Hernando de Soto and the mystification of capital

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19 January 2007

In a critique of Hernando de Soto's bestselling The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else, Staffan Granér finds de Soto's methods unreliable and his theories over-simplified. De Soto claims that if "dead capital" were legalized, it would elevate the poor out of poverty. In reality, de Soto's formalization of the economy aims to protect rights of ownership and ease the way for free market transactions, not to create regulations and a social safety net. "By maintaining that poverty can be solved simply by giving all of the poor formal rights of ownership", says Granér, "de Soto pulls a mystifying veil over what are in fact real social discrepancies."

Hernando de Soto’s book The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else has become something entirely unique: a bestseller from the field of Development Economics. Since the book first came out in 2000 [1] in Spanish and English, it has been translated into at least nineteen other languages, including Arabic, Chinese, and Russian. [2] The book has often received gushing praise in the press, as witnessed in examples from such well-known newspapers and magazines as The Times: “No less than the blueprint for the new industrial revolution.”; or The Economist: “The most intelligent book yet written about the current challenge of establishing capitalism in the developing world.” In a review before publication, Sweden’s largest daily newspaper wrote, “If there is any justice in the world, de Soto [will be] a clear candidate for the Nobel Prize in Economics.” [3]

Several of the world’s most prominent figures, such as Bill Clinton, Kofi Annan, George W. Bush, Margaret Thatcher, Mexico’s Vicente Fox, and Egypt’s Hosni Mubarek are in agreement with this panegyric. Even Luiz da Silva and his leftwing Brazilian administration refer to de Soto as the inspiration behind one of his more radical reform programmes.

Instituto Libertad y Democracia (ILD), the research institute in Lima founded and directed by de Soto, has been ranked as the world’s second-most influential think tank, with assignments from the ILO, the UN, and some thirty governments in the Third World
and former Soviet states.

Among academic economists and researchers in economic development, the reception has been less univocal. Prominent Nobel Prize recipients such as Ronald Coase and Milton Friedman chime in with the chorus of praise. Elsewhere, however, in less popular scientific publications, criticism and a demand for common sense and moderation has been expressed.

Even before I give an account of the primary features of the line of reasoning that has received this overwhelming political and media response, it may be appropriate to introduce some notion of why so many find de Soto’s analysis appealing. He claims not only to have the answer to the question posed by the book’s subtitle, but also offers a simple recipe for its solution, which does not demand much more than the good will of decision makers and legislators. Many earlier explanatory models have involved a number of ingredients, indigestible for many, which de Soto’s analysis seems to be able to do without. First of all, de Soto’s suggestions do not include any need for redistribution of wealth from privileged groups, or debt relief, whether on a global or a local level. Nor are the gaps between the world’s nations and regions ascribed to any historical injustices or positions in an unequal economic world order. It is not market capitalism per se that lacks the ability to bring prosperity to poor countries. Market capitalism is – as de Soto often repeats – “the only game in town”. The only thing necessary is to do away with the specific institutional factors that prevent capitalism in the Third World from developing to its full potential, as in the industrial and welfare states. Here de Soto aims his rhetorical weapon at what he views as the socialist and Marxist monopoly on representing the interests of the poor. [4]

Second, de Soto explicitly distances himself from the old Weberian idea that poor people’s ability to achieve prosperity and advancement is restricted by cultural dispositions and patterns of behaviour. People in developing countries are, de Soto claims, just as capable of innovation, creativity, and entrepreneurism as those in the West. The poor are not the problem; they are the solution.

The crux of de Soto’s argument about why the nations of the Third World and the former Soviet bloc are burdened by crippling poverty is that there are deficiencies in their organization of property rights. This applies to legal institutions as well as their implication and adaptation to factual circumstances. According to de Soto, the poor have at their disposal all of the material resources they need to secure prosperity. What they lack above all is a formal, officially registered right of ownership of these assets. The absence of such legal instruments means that the assets of the poor cannot be purchased, exchanged, sold, bequeathed, lent, or transferred in any way other than within the framework of limited networks, often subjugated parasitic local institutions of power. Thus, these assets cannot serve as the basis for an efficient and dynamic accumulation of capital. They become, in de Soto’s words, “dead capital”. Thus the informal sector becomes what is usually called undercapitalized and as a result cannot realize its full potential.

It is de Soto’s mission to clear away the bulwark of bureaucracy, corruption, and irrational legislation and application of law that separates the informal sphere of economic activity from the formal economy’s well-defined, registered, and regulated
sphere of economically functional private property. His examples of how this bulwark functions are at times drastic. In one experiment, his colleagues at the research institute tried to register a newly opened dressmaker’s workshop as a completely legal individually owned company. If we are to believe the report, this consumed 269 workdays, six hours a day. The fees required by the process were equal to 31 months’ pay for a Peruvian worker at minimum wage. To receive legal permission to construct a building on government-owned land demanded 207 separate contacts with 52 different officials. To get the title of this building once it was finished is supposed to have involved 728 such contacts.

During the 1990s, de Soto was one of Peruvian President Alberto Fujimori’s advisers on economic issues. As such, he was active in pushing through the programmes for structural adjustments initiated by the World Bank and IMF as a cure for the debt crisis of the 1980s. The ingredients were the same as those in the rest of Latin America. Among them were contraction of the public sector, liberalization of the market, free trade, privatization of public assets and enterprises, as well as various measures to keep wage costs down. This policy, which goes by the name “Fuji Shock” in the recent history of Peru, was also applied with unusual brutality in that country. The Fujimori regime went even further than Mario Vargas Llosa’s rightwing party and the IMF had originally suggested.

The effects are well known: macroeconomic stabilization in the form of a balanced budget and an end to hyperinflation, but growing poverty and misery because of rising food costs, decreasing minimum wages, and mass dismissals of personnel in the public sector and non-competitive industry. Long-term growth effects were far from impressive, with new economic crises appearing in the late 1990s. It is probably against this background that one should understand de Soto’s interest in the question of why the liberal market economy textbook formula does not seem to work in many poor countries.

The phenomenon to which de Soto primarily refers will most likely seem familiar to many who have ever visited the shantytowns that surround the rapidly growing big cities of Asia, Africa, or Latin America. If one looks for the poverty of passive underemployment one can certainly find it, but the more lasting impression is that of energetic economic activity. The people who live in the slums have fled the countryside to support themselves and they are, for most hours of the day, completely occupied with exactly that. Here one finds not only crowds of craftsmen and junk dealers, but also true workshops, textile industries, carpenters, shoemakers, and small assembly industries, to name a few. Service employees flow from this area to the heart of the city in the form of housekeepers, casual labourers, rickshaw drivers, street vendors, food-stall owners, prostitutes, and drug dealers. This is business at a micro level with no registration, legal contracts, taxes, or accounting. It is a daily sale of labour in an uncertain localized spot market without employment contracts. These are economic transactions and relations which in many respects are established and maintained without legal protection and regulation. The participants have to depend on their trust in social networks, established norms, their own ability to enforce sanctions, or the benevolence of the stronger toward the weak.

The ever-ongoing economic activities in the slums also include house building. These are often the simplest imaginable constructions made of tin-plated roofs, bricks, and cinder
blocks, but the variation is great. The property usually lacks official registration or title. The owners are squatters on the land that belongs to the state or some absent landowner. Often the shantytowns are built on rocky, dry, and rugged ground, on garbage dumps, in railway yards, between the lanes of freeways, or in the shadow of factories leaking poison. Areas that had little economic worth before the squatters filled them with life, and which would return to the same condition if they were evicted. In some places, bulldozers have come and levelled the towns to the ground in order to create living space for the middle class, prepare the land for growing heavy industry and infrastructure, or just in order to carry out some ambitious development scheme. This happened in Delhi under Indira Gandhi’s brutal martial law during the 1970s and it is happening in Bombay, Shanghai, and Harare right now, but these are nevertheless exceptions.

Thus, the economic activity carried out in the informal sector not only takes place outside the forms taken for granted by the textbooks of economics. It is to a large extent hidden from the national accounts. De Soto illustrates this by showing that while the construction sector was relatively small and stagnant in the national accounts of Peru and Brazil, the sale of construction materials in those countries has been large and growing.

A great deal of research has been done on informal economies – or, to use competing terms, the shadow economy, the hidden, the underground, the black economy – research which de Soto ignores completely. [5] Many of the general observations that are relevant and appropriate in de Soto’s argument can be found in this research as well.

The contribution that has given de Soto and ILD a place in the textbooks of development economics is that they actually have dared to put a value on the dead capital that resides within the limbo of the informal economy. Their method is unconventional but sufficiently heroic and laborious to impress some econometricians who have themselves been restricted to the limited horizon of statistical indicators. During the last decade of the twentieth century, ILD’s researchers set out to do fieldwork in order to count and estimate the value of buildings in five cities. It was only the buildings themselves that were estimated, not the value of industrial and commercial activities. The overwhelming majority were of course dwellings. The explanation is practical. The production of the informal sector takes place in the shadows, but the buildings stand where they are. That’s why de Soto also claims that the estimates they produced should be understood as minimum values. If the buildings themselves are worth so much, the value surely must be even bigger if the productive activities were counted as well? Besides in Lima, the study was also carried out in Mexico City, Manila, Cairo, and Port-au-Prince. However, regarding Mexico City there are no figures presented in the book, and it is unclear how the situation there would influence the conclusions.

Nor do we find out much about how the researchers in the field acted in order to find out what market value real estate without formal titles might have, if they were to be formally registered. Here the reader is expected simply to trust the researchers’ own judgment in a procedure that with all certainty can never be repeated. This is undeniably problematic, as one of the foremost reasons that de Soto’s writings have attracted so much attention is the astonishingly high potential value that is ascribed to dead capital. It is these resources that are supposed to elevate the poor out of poverty. The results of the case studies have served as the basis for assumptions about global averages for the share of informal real estate and its value in 179 developing nations and former Soviet states.
The presented sum is tremendous: 9.34 trillion dollars, of which 6.74 trillion is the appraised value of the property in shantytowns.

Such an astronomical figure is undeniably difficult to grasp. De Soto makes a pedagogical attempt to do so by maintaining that it is “almost precisely as much as the total value of all companies listed on the most important stock exchanges in the world’s twenty most developed countries”. As is most often the case, de Soto drops figures without bothering about references. If one checks his claim against the home page of the New York Stock Exchange, one can establish that the total value (Global Market Capitalization) of this exchange alone, certainly the world’s largest, rose to 16 trillion dollars in 2001 and that it had grown to 19.8 trillion by 2004.

Here the reader must also ask whether observations of four large cities in relatively small countries can form the basis for such precise assumptions applied to China’s and India’s mega-populations or other so-called developing countries. In a worldwide examination of informal economies’ extent, Peru, the Philippines, Egypt, and for that matter Mexico (Haiti was not discussed in this report) were counted among the very least formalized economies of their respective regions. [6] This of course renders them interesting objects for studies of the phenomenon of the shadow economy, but hardly appropriate points of departure for general conclusions about its global scope.

But the most obvious problem that comes up when de Soto’s calculations are put under critical scrutiny is to find any connection at all between the figures of the share of informal property and their estimated value as given in the case studies, and the assumptions about the same values applied to the global demographic material. [7] De Soto’s calculations assume that 85 per cent of all urban real estate in the Third World is informally held. This is somewhat lower than the share given by ILD’s report of their own case study in Egypt (92 per cent), but significantly higher than the figures given for Peru (53 per cent), the Philippines (57 per cent), and Haiti (68 per cent). We can also conclude from the calculations that the average value of all this informal urban real estate around the world should be taken to be as high as $20 500. But this figure has no obvious support in their case studies either. The average value for Peru – the richest of the investigated countries – is in fact given as somewhat higher ($21 471), but for the other countries it is significantly lower (Egypt, $16 403; the Philippines, $14 939; Haiti, $5739). [8] The majority of the world’s poor live in countries with significantly lower GNP per capita than Peru; Egypt and the Philippines, too, are richer according to this measure than the giants India and China. [9] As a reader, one is consequently left in a state of total uncertainty about what actually forms the basis of de Soto’s estimates.

The book gives few clues as to how de Soto and his group determined the value of informal property in rural areas, not even on the level of national case studies. Not only buildings but also unregistered farmlands are included in this category. And, it seems, also areas administered through collective, cooperative, or public organizations. The global value of informal agricultural assets is extrapolated to $2.6 billion. This is of course a huge figure on its own, but as part of the calculated total value of informal assets, it seems nevertheless remarkably low. This is also one of de Soto’s messages. The great potential is to be found in the cities. The massive urbanization of the last five decades should be seen as an opportunity, not a threat.
The above mentioned could seem nothing more than an irrelevant numbers game. It lies in the nature of the informal economy that it operates in obscurity so that its scope and character are difficult to estimate. But the numbers themselves play a central role in the promotion of de Soto’s book, and in the praise of ILD’s research contributions, it is often noted how the extent of the informal economy has now been revealed, using unconventional research methods.

We can of course leave exact quantification to the side and be content with the fact that de Soto and his collaborators have established that the informal sector makes up a very large part of the economy in the studied cities, and that the major share of property there lacks any kind of registered proof of ownership. It is probably also appropriate to assume that this is the general condition in poor countries. To that extent de Soto’s book does in fact agree with many other observations and research results but does not add much new knowledge. Understanding more about how resources are disposed of and managed in the informal economy then becomes at least as important as the price-regulated transactions and public administration treated in traditional economic textbooks.

But de Soto’s claim is more grandiose. The extent of informal capital is presented as the determinant factor that turns some countries and regions into wealthy societies while the majority of the world’s population lives in relative poverty. If informal capital could be formalized, the economies in those countries could follow in the footsteps of the rich Western world. If regimes and lawmakers could only mobilize the proper will and determination to tear down bureaucratic and judicial hindrances, the dead capital could come to life.

Here we see the need to consider the book’s argument a little more closely. What does it actually mean to bring dead capital to life? In de Soto’s gospel, dead capital is presented almost as a buried treasure. Put a price tag on the capital owned by the poor, make it available for price-regulated transactions, and the poor will suddenly be prosperous.

But a society’s potential to produce material wealth is not determined primarily by a pile of assets, with or without a price tag. The decisive thing is rather the flow of utility that these assets might yield when they are combined with human and natural resources, and how this flow is distributed. So-called dead capital is in this sense far from sterile. There are people living in the shacks and houses of the shantytowns. Even in unregistered companies, goods and services are produced. If these assets were to be accorded formal legal status, it would not automatically mean that the flow of utilities to which they contribute would be changed. We should certainly attain a more realistic notion of national accounting, but formal bread doesn’t weigh any more than the informal kind.

What de Soto actually argues is that these assets would produce significantly more wealth if they were drawn into the formal sector. There are certainly theoretical arguments in favour of this. Here we find the efficiency argument that de Soto shares with other apologists for free market exchange. Taking the perspective of welfare into consideration, one would argue that a formalized economy creates better conditions for applying legislation and regulation to protect labour, tenants, and consumers: for example, prohibition of child labour and debt slavery, regulation of workplace environment and fire safety, minimum wages, and rent control. De Soto says nothing about such possibilities. His formalization of the economy aims to protect rights of
ownership and ease the way for free market transactions, not to create regulations and a social safety net. Nor do such regulations require that property rights are formalized specifically in favour of private ownership; the same effects can be achieved in cooperative or public regimes. Above all, they require a welfare-oriented political will and strength in which a formalization of economic relations makes up a perhaps important but far from sufficient foundation. In countries where politics, justice, and the monopoly of violence have traditionally been controlled by an economic elite, there are also good reasons for weak groups to keep their meagre assets out of the reach of public control.

There is no unambiguous empirical support for the idea that the formal economic sector is more effective than the informal. On the contrary, a number of studies indicate that productivity is in fact higher in the informal sector, probably because labour is exploited more harshly and bureaucracy plays a smaller role. [10] For example, in Taiwan, which is often put forward as the most dynamic of the East Asian “tiger” economies, a significant part of the industrial sector is primarily informally organized. Alongside large-scale industry, in which government influence has at times been great, a very expansive textile industry and some simpler assembly industries have been established within the framework of what has sometimes been described as guerrilla capitalism. [11] Here credit mobilization, control, and security functions are organized within a framework of complex relations of family connections and social networks that extend across all of East and Southeast Asia and have historical roots in the commercial class that fled Shanghai and other mainland Chinese coastal cities during the revolution.

The argument upon which de Soto places the greatest emphasis is, however, that formalization and registration of property facilitates the mobilization of credit. This too is in some respects reasonable. A requirement for a bank or other lender to accept real estate or other capital as security for a loan is of course that the asset can be sold if the borrower cannot pay. Probably the lender also wants to be able to verify the legitimacy of the borrower’s ownership of the property, for instance that it is not being lent to someone else. The more difficult it is to obtain this information, the more dubious the security, which reasonably enough puts upward pressure on the rate of interest. It is therefore difficult to deny that formalization and registration of ownership of the shantytowns’ assets makes it easier for the inhabitants to borrow money. The question is only how much easier, and what significance this has for the welfare of the people living in the slums? The process by which de Soto expects that the formalization of dead capital will bring prosperity via increased mobilization of credit actually involves a number of complex transformations that de Soto hardly bothers to problematize. Assets will become security, security will produce credit, and credit will produce higher incomes.

The research undertaken on the topic of opportunities for the poor to mobilize credit shows that the lack of formal property rights is not the only, and far from the most important, obstacle when, for instance, people living in slums apply for credit. Their lack of contacts, education, and language skills as well as the lack of documented and regular income often stands in their way even if property with formal titles can be used as security. [12] Research on credit in developing countries shows that lenders often demand securities valued several times higher than the sum of the loan. This transformation would imply a significant decrease in the value de Soto estimates for dead capital. [13] Nor can we take for granted the fact that people who get access to more credit use it only for long-term income-producing investments. That is not the case in
wealthy Western countries and surely even less the case in poor slums whose inhabitants usually live on minimal economic margins.

In de Soto’s rhetorical construction, the informal character of the economies becomes not only an explanation of why people live in poverty. Informal economy emerges more or less as synonymous with poverty. If the economic life of the poor could be incorporated into the rationally organized formal economy, their living conditions would improve rapidly. Poverty does not actually arise from a lack of resources, but a lack of proof of ownership. In this way the organization of property rights becomes the only relevant distinction between formal and informal. All other components are ignored or treated as nothing more than secondary effects.

Empirical research produces a significantly more multifaceted image of the informal economy. Its businesses can be factories with up to 100 employees or a woman with a bathroom scale on a street corner, as well as drug cartels or security companies. Its buildings can be sheds constructed of mail sacks and tin plate or more solid constructions of bricks or concrete blocks. Here one also finds multi-family dwellings whose inhabitants frequently pay rent-like fees to local gangsters or, if you like, guardians. Thus if one wanders long enough in the shantytowns, one can encounter luxurious and frequently well-fortified villas where such slumlords might reside. They too were surely built on squatted ground, and as such of course belong to the informal property sphere. The informal economy can be an occupied factory in Argentina or illegal immigrants hired on the black market who work for low pay as seasonal workers within agriculture, who do housework, and who uphold an ever-greater portion of the work-intensive service sector in the wealthy Western countries. In the informal economy, one finds international networks of prostitution, trafficking, and drug trade, but also the villages’ food production for their own use and sale in local markets, or neighbours and friends who exchange services with one another.

De Soto’s dualistic distinction between two homogenous economic sectors, the formal and the informal, thus becomes a rather coarse distortion of reality. It is probably more accurate to see gradual differences between multitudes of arrangements of property rights which within themselves contain formal as well as informal elements to varying degrees. This difference of degree is furthermore primarily qualitative in character and thus is difficult to quantify in a meaningful way. In many cases the informal economy can best be described as a complement to the formal sector, such as when the street corner cigarette vendor becomes the final link in a transnational tobacco industry’s production and distribution chain.

When a dualism of that kind merges with a developmental history perspective, de Soto’s reasoning gives a - to my mind - rather musty aftertaste of old modernization theory with roots in an evolutionary historical model. It is a theoretical perspective that takes as its points of departure the conceptual dichotomy of traditional and modern, and the expectation of a cumulative and linear process of evolution. In this tradition, developed, modern Western countries and a flattened, homogenous model of the forms of production and institutional structures established there were granted the right to supply an itinerary for the one-way road of development that the so-called underdeveloped countries were supposed to travel. Poverty then becomes a question of backwardness; the thing to do is to mobilize those resources needed to speed the process and get rid of
the institutions that hinder or slow the journey of the poor toward the prescribed goal. In alignment with this perspective, de Soto places the informal economy in a traditional, pre-modern sphere. Poor countries have not been able to free themselves of the impediments of informal relations.

This evolutionism does not tally with historical experience. It is far from given that development moves toward more formal organization. As de Soto himself indicates, for example, the development of the Brazilian rental market during the crisis years of the 1980s and 1990s implied that almost the entire sector was deformedalized. The research that has been done on the extent of the informal economy in Great Britain shows that the sector grew drastically during the crisis of the 1970s and the subsequent austerity programme of the Thatcher regime. [14] In these events, history does not support the notion of a one-way causal relation between informal arrangements in economic relations and poverty. The above examples rather show the opposite; when conditions and unemployment worsen, an informal economy expands.

Other objections to the evolutionary interpretation can be based on the globalization of the world’s economy. When the world’s economies are integrated to an ever-greater extent at the global level through increased trade, migration, and financial flows as well as ever-larger transnational companies and economic networks, the scope of formal institutions that regulated the ownership of wealth at the national and regional levels is undermined.

This takes many concrete forms. Illegal immigration implies that a significant part of the world’s population is forced to conduct its self-support completely on an informal basis. In general, increased ethnic segregation, primarily of labour markets but surely also of, for example, real estate markets and credit markets in many places, gives the informal economy good opportunities to grow at the cost of the formal economy. The difficulty in achieving consensus on how to determine property rights to collective global goods such as the fishing reserves of the world’s oceans, scientific discoveries, copyrights, or the scarce resource that is comprised of, say, the limited duration of the stratosphere under the effects of human production, are examples of this. The economic aspect of the globalization debate of recent years is perhaps primarily about how such a formalization of economic relations ought to be formed. There is no unambiguous path here. Instead, special interests and ideological positions face off against one another. The MAI proposal’s demand for protection for international investors opposes demands for the Tobin tax, sanctions against tax shelters, or the Kyoto Protocol’s regulation of emissions. Open source stands opposed to intellectual property rights.

This conflict perspective leads us directly to what in my opinion is de Soto’s weakest point. If I were to put on my most far-sighted glasses I would probably be able to overlook the majority of the objections that I have formulated thus far. There is no point in objecting to the statement that the informal sector makes up a very large part of the economies of many poor countries. All factors considered, it seems reasonable to assume that in many ways this makes life more difficult for people living in these countries, even if the connection between cause and effect is, as I have demonstrated, far from unambiguous. One can thus hardly claim that the opportunity for a stronger actor to exploit and oppress the weaker decreases if property rights are informal.
It is when he begins to discuss how more effective and wealth-generating institutional organizations should be formed that de Soto’s simplifications become truly irritating. Mainly this is just a question of correcting some disparities in legislation, the application of law, and bureaucracy. What needs to be corrected can be determined by comparing the successful West with the impoverished East and South. The losers in this argument are few and hardly sympathetic; they are corrupt bureaucrats and their collaborators belonging to a small group of businessmen protected from competition, who have monopolized the formal sector. Everyone else, those who are forward-looking and want to create something new instead of preserving what exists, from the poor entrepreneurs of the slum to international big capitalists, stand out as clear winners.

De Soto refers to the historical development that the successful industrial nations have already gone through. References to European development are sweeping, despite the fact that the literature on this subject is extensive and full of controversies. De Soto contents himself by pointing out that something clearly happens in the transition from feudalism to capitalist property relations. It is in the history of the United States that he finds his concrete examples. The ideologically loaded version of history that de Soto recounts here is well known from Hollywood screen versions as well as from scholarly studies in history. It is the story of the great Western frontier, where settlers, ranchers, and gold miners successfully established a formalized system for exclusive ownership of grazing lands, farmland, homesteads, mines, and miners’ claims. Just like today’s slum dwellers, they began as squatters, occupiers, and in the beginning, like the majority of the Third World’s farmers, they held no formal titles to the land they used. It is the American system’s ability to transform the extralegal rules and customs that the squatters developed into property rights legislation that, according to de Soto, created the very basis for dynamic capitalism.

It is this legal development that de Soto wants to carry over to the poor countries. Formal extra legal claims must, he says, be accepted and integrated into the formal system. It is certainly a revolutionary thesis, but it is not easy to see where de Soto imagines it will lead. The institutional landscape that de Soto wants to reconstruct has little in common with the nineteenth-century American frontier. Here there is actually a whole raft of contesting legal claims posed against one another. Who, in fact, is the one to whom formal ownership should be granted? And what actual rights and responsibilities arise from such formalization?

Not even de Soto’s favourite example from North America is exempt from such conflicts. Besides the most obvious one, that the original inhabitants were robbed violently of their hunting grounds and cultivations for the benefit of the conquerors’ expansion, the settlers also had conflicts with each other about their claims as well as conflicts with other interested parties. Federal and state officials had sold and distributed land concessions to mining and rail companies. The struggle between those companies and the settlers is a repeated theme in the history of the expansion of the United States.

Even more complex were similar conflicts in the process of European modernization, where the relative scarcity of land was significantly larger and the heritage of feudal structures palpable. As Marc Bloch once stated, in pre-modern Europe it could be impossible to point to any one person as the owner of a particular parcel of land. The claims to the land and its fruits could be made by various interests and branched out
along horizontal as well as vertical lines in the social landscape: between the peasant farmer and his immediate superiors, and further up in the feudal hierarchy to the level of jurisprudence, as well as between farmers and their relatives, neighbours in the village, and other networks of local collaboration.

The concept of ownership in its narrow legal sense does not suffice to provide a conceptual vocabulary for such a network. It is more appropriate to imagine a bundle of legal claims that regulate the rights of individuals and groups to determine use of various resources. Such bundles are constructed and supported not only by formal legislation and the power of the state to impose sanctions, but also by social networks, customs, and norms. In the end, the limits to each individual’s or group’s potential for entitlement are set by the legitimacy granted their claims by other interested parties or by the resources of power the various parties are able to mobilize. The distribution of such bundles of legal claims are not only formed at the individual level but also derived from social categories, such as estate, caste, class, gender, and ethnic identity.

Property rights thus do not primarily express an individual’s relation to specific assets; rather, relations between individuals are mediated through their relation to these assets. These rights manifest, as Karl Marx once argued, social relations. De Soto is not at all a stranger to this definition; in fact, he repeats it approvingly in a number of places. Still one can well ask oneself if he is prepared to follow through to the logical conclusion of such an argument.

The bundle of property rights can be divided and given many different dimensions. Three that are often mentioned are the right to use an asset, the right to the surplus it generates, and the right to make transactions with it. Other important dimensions include the possibility an interested party has to exclude others, [17] as well as the degree of formality in the formulation of the rights. These dimensions are mutually dependent on one another. If one of them is changed, the conditions for the others are shifted as well. To have formal property rights usually implies that the owner has a broad spectrum of rights over an asset. However, this is far from applying all the time; we need only consider the restrictions on a married Swedish woman’s right to control her matrimonial property that we find well into the twentieth century, despite the fact that she formally owned it. In practice, each society accepts a number of limitations on the owner’s rights without disqualifying him or her from formal ownership. An analytically defined boundary between ownership rights and other forms of legal property arrangements is in such cases impossible to determine; it is articulated in each context according to the prevailing legal system and applicable legal interpretation.

To specify, register, and formalize certain individuals’ exclusive rights to informal assets means that one at the same time must dismiss the possible claims of other interested parties. Formalization almost always implies a redistribution of legal capacity from certain individuals and social categories to others. It is these distributive effects that de Soto tiptoes around the entire time when he suggests that extralegal claims should be legalized. He writes that we have to accept de facto conditions and give them a legal framework. But these conditions are not the same after legalization as they were before. Who will receive these rights? The slumlords and the rent sharks or those who actually live in the informal buildings? Those who run the workshops and factories or those who are pocketing the protection money today? Those who occupy the land or an absent land
owner, or perhaps the transnational company to whom the state or the private proprietor sold the land? Should we legalize the claims of the workers at the occupied Argentinean factories that went bankrupt during the last crisis or protect the claims of the creditors in the bankrupt’s estate, or should we perhaps acknowledge and defend the formal factory owner’s right to appeal the bankruptcy?

What de Soto presents as a simple confirmation of the informal rules is in fact a battlefield of conflicting interests and legal claims. On his own Latin American home territory, land reform has dominated the property debate ever since Emiliano Zapata’s Mexican revolutionaries formulated their Plan de Ayala in 1911. Not until the second half of the twentieth century was the Mexican reform process followed by others in Bolivia, Guatemala, Colombia, Peru, Chile, and finally Nicaragua and El Salvador during the 1970s and 1980s. Despite the reforms, the ownership of land in Latin America is still extremely unevenly distributed. Today the land reform tradition is conducted principally by the Brazilian grassroots movement MST, which during the last fifteen years has organized thousands of occupations of land that is owned but not used by large landowners. The occupations have mobilized more than 100,000 families. [18] De Soto mentions MST and their informal regulation of property rights as an example of squatters whose rights must be strengthened. He neglects the fact that MST’s struggle is actually directed against formally irreproachable owners. Nor does he mention that they often choose to organize their control over occupied land in collective and cooperative forms rather than as individual or private owners.

The land question in Latin America, at least in the rural areas, involves another problem beyond the absence of formal property rights, namely, that the formal rights of ownership of land can be traced back to the elite rule of the Spanish and Portuguese conquista. These rights were to an extreme degree introduced from above, in a way that can hardly be recognized as legitimate by the other affected parties. It is a historical uneven distribution that is visible today not only in land assets but also in an extremely unequal distribution of income and wealth. This is not unique to Latin America; it can be recognized as a pattern in many other places where modern property relations were established under colonial conditions. Such effects on distribution have, as mentioned before, no place in de Soto’s model. By maintaining that poverty can be solved simply by giving all of the poor formal rights of ownership, de Soto pulls a mystifying veil over what are in fact real social discrepancies.

Certainly de Soto’s rhetoric can be used to inspire and motivate meaningful reforms. For example, in the Brazilian reform programme for legalizing homes in the favelas of the big cities. But as long as the author himself avoids the problems of distribution, it seems most likely that the book will be used primarily to defend the sacred rights of private ownership, now seen as an engine in the struggle against poverty, and thus block an important development of redistributive welfare politics.

Footnotes


2. Instituto Libertad y Democracia/English/Publications/Mystery of Capital/ Different


4. De Soto's first internationally recognized book was given the English title The Other Path: The Economic Answer to Terrorism (New York: Basic Books, 2002) -- the Spanish title was El Otro Sendero (Lima: El Barranco, 1986), a title in which one can sense a direct challenge to the infamous Peruvian Maoist guerilla Sendero Luminoso (The Shining Path).


7. I am not the only one incapable of finding a connection. This criticism has been raised sharply in Woodruff, C., "Review of de Soto's The Mystery of Capital", Journal of Economic Literature, 39:5, 1215-1223.

8. De Soto 2000, 33, table 2.1; appendix fig. A. 1-A.

9. World Bank, World Development Indicators 2002. This is valid whether one reckons the GNP according to the prevailing currency exchanges or corrects for differences in purchasing power.


12. See Smets, P., "The market does not work for all; and not just because of lacking property titles", Focaal -- European Journal of Anthropology, 41 (2003), 193-196, and
sources cited there.


17. Tony Honoré distinguishes between no less than eleven such dimensions. Honoré, T., "Idéer om ideer" Idéer om ideer Tidens idéserie 7, Stockholm 1994, 63-97.


Published 19 January 2007

Original in Swedish
Translation by Linda Rugg
First published in Ord&Bild 2-3/2005 (Swedish version)
Downloaded from eurozine.com (https://www.eurozine.com/hernando-de-soto-and-the-mystification-of-capital/)
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