

Law, Property & Society

Hernando de Soto
and Property
in a Market Economy

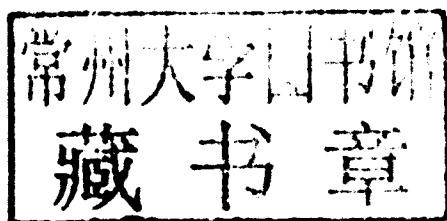
Edited by D. Benjamin Barros

Hernando de Soto and Property in a Market Economy

Edited by

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In Memoriam
Barbara L. Barros
1950–2009

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Introduction

D. Benjamin Barros

The Peruvian economist Hernando de Soto is one of the world's leading public intellectuals. His books *The Mystery of Capital* and *The Other Path* have been tremendously influential in shaping discussions about development economics and related fields throughout the world. He has been included on *Time's* list of the 100 most influential people in the world, and has received praise from politicians from across the political spectrum. His work also has been controversial, and some of his arguments have received sustained criticism.

In his work in general, and in *The Mystery of Capital* in particular, de Soto makes two related arguments about property. First, he argues that the institution of property is necessary to the proper functioning of a market economy. De Soto's argument is supported by a detailed analysis of the role that property serves in making a capitalist economy work. In Chapter 3 of *The Mystery of Capital*, de Soto identifies six tasks that a formal system of property performs: (1) property fixes the economic potential of assets; (2) it integrates dispersed information into one system; (3) it makes people accountable; (4) it makes assets fungible; (5) it networks people; and (6) it protects transactions.

Second, de Soto argues that bringing the assets held by the world's poor into formal property systems will lead to a radical improvement in their wealth and wellbeing. De Soto observes that the poor often have assets—for example, the land they farm, the shanties they live in—but these assets are held informally. Because they are held outside of a formal property system, these assets are dead capital—they cannot easily be sold or used as security for a loan. Formalizing the poor's ownership of these assets, de Soto argues, will transform the assets into living capital that can be used to bring great improvement to their owners' lives. De Soto has acted on his theories, working through his Institute for Liberty and Democracy to pursue land titling programs.

Criticism of de Soto's work often centers on his apparent assertion that land titling is some sort of magic bullet for poverty. The results of empirical studies on the impact of land titling has been mixed, with some studies showing that formal ownership brings tangible, though modest, improvement in the owner's standard of living and access to capital.¹ In fairness to de Soto's critics, *The Mystery of*

1 See, e.g., Sebastian Galiani & Ernesto Schargrodsky, *Property Rights for the Poor: Effects of Land Titling*, available at http://www.utdt.edu/Upload/CIF_wp/wpcif-062005.pdf; Erica Field & Maximo Torero, *Do Property Titles Increase Credit Access Among the*

Capital can be read as suggesting that bringing informally-owned property through a titling program will by itself lead to a radical increase in the wealth of the poorest members of society. In fairness to de Soto, however, he appears to agree that land titling alone will not be sufficient to bring the benefits of a market economy to the poor in developing countries. In an interview, de Soto said:

I'm not saying . . . that other reforms aren't necessary. I'm simply saying that a property rights system is a principal reform, without which other reforms are difficult to manage. It's quite clear that property law alone does not resolve the other problems. But to me, what is also quite clear is that without property law, you will never be able to accomplish other reforms in a sustainable manner.²

As these comments suggest, it is important to distinguish between the two types of arguments that de Soto makes about property. De Soto's arguments that formal property systems are *necessary* to the proper functioning of a market economy receive little, if any criticism. In contrast, de Soto's apparent argument (the above quotation notwithstanding) that property formalization is *sufficient* to bring the benefits of a market economy to the poor has received sustained criticism.

Property lies at the heart of de Soto's ideas, and many property scholars closely follow de Soto's work. I know from personal experience that de Soto's ideas are a frequent topic of discussion at gatherings of property scholars. De Soto's ideas, however, have been strangely absent in legal scholarship about property. To be sure, de Soto has been cited occasionally by property scholars, but the discussion of his work within the legal academy has been minimal compared to the sustained attention that it has received in other arenas such as development economics. There thus has been a mismatch between the impact of de Soto on property scholars' thought and the discussion of his ideas in the work that those scholars produce.

This volume brings together contributions from eleven property scholars from the United States and Canada, taking an initial step in remedying the relative neglect of de Soto in property scholarship. The power and scope of de Soto's ideas are reflected in the range of topics covered in the chapters of this book. These chapters fall into four general categories.

First, the initial four chapters contain general critical analyses of de Soto's ideas about property. In Chapter 1, Eduardo M. Peñalver draws progressive lessons from de Soto's ideas. While de Soto has received praise from political figures across the political spectrum, his market-friendly ideas make him most easily identifiable with the political right. Peñalver suggests that this association

Urban Poor? Evidence from a Nationwide Titling Program, available at <http://www.rwj.harvard.edu/papers/field/Field%20Do%20Property%20Titles%20Increase%20Credit....pdf>.

2 Jeremy Clift, *Hearing the Dogs Bark*, FINANCE & DEVELOPMENT, December 2003, at 11.

is misplaced by arguing that de Soto's positions should lead to a commitment to relative equality in resource distribution. Peñalver notes that de Soto has been critical of government policies that redistribute property from one interest group to another, but he argues that de Soto "by and large endorses the progressive notion that the state may properly redistribute wealth from the rich to the poor in order to assure that their basic needs (however defined) are satisfied."³ This type of wealth redistribution, Peñalver argues, is necessary to maintain the stability and utility of formal property systems in both mature and developing market economies.

In Chapter 2, Carol M. Rose raises two groups of questions about de Soto's emphasis on land titling and property formalization. The first group of questions involves conflicts between title formalization, which often ratifies land invasions, and efforts to preserve land and other finite resources. The second group of questions asks whether de Soto's proposals about land titling would apply universally in all contexts. Rose suggests that de Soto's work, heavily influenced by the experiences of internal migrants in Peru, does not adequately engage in issues of resource preservation and might not easily translate out of its original Peruvian context. Rose also argues that consideration of these two groups of questions suggests important lessons for developed economies. One of these lessons is that the conflict between formalization and resource preservation highlights the need to protect a society's total wealth, not just the wealth reflected in private property rights.

In Chapter 3, Gregory S. Alexander argues that de Soto's account of why capitalism has worked in some countries but not others is incomplete because it neglects the role of culture in a country's economic performance. As Alexander notes, this neglect is intentional—de Soto has specifically rejected cultural explanations for economic differences between countries. Alexander argues that de Soto is wrong to reject the role of culture, and argues that capitalism has succeeded in countries with relatively egalitarian cultures but failed in countries with relatively hierarchical cultures. Many less-developed countries have what Alexander calls a culture of hierarchy, with high disparities of wealth and income, a small or non-existent middle class, limited social mobility, and customary systems of land ownership. The more-developed countries where capitalism has flourished have what Alexander calls a culture of propriety, where there is a robust middle class, a high degree of social mobility, a property ownership system that facilitates innovation and entrepreneurship, and a generally egalitarian political ideology. Simply expanding the reach of a formal property system in a country with a culture of hierarchy, Alexander suggests, will not be enough to allow capitalism to flourish.

De Soto devotes Chapter 5 of *The Mystery of Capital* to lessons to be learned from United States history. Alfred L. Brophy analyzes de Soto's use of U.S. history in Chapter 4 of this book. Brophy argues that de Soto is correct that the institution of property played an important role in the development of the United States, but that the lessons to be learned from U.S. history are far more complex than de

3 *Infra* at 14.

Soto suggests. Like Alexander, Brophy suggests that culture was as, or perhaps more, important than law in allowing capitalism to flourish in the United States. Drawing in part on reflections of property in American art and fiction, Brophy argues that the United States had, and has, a fundamentally capitalist culture. As a result, “a more complete picture is that both our law and our national character are capitalist.”⁴

Second, the next two chapters discuss the possible dangers of land titling and other sudden introductions of property rights. In Chapter 5, Ezra Rosser examines de Soto’s ideas about property formalization through the history of allotment of tribal property to Native Americans in the late nineteenth and early twentieth centuries. The transfer of tribal property to individual ownership was accompanied by pro-property arguments that are remarkably similar to those that feature in de Soto’s work. The outcome of the allotment policy was disastrous for both the individuals and communities involved. The example of allotment therefore presents a cautionary tale about what can go wrong in a land-titling effort. Rosser notes that contemporary land titling efforts might be able to avoid the problems that plagued allotment, but he argues that the risks illustrated by allotment should be considered and addressed by de Soto and other modern advocates for land titling.

In Chapter 6, Rashmi Dyal-Chand uses the current financial crisis to raise further questions about the desirability of property formalization. Dyal-Chand argues that certain troubling patterns tend to emerge when new forms of property are introduced or when certain property rights are extended to poor or unsophisticated people who previously did not have access to them. Because of information asymmetries, the recipients of these newly-introduced property rights are often ignorant of their value. These new forms of property also are often accompanied by bubbles (followed by busts) in property values. The result may be financial meltdown leading not only to individual losses but also to system-wide loss of wealth. Dyal-Chand suggests that regulatory strategies are needed to avoid having the poor hurt by property formalization projects intended to help them.

Third, the following two chapters apply de Soto’s ideas to issues in property theory. In Chapter 7, Nestor M. Davidson analyzes de Soto’s argument that one of the most important roles that a property system serves is to gather information about an asset and to transmit that information at a distance. At a general level, de Soto’s argument is clearly correct—property systems do, indeed, collect and transmit information. Davidson argues, however, that two potential problems may arise in translating the facts on the ground about an asset into the more general language of a property system. One problem is that a property system can only contain a finite portion of the information available about an asset. This subset of information, in turn, may be misleading, and may exclude many of the most relevant facts about the asset. Another problem is that the systems for transmitting information about property are not self-generating—they are typically created by

4 *Infra* at 60.

a state. As a result, these systems may reflect certain government-imposed choices about the conditions of property ownership.

In Chapter 8, Larissa Katz uses de Soto's work on the costs of informality to critically analyze the concept of anticommons, a very influential idea in contemporary property theory most associated with the work of Michael Heller. At its broadest, the concept of anticommons could encompass any scenario in which too many people control the use or disposition of an asset, resulting in that asset's underuse. Drawing on de Soto's discussion of the red tape that faces entrepreneurs in developing economies, Katz makes a distinction between underuse problems that arise when there are too many owners of an asset and underuse problems that arise from having too many people who have a say in the use of an asset. In the former category, the problems arise from facts about ownership; in the later, the problems arise from facts about who controls use. The two categories are not congruent because many non-owners (for example, government regulators or contract counterparties) may have a say about the use of an asset. Katz argues that the concept of anticommons should be limited to the former category, where asset underuse is the result of the ownership characteristics. Katz then argues that most problems of asset underuse fall outside of this narrow anticommons category, and are caused by problems with the distribution of private and public authority over the asset, rather than problems with the ownership of that asset.

Finally, the last three chapters apply de Soto's ideas to specific legal issues. In Chapter 9, Nicole Stelle Garnett considers the role of informality in urban transportation and street vending. These two areas of economic activity are at the center of de Soto's discussion of the burdens facing entrepreneurs in *The Other Path*. On the surface, de Soto's concern with mercantilist policies that inhibit innovation in less developed economies would seem not to apply in mature market economies like the United States, which are generally seen as being very open to innovation. Through examples drawn from American cities, Garnett shows that many of the same issues that de Soto encountered in countries like Peru also appear in countries like the United States. Garnett argues that urban transportation and street vending are amenable to mercantilist regulation because entrepreneurs operate in the public commons, making simple property solutions like titling untenable, and because informal entrepreneurial enterprises conflict with elite aesthetic images of good city life. Garnett concludes by suggesting that the continued presence of illegal transport and vending businesses in many U.S. cities emphasizes the need to draw on one of de Soto's important insights and focus on the costs required to bring a business into the formal legal economy.

In Chapter 10, Juliet M. Moringiello uses de Soto's analysis to critique the U.S. legal system's treatment of intangible assets. As de Soto explains in Chapter 3 of *The Mystery of Capital*, one important role of a property system is to collect and transmit information about an asset. Moringiello argues that while the U.S. legal system serves this function well for tangible assets, it does so much less effectively for intangible assets. Article 9 of the Uniform Commercial Code governs one type of interest in intangible assets, security interests in personal property. Moringiello

argues that Article 9 fails to fulfill two of the important tasks that de Soto identifies for a property system—integrating dispersed information into one system and making assets fungible. These deficiencies in the legal system’s treatment of intangible assets will become increasingly problematic, Moringiello suggests, as intangible assets become ever more central to the functioning of a mature market economy.

In Chapter 11, Denis J. Brion draws on de Soto’s insights to criticize the broad use of eminent domain to promote economic development. The use of eminent domain for this purpose has received a great deal of public comment since the United States Supreme Court’s controversial decision in *Kelo v. City of New London*.⁵ The use of eminent domain for land assembly and the informal ownership of land present similar issues. If a parcel of property is divided among many owners, or if the parcel is held informally, then it may not be put to its highest and best use. The broad use of eminent domain, then, would appear to be consistent with de Soto’s ideas about turning assets like land into the capital that allows a market economy to thrive. Brion uses welfare economics to argue, however, that the broad use of eminent domain counterintuitively removes land from the realm of efficient market exchange, and therefore reduces that land’s effectiveness as capital. The result is that the broad use of eminent domain is likely lead to a long-term reduction in aggregate social welfare, even if it will lead to a short-term increase in wealth.

5 545 U.S. 469 (2005).

Chapter 1

The Costs of Regulation or the Consequences of Poverty? Progressive Lessons from de Soto

Eduardo M. Peñalver¹

Titling is a hot topic in contemporary development circles. The World Bank's 2006 World Development Report, for example, touts the "potentially large benefits" that would result from formalizing title in both rural and urban lands.² And, since the 1980s, the Bank, along with a number of the other major international development agencies, has poured billions of dollars into titling projects in the hopes of improving the lives of some of the world's poorest human beings.³ A great deal of the credit (or, depending on one's assessment of the merits of these programs, blame) for the explosion of titling programs lies with Hernando de Soto, whose books *The Other Path* and *The Mystery of Capital* aggressively and eloquently made the case for titling as a development strategy. De Soto's diagnosis, in a nutshell, is that underdevelopment is a result of "informality," to use his preferred term. By informality, de Soto means extralegal economic conduct, whether in the operation of a business, the construction of a house, or the occupation of a parcel of land. Widespread informality occurs when large numbers of people are excluded from participating in the market system.

Why does de Soto think that informality leads to underdevelopment? After all, he takes great pains to point out that the poor inhabitants of underdeveloped nations are not as destitute as they seem. Even landless squatters, who are living in homes they have built on land (state or private) that they do not own, have a great deal of wealth. Indeed, de Soto's most dramatic claim in *The Mystery of Capital* is that squatters have at their disposal \$9.34 trillion in real estate wealth. The problem, de Soto says, is that they "have houses but not titles."⁴ And without titles, he argues,

1 Thanks to Larissa Katz for helpful comments and suggestions.

2 THE WORLD BANK, WORLD DEVELOPMENT REPORT 2006: EQUITY AND DEVELOPMENT (2005), available at http://www-wds.worldbank.org/servlet/WDSCContentServer/WDSP/IB/2005/09/20/000112742_20050920110826/Rendered/PDF/322040World0Development0Report02006.pdf.

3 See Bernadette Atuahene, *Legal Title to Land as an Intervention Against Urban Poverty in Developing Nations*, 36 G.W. INT'L L. REV. 1109, 1111 (2004).

4 HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE, 7 (2000) [hereinafter MYSTERY OF CAPITAL].

informal owners cannot put their assets to work as capital. "It is the unavailability of these essential representations," he argues, "that explains why people who have adapted every other Western invention, from the paper clip to the nuclear reactor, have not been able to produce sufficient capital to make their domestic capitalism work."⁵ Without title to their homes, squatters cannot easily sell those homes or access formal credit markets that would enable them to leverage the value of their homes as collateral for loans that they might, for example, use as seed money for small businesses. De Soto's prescription is simple: to liberate the latent wealth that already exists among the poor, we must bring those operating in the "informal" economy into the formal economic system by, for example, granting squatters legal title to the land they occupy.

De Soto's embrace of markets and private property rights as his principal development strategy has earned him a great deal of affection from the political right, both in Latin America and the United States. *The Other Path* featured a foreword by conservative Peruvian politician and novelist Mario Vargas Llosa as well as cover praise from the first President Bush, Richard Nixon, and neoconservative Catholic theologian Michael Novak. Similarly, *The Mystery of Capital* attracted fawning comments by such leading conservatives as Margaret Thatcher, Milton Friedman, Jeanne Kirkpatrick, and William F. Buckley, Jr. Conversely, de Soto has frequently been on the receiving end of attacks from thinkers on the political left.⁶ On one level, this line-up of praise and criticism is not very surprising. As Ray Bromley explains it, "[d]e Soto's advocacy of market forces, free trade, and privatization fits a classic right-wing prescription, as does his emphasis on entrepreneurship, technological innovation, and the inherent dynamism of the unplanned economy."⁷

Against this apparent consensus, and even to a certain extent against the thrust of de Soto's own writing, I will argue in this short paper that the political implications of de Soto's core ideas are actually far more ambiguous than might initially seem to be the case, and perhaps more than de Soto himself realizes. In the next section, I will argue that, despite the widespread tendency to understand de Soto's work as favoring traditionally conservative economic policies, we can draw more progressive lessons from it as well. In the third section, I will argue that de Soto's basic diagnosis brings to center stage the state's obligation to combat excessive inequality. In the concluding section, I will point toward some lessons this progressive reading of de Soto has to offer, even for those of us living and working in the developed world. Although de Soto employs a number of examples, including cases drawn from the world of landownership, transport, and street-vending, my principal focus throughout will be on his discussions of land.

5 MYSTERY OF CAPITAL, *supra* note 4, at 6–7.

6 Ray Bromley, *A New Path to Development? The Significance and Impact of Hernando de Soto's Ideas on Underdevelopment, Production, and Reproduction*, 66 ECON. GEOGRAPHY 328, 331 (1990).

7 *Id.*

The Conservative de Soto

The conservative, and in many ways the most natural, reading of de Soto's work understands his fundamental insight to be a profound skepticism of state intervention in the market. Viewed from this perspective, de Soto assigns primary responsibility for informality, and the poverty it enshrines, to the costs of wasteful state regulation. As Vargas Llosa puts it in his foreword to *The Other Path*, "[b]lack-marketeering is the masses' response to the system ... which invents laws to frustrate the legitimate desires of the people to hold jobs and have a roof over their heads."⁸ And if regulation is the root of the problem, then the solution for informality is the withdrawal of the state from economic intervention.

There is no denying that this powerfully anti-statist message is a crucial part of de Soto's self-understanding. Part II of *The Other Path* centers around a sustained critique of what de Soto (somewhat confusingly) calls the "mercantile" state. The mercantile state is characterized, de Soto argues, by wasteful regulation, a bloated bureaucracy, and endless cycles of rent-seeking and interest-group politicking. Thus, in discussing barriers to landownership, for example, de Soto goes into great detail about the bureaucratic hurdles that stand in the way of the legal acquisition of vacant state land. "[T]his procedure," de Soto observes, "takes 43 months (3 years and 7 months) and involves up to six different state departments, including the president of the Republic. ... [T]he 43 months that it takes for adjudication are the result of 207 bureaucratic steps involving 48 different government offices. Each step takes about one working week."⁹

In addition to the anti-regulatory bent of many of his arguments, de Soto frequently condemns state-sponsored redistribution. Chapter Six of *The Other Path*, for example, is dedicated to a blistering condemnation of "the redistributive tradition" in Latin America.¹⁰ "There appears to be a tradition among our country's lawmakers," de Soto argues, "of using the law to redistribute wealth rather than to help create it."¹¹ This redistributive tradition, he writes, "has created in Peru a society where almost all the country's vital forces have organized in political and economic groups, one of whose main aims is to influence government in order to obtain a redistribution which favors them or their members."¹² To summarize, then, the conservative reading of de Soto emphasizes wasteful regulation as the source of informality and opposes state-sponsored redistribution of resources in favor of policies that emphasize wealth creation.

8 Mario Vargas Llosa, *Foreword* to HERNANDO DE SOTO, *THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD* [hereinafter *OTHER PATH*], xiii, xviii (Alfred J. McAdam, trans., 1989).

9 *Id.* at 136.

10 *Id.* at 189.

11 *Id.* at 189.

12 *Id.* at 190.