formal rights to their property, their incomes being fairly erratic. This meant that unlike informal credit arrangements, one missed payment could lead to dispossession. This criticism is supported by several studies in Africa that have found that rigid formal contracts in developing countries can have detrimental consequences for the poor who often require more flexible contract terms on account of their unpredictable income.\footnote{Messick, “Judicial Reform and Economic Development: A Survey of the Issues,” 129.} De Soto considers dispossession one of the fundamental benefits of making property legible, but he ignores the extent to which, even with well crafted legislation and functioning institutions, this could be a dangerous situation for the urban poor.\footnote{de Soto, The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else 55.} This is one of the many ways in which, for the poor, informal housing can provide an essential coping mechanism - something de Soto acknowledges but does not care to explore.

Recent reviews of land titling programs seem to support the supposition that property formalization is of dubious benefit to the poor.\footnote{Payne, "Introduction," 9.} Some experts even argue that property formalization can be detrimental to the poor because it risks creating a “pattern
of land ownership that is more rigid, more regulated, better enforced and hence considerably less affordable than before." 389 Thus, far from helping the poor, formalization programs risk adding new costs that can price individuals out of what had been an affordable market. 390 The cost of the actual formalization program can also be high for the poor. In Guayaquil, Ecuador, for example, Lanjouw and Levy estimated “that the costs of obtaining a title represents, on average, 102%... of household annual, per capita, consumption. Although the costs may be spread out over time, they clearly represent a substantial expense for squatter households.” 391 Another problem identified with formalization programs is that attempts to “convey individual titles to the poor in planned settlements have overestimated the ability of these ‘owners’ to find economic livelihood in the absence of additional support beyond the allocation of land.” 392 Consequently, formalization schemes often result in the poor selling to middle class speculators, or being forcibly removed from their homes by gangsters, anticipating the neighborhood’s formalization. 393 Even de Soto’s work with the Peruvian government during the mid-1990s to formalize the property of millions of rural and urban Peruvians has had no success in lowering poverty rates in Peru. 394 Another difficulty that de Soto overlooks is that investing in housing is far from a guaranteed return on investment as

389 Ibid.
393 Gravois, "The De Soto Delusion."
394 Bourbeau, "Property Wrongs," 78.
increasing ones’ capital in such a transaction is highly dependent on timing, location and a host of other factors.\textsuperscript{395}

Furthermore, there is a paucity of empirical evidence that a connection actually exists between home-ownership and economic development as de Soto supposes.\textsuperscript{396} Some recent studies have even suggested that causation might work in the opposite direction, that high rates of homeownership might have a detrimental impact on economic development. Andrew Oswald, for example, argues that high rates of home-ownership in some European states has seriously harmed labour mobility and consequently hampered their economic growth.\textsuperscript{397} Geoffrey Payne, an urban planning specialist, also offers data that does not seem to mesh with de Soto’s claims regarding home-ownership, pointing out that many parts of the developing world actually possess higher rates of home-ownership than the developed world. To take one example, as of 1996, 17\% of Munich’s residents owned their own home, while 53\% of Delhi’s residents did. Yet few observers would likely characterize India as more economically prosperous than Germany.\textsuperscript{398}

Definitional difficulties are another problem facing de Soto. As Ray Bromley observes “the informal sector is such a vague term that it often encompasses different interpretations and assumes a universal positive connotation rather like parenthood or

\textsuperscript{395} It is worth noting that as of this writing, the entire world economy teeters on the edge of one of the largest recessions since the Great Depression, due in no small part, to the collapse of the American housing market. The current housing crisis in the United States owes its genesis to a deadly combination of global capital imbalances, poor financial regulation, excessive risk-taking, a culture of irrational exuberance and the dominance of the financial sector in the American political system (Problems the IMF has encountered in numerous emerging market crisis of recent years). All of these factors collided to create a massive asset bubble in the US housing market and subsequently a staggering loss of wealth. For more on similarities between this crisis and emerging market crisis of the 1990s see Simon Johnson, "The Quiet Coup," The Atlantic May 2009.


\textsuperscript{397} Andrew Oswald, "The Housing Market and Europe's Unemployment," (1999): 8.

\textsuperscript{398} Payne, "Introduction," 11.
friendship.” One might fairly wonder whether positing an informal sector that is clearly delineated from the formal sector is of any utility at all since “what is gained in the clarification may be lost by separating the inextricably intertwined.” Part of the problem with defining informality is that what constitutes informality is always defined in relation to the system in which it is situated. Simply finding a definition of informality raises a host of problems for the researcher: should categories be formulated in terms that are based on the meaning participants ascribed to the activities involved? Or should there be a set of “objective” external criteria that would be imposed by the observer? Or should one create an ideal Weberian type whereby “logical categories could be synthesized from the available empirical and historical data so that particular instances can be compared to the general type.” There is simply no clear consensus within the scholarly debate on informality as to how these issues should be dealt with. This was one problem encountered by the IHE study. While it used legal status as the demarcation between the formal and informal sector, Cairo’s informal housing still exhibited a wide variation of informality ranging from owners who simply lacked a bill of sale to individuals who had occupied government land. While this was perhaps not an insurmountable problem when simply conducting a survey, it does raise the question of whether it is wise to base government policy on a category as broad as informality, given how many different types of property arrangements it encompasses. While simplifications, such as the concept of informality, are a prerequisite of central

401 Ibid.
402 Ibid.
management they also, when taken to extremes, risk forming policy that will have
detrimental consequences not envisioned by social engineers.\footnote{James Scott, \textit{Seeing Like a State: How Certain Schemes to Improve the Human Condition Have Failed} (New Haven: Yale University Press, 1998).} As some studies of legal reform have found, grafting formal enforcement methods haphazardly onto existing informal legal systems can have disastrous consequences.\footnote{Messick, "Judicial Reform and Economic Development: A Survey of the Issues," 129.}

It is also far from clear that all developing states’ legal systems are as Kafkaesque as de Soto maintains. Nathan Brown in his survey of “rule of law” conditions in the Arab world concluded that, while the Egyptian system is far from perfect, it is neither the corrupt servant of elite interests or the instrument of regime populism that it is often portrayed as being. Though there is some truth to both interpretations, Brown maintains that both are over-played. In terms of business and the courts, Brown found that Egyptian courts were neither elite dominated nor exceedingly responsive to the needs of the poor, although some in Egypt’s business community have made this latter claim.\footnote{Brown, \textit{The Rule of Law in the Arab World: Courts in Egypt and the Gulf}, 221.} Rather, Egypt’s judicial system is a massively overburdened institution designed to serve the needs of the lower classes.\footnote{Ibid.} The Egyptian court system, Brown found, was quite responsive to non-elite litigants. However, elites were more able to avoid the system, choosing binding arbitration for example, over the often plodding court system.\footnote{Ibid, 234.} Egypt’s judges, for their part, also remain fairly liberal in outlook and have proven to be a thorn in the side of Nasser, Sadat and Mubarak with their undemocratic proclivities.\footnote{David Mednicoff, "Middle East Dilemmas," in \textit{Promoting the Rule of Law Abroad: in Search of Knowledge}, ed. Thomas Carothers (Washington D.C.: Carnegie Endowment for International Peace, 2006).} Given the fairly heavy resource constraints placed on the Egyptian system, however, one might wonder how, in the absence of an overall improvement in the state’s economic
situation, Egypt’s courts can really be made more efficient in the current context. Nor does it seem clear that the one-time efficiency gain from such a reform would spur Egypt’s economic development given that businesses, both large and small, already seem able to more or less cope with Egypt’s imperfect legal system.\textsuperscript{409} De Soto also ignores that while many developing countries experience large bureaucratic delays in their justice system so too do many developed countries.\textsuperscript{410}

One might also question how politically neutral aid organizations promoting formalization schemes in Egypt are. USAID, for example, one of de Soto’s close allies in Egypt, is far from free of political entanglements. There is, in fact, divisive debate about USAID’s role in Egypt. Many Egyptian critics accuse USAID of “pervasive corruption, huge consultancy fees and hidden agendas aimed at stripping Egypt of its agricultural export potentials and purging the school curricula of their Islamic flavour.”\textsuperscript{411} Furthermore, as USAID has been an advocate of a highly ideological market-based agenda it is difficult for it, or the World Bank for that matter, to claim that their involvement in Egypt is not political. Their involvement in encouraging the dismantling of the system established under Nasser is a patently political act. In a scathing critique of their role in development assistance in Egypt Timothy Mitchell accuses the World Bank and USAID of portraying themselves as intelligences external to their object of

\textsuperscript{409} Brown, \textit{The Rule of Law in the Arab World: Courts in Egypt and the Gulf} 234. Kennedy, \textit{The Dark Sides of Virtue: reassessing international humanitarianism}.

\textsuperscript{410} Bromley, ”A New Path to Development? The Significance and Impact of Hernando De Soto's Ideas on Underdevelopment, Production, and Reproduction," 334.

\textsuperscript{411} Gamal Essam El-Din, ”The USAID Debate,” \textit{Al-Ahram} October 30, 2003. Liz Cheney, former US Vice President Dick Cheney’s daughter, was deputy assistant secretary of state for the Near East. She was an important proponent of economic and political liberalization as well as decentralized reform programs during her tenure. She served as deputy assistant secretary of state for the Near East from 2002-2007 with an interruption in 2003 to serve on Dick Cheney’s re-election campaign.
interest. Far from being detached rational observers, he argues, they are central to Egypt’s power configurations, as agents enhancing the state’s power to distribute wealth and patronage. This view is supported by authors such as Graham Harrison who believes that “the national-international boundary has been rendered so… porous by a historically embedded ‘mutual assimilation’ of donor and state power” that “rather than conceptualizing donor power as a strong external force on the state, it would be more useful to conceive of donors as part of the state itself.” Mitchell also criticizes USAID for focusing on technological and managerial solutions to problems of powerlessness and social inequality which, he argues, require social and political solutions.

Organizations such as USAID and the ILD, he avers, depoliticize policy debates in Egypt and transform them into questions of resource management rather than social justice. This is a problem at the core of both de Soto’s work and the Project for Markets - an indifference to the social and political dimensions of legal reform.

De Soto maintains that culture is no barrier to development, an idea he has tried to sell the world over. But while culture may not be a barrier to development, a country’s political economy most certainly can be. As Sally Eden argues, if policy is to work “in practice,” then it has to take into account the context of how social and political life are actually experienced by people “on the ground” as opposed to viewing the law as a technical mechanism to be imposed on society from above. This is perhaps the most biting criticism of de Soto’s work in Egypt, and elsewhere: he ignores the extent to which

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413 Ibid, 30.
416 Miller, "The Poor Man's Capitalist."
legal reforms will not necessarily create just outcomes nor overcome the powerlessness of Egypt’s vast majority in the face of an economy dominated by the military. One might rightly wonder if the extension of formal title in this context would actually increase the power of Mubarak’s regime to control its subjects by allowing it to use property titles to placate the urban poor as well as track their movements more closely. All of this raises the same uncomfortable question that faced the L&D movement: that Western legal reforms could actually help strengthen the authoritarian regime of leaders like Hosni Mubarak.
Conclusion:

Despite the criticisms that have been leveled at the Project for Markets, its popularity, like that of notions of the rule of law generally, does not seem to be waning in the twenty-first century - quite the opposite. Whereas Trubek and Galanter’s article of 1974 “Scholars in Self-Estrangement” signaled the death knell of the L&D movement, Carothers’ article has become more of a call to arms: a flurry of studies on the rule of law and economics were published in response and many in the field remain optimistic on the rule of law’s future in development. How this debate will conclude and whether current attempts to study the rule of law will succeed are far from certain. But it does appear that we are witnessing the emergence of a more nuanced and perhaps mildly chastened approach to linkages between development and the rule of law which is becoming more inclusive of the social elements of development. Many officials at international financial institutions, inspired by Amartya Sen’s Development as Freedom (1999), are coming increasingly to see the rule of law not simply as an instrument for creating market growth but as an intrinsic good, laudable in and of itself.418 This rethinking should not be exaggerated, however: the Project for Markets, unlike the earlier Law and Development movement, continues to wield massive influence despite the criticisms leveled against it.419

Given the many difficulties it faces it is hard to explain the continued success of the Project for Markets as purely the result of the persuasive academic arguments of its adherents. It is perhaps better to understand the Project for Markets not simply as an

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intellectual movement for legal or economic reform but as a campaign that was, at its core, political. The Project for Markets was engaged, whatever its intellectual justification, in an attempt to reorder the developing world and post-socialist states politically. Its continued popularity can likewise be at least partially attributed to a continued commitment to neoliberalism by many transnational elites. Neoliberalism, though altered, has not fallen by the wayside as the embedded liberal system did in the 1970s. The World Bank, for example, despite its critics’ misgivings and its newfound social agenda, continues to remain more or less focused on legal projects that aim to promote the conditions for market activity.

Once again, de Soto provides a window on the Project for Markets as his ILD also remains popular with international financial institutions. As recently as 2007, the Inter-American Development Bank launched a joint venture with the ILD to institute property formalizations schemes in Haiti, the Dominican Republic, Guatemala, Mexico and Panama. One can see that at least part of the explanation for de Soto’s continued popularity - and really his popularity all along - lies in his connection to a free-market political ideology. In the words of Ray Bromley, de Soto’s work:

Illustrates the crucial interlinkage between ideas, local conditions, intellectual environment, and global support - a microcosm of geography in the broader context of social science. Without international financial support for research, travel, and publication, given largely on ideological grounds, his work on Peru would have been smaller in scope and virtually unknown.

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421 Mitchell, Rule of Experts: Egypt, Techno-Politics, Modernity, 244.
422 Auerbach, "The Meanings of Neoliberalism," 47.
In this sense, Bromley argues, de Soto can even be thought of as the “Third-World’ version of Friedrich Hayek or Milton Friedman, advocating unbridled capitalism as the solution to underdevelopment.”  However, de Soto is perhaps better understood as a political campaigner or polemicist than as an academic. As Bromley points out, the primary purpose of the ILD has always been to “develop an institutional perspective that contributes to the climate of public opinion and influences public policy, rather than to act as a repository of knowledge, to participate in academic debates, to generate scholarly projects, or to promote social action programs.”  De Soto has himself more or less admitted that his work is primarily polemical in nature, “Like any person with political qualities, I know how to put a whole program behind a very simple slogan… I’m not writing for Harvard students, I’m writing basically for Aristide and Hosni Mubarak and Gloria Arroyo and Fox. Political leaders know this isn’t a one-shot idea. They know it amounts to a revolution.”  De Soto’s work has thus remained popular because, while its intellectual foundations may be weak, it is still popular with the free market right as well as the World Bank and IMF who are particularly receptive to his emphasis on the “inherent dynamism of the unplanned economy.”

From the perspective of governments in developing countries, including Egypt’s, it is not hard to see why de Soto’s arguments remain so politically appealing. For one thing, de Soto’s arguments are broad enough to appeal to those of various political inclinations but also too vague to really recommend any specific set of concrete

427 Ibid: 331. De Soto has, on occasion, described himself as a disciple of Hayek.
428 Ibid.
429 Miller, "The Poor Man's Capitalist."
policies. 431 It seems that when the rule of law is invoked traditional debates in political and economic theory are simply forgotten. 432 Furthermore, the reforms de Soto advocates offer a huge pay-off by the simple act of recognizing the urban poor’s property, and in a manner that accords quite well with free market ideologies still present in international institutions. 433 Governments in the developing world are attracted to a strategy that offers a potential increase in the tax base as more homes become legible but that also encourages owners of informal housing to view their struggle not as a political one for community rights, but as an individual one. In this way, the residents of informal areas can be steered clear of political action against the government, and distributional issues will fade into the background. Formalization programs are also popular with governments because they offer housing policy “on the cheap,” because it is far less expensive to offer titles than to provide infrastructure, especially when governments and international agencies are able to turn a profit by making the poor bear the cost of formalization. 434

In light of much of the evidence against de Soto’s arguments, as well as his own admission of the political nature of his campaign, one might fairly wonder whether de Soto is actually aware of many of the flaws in his argument but chooses to embellish his findings to gain support for policies which on the whole he thinks are beneficial. But if the “mystery” of capital is little more than a mirage conjured by de Soto to spur interest in the informal sector; is this mirage simply unhelpful or is it actually dangerous for the

431 Bourbeau, "Property Wrongs," 79.
432 Kennedy, "The "Rule of Law", Political Choices, and Development Common Sense," 144.
434 Gilbert, "On the Mystery of Capital and the Myths of Hernando de Soto: What Difference Does Legal Title Make?," 8. The latter, adequate infrastructure, it should be noted, was the one serious problem that the IHE study found confronting informal but not formal housing in Cairo.
poor? Alan Gilbert summarizes nicely why de Soto’s campaign should be seen as more than simply innocuous lobbying:

The uncomfortable truth is that in practice, granting legal title has made very little difference. If granting legal title has made little difference, then, why worry about de Soto? The answer is that de Soto is dangerous insofar as he is conjuring up a myth about popular capitalism. He is fanning the illusion that anyone, anywhere, can become a fully-fledged capitalist. Although he offers little or no empirical evidence in support of his assertion… But because de Soto is a big name, his message will be taken up by some powerful people. As such, the argument needs to be shown up for what it is.435

As Gilbert avers, de Soto’s argument regarding property formalization is dangerous because he encourages policy makers and the lay reader to believe in a misguided fantasy that ignores complex economic, political and social realities. De Soto’s assertion that all governments need do is abrogate their responsibility for economic development and ‘leave it to the market’ is simply not practical. Such an approach may be appealing to global leaders who in the last decade have worshiped at the “altar of free-market capitalism, globalisation and innovation” (the oft derided “Davos man”), but it has not provided a solution to the problem of economic development.436 Whether or not one believes that formalizing property rights is an intrinsically laudable goal in developing countries there is simply no evidence that such reforms can ‘harness’ the developing world’s ‘dynamism’ and lift the world’s poor out of poverty.

I have argued that the extension of formal property rights does not necessarily guarantee that the poor will profit from investment in the real estate market or that business ventures started with formal credit will succeed. I have also shown that formal property rights apparently do little to address some of the most pressing problems facing

the poor, such as adequate infrastructure and social services. Furthermore, the historical record does not indicate that there exists a clear line of causation running from secure property rights to the creation of liberal western-style democracy. To assume such a progression exists simply because it has occurred in some Western states is to fall into the logical fallacy that correlation equals causation (post hoc ergo propter hoc).

Unfortunately, the general public has rarely been presented with critiques of de Soto’s flimsy arguments, such as those I draw together here. Quite the opposite in fact: the media in general sings de Soto’s praises. As recently as May of 2009 de Soto was on the Canadian Broadcasting Corporation’s [CBC] *Sunday Edition* receiving Michael Enright’s glowing and unconditional praise, introduced as a renowned economist with an idea that could ‘change the world’. De Soto’s work even appeared in an essay collection on international development, entitled *Thinking Big: Responding to Urbanization in the Developing World* (2006), sponsored by the Canadian International Development Agency [CIDA]. Such presentations lend further credibility to an individual who in my opinion actually deserves little.

In the end, however, it matters little, whether de Soto is a charlatan or a true believer in his brand of right-wing romanticism, his ideas simply do not work.\(^{437}\) It is for this simple reason that I hope this project has, in some small way, contributed to a critique of de Soto and helped the reader place him in the broader historical context of the evolving role of the rule of law in development assistance. Given that the rule of law is increasingly, and often unreflectively, deployed by international development and foreign policy planners as a panacea for all the world’s ills, I think this is an important field for

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\(^{437}\) Gilbert, "On the Mystery of Capital and the Myths of Hernando de Soto: What Difference Does Legal Title Make?,” 3. Some officials at USAID actually concluded the latter and were embarrassed their organization had ever been associated with him.
further research. I also hope that in future the rule of law will receive greater attention from studies that are both more realistic and more critical of the accepted wisdom regarding the possible ‘pay-offs’ and ‘pit-falls’ of its use in development assistance.
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