

DEAD CAPITAL

(in US \$ Millions)



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I. Mapping the Informal Majority

Economic informality exists when there is a lack of access to the legal means needed for specialization within enterprises and for interaction via property rights arrangements. There is, of course, always a certain amount of informality in any economy. But in the economies of LAC informality is the rule, not the exception.

The Majority in the region cannot make the market work to their advantage because they are fragmented in non-specialized groups where labor cannot be divided efficiently and where they lack the means to define, benefit from or enforce economic rights.

In this “extralegal world,” only the elite are able to create wealth, thereby generating frustration among those outside the system. Extending the benefits of the market economy to those living in the informal world will require an understanding of the underlying causes of informality in order to adopt comprehensive and inclusive policies.

The main objective of this preliminary assessment is to increase awareness of the nature, magnitude, and importance of informality in Latin America and the Caribbean, as well as to identify areas for which further development actions are needed.

The present assessment is based on 12 countries.¹ This is intended as a first phase in mapping the informality and dead capital of the other IDB Member States in the region. It describes and analyzes the legal and institutional frameworks found in each country, focused on the:

- **access to property rights and business formalization;**
- **the characteristics of the informal economy; and**
- **magnitude of “dead capital”.**

The analysis identifies the main characteristics, organizations, and practices of the informal or “extralegal economy,” and provides a preliminary quantitative estimation of the “dead capital” -- or those assets existing outside the formal economy that cannot be leveraged in the formal market. Although this is a preliminary study, the research includes a general analysis of the three basic institutions required for development:

- **Fungible Property Rights**, that provide people with the legal status required for identification and location of their assets in the market, but also with the legal means to use these assets and maximize their value,
- **Legal organizational forms**, that enable entrepreneurs to specialize through legal and economic instruments that permit distinct legal entities, allow “asset partitioning,” and an efficient “division of labor.”

¹ Argentina, Bolivia, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Panama and Peru.

- **Identity devices**, that allow citizens and enterprises to operate in the market, benefiting from the widest networks possible in the national and global economy.

II. Main Findings

The results from this study confirm that **the informal Majority lives without access to the legal means and instruments that protect and nurture people and businesses in the formal sector**, with no access to the legal means that are necessary to capitalize their assets and organize their work productively. Nevertheless, they manage to perform basic economic and legal procedures, such as:

Adjudicating and owning property...

Neighborhood associations fill the vacuum left by the State, generating and administrating property rights, authorizing transactions, and keeping records.

Creating and operating businesses...

Small and family enterprises try to resemble to legal business forms and achieve high productivity through economic transactions based on agreements.

And using mechanisms to expand their work

The struggle to access the market demands enterprises to develop capacity for hiring, supplying, purchasing, obtaining credit, and resolving contractual disputes.

It is imperative to legally empower the excluded, unlocking their assets and businesses because:

The Majority cannot protect their land or homes or use them economically

Finding: 75.6% of rural properties in this assessment are outside the formal legal system of titling, registration and other legal instruments that render property fungible in the market.

Finding: Fully 65.0% of houses also exist outside of the formal market, lacking access to full legal title or other legal descriptions that enable housing to serve as a store of value and the basis of accumulating family wealth.

Includes: Parcels and dwellings without titles or valid registries, or with legal irregularities or with restrictions to transfer them.

The Majority cannot specialize or grow in their businesses

Finding: 91.7% of enterprises are outside of the formal economy, lacking access to the legal protections and instruments that enable enterprises to productively use all of their assets.

Includes: Enterprises not legally established, operating with legal irregularities, without asset partitioning or limited liability. Close to 23 million businesses operate in the informal economy: without the legal tools to divide labor efficiently, follow principles of corporate governance, and separate business assets from personal risks. The majority of enterprises in the region are missing the opportunity to specialize, to expand and integrate globally.

The Majority cannot mobilize their assets or be identified

Informal, or “extralegal assets” become **dead capital** when cannot be used effectively for economic transactions, guarantees, contributions or compensations. Their combined monetary value exceeds by far traditional sources of funding and foreign aid.

Institutional Barriers

Despite recent reform efforts in the region, most legal frameworks remain unclear, unworkable, costly or poorly enforced. In order to illustrate this situation, three representative cases were analyzed in each of the 12 countries:

First Case: Access to property rights is a lengthy and costly process that confronts citizens attempting to purchase, register, and obtain a title on a piece of land, as well as to obtain authorization to build on that land.

The time required for the completion of the process varies from **4 months to 11 years**.

The cost fluctuates across countries between **US\$ 1,040 and US\$ 13,610**.

Countries that have implemented titling reforms perform better than those that have not. Still, further progress is needed to achieve international standards.

- **Lacking the access to secure and enforceable property rights, common citizens cannot protect or use their assets to create wealth, start a venture, or safely invest the remittances they receive from abroad.**

Second Case: Access to formal business organization is a lengthy and costly process whereby burdensome procedures impede entrepreneurs who attempt to create small businesses, thereby raising costs and often forcing them to remain extralegal.

The time required for the completion of the process of business formalization varies from **16 days to 4 months**.

The cost fluctuates across countries between **US\$ 555 and US\$ 7,536**.

Many reforms efforts have focused on this area and significant progress has been achieved in countries such as Bolivia, Colombia and Honduras, among others. However, much remains to be done in other countries, including Guatemala, Haiti, Mexico, and Panama.

- **The entrepreneurship of citizens does not translate into increased global economic integration. Current legal frameworks keep the majority of enterprises in the extralegal world: fragmented, inefficiently and without access to expanded markets.**

Third Case: The economic use of property is a lengthy and costly process, in which the requisites demanded by financial institutions for granting credit and accepting collateral are so complex and costly that common citizens are faced with exclusion once again.

The time required for the completion of the process varies from **8 months to 4 years**.

The cost fluctuates across countries between **US\$ 752 and US\$ 12,489**.

Notwithstanding recent gains made in the provision of microfinance services, the Majority are still unable to obtain credit from formal financial institutions.

- **Access to credit is one of the most important conditions for business development, but is largely unavailable to common citizens and small businesses because of the formidable institutional barriers.**

Despite these obstacles that erode productivity and competitiveness, the extralegal sector still struggles to become part of the modern economy.

III. Going Forward

Three crucial elements can drive change and bring progress

Property Rights → **A legal shortcut to:**

Fix and integrate into reliable records the economic and social characteristics of assets.
Make assets fungible by representing them in all sorts of transactions, making people accountable for them.

Establish reliable networks where people can be identified and interact, protecting transactions and keeping track of them.

Organizational Forms → **A legal shortcut to:**

Divide labor efficiently based on functional hierarchies in order to increase productivity. Implement corporate governance practices to establish sound decision making processes and facilitate accountability.

Separate personal assets from those of the enterprise, limiting responsibility over both business and personal risks

Expanded Markets → **A legal shortcut to:**

Identify people, businesses and transaction documents making activities traceable and reliable, even when dealing with unknown suppliers or customers.

Obtain or give credit, celebrate contracts, claim demands, and grow scale of operations.

The solution to poverty is precisely among the poor. They are not the problem; they are part of the solution.