

# **AFTER 10 YEARS OF CRITICISM: WHAT IS LEFT OF DE SOTO'S IDEAS?**

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## **Abstract**

In 2000 Hernando de Soto published his book *The Mystery of Capital*. In this book he advocates that politicians take measures to provide the informal sector with access to the formal economy by the granting formal property rights and to break down bureaucratic barriers. The book has been influential. As if before 2000 nothing was published on property rights, titling and development, de Soto was invited by governments and international organizations to convey his new message. Bill Clinton called him 'the greatest living economist' (World Urban Forum, Davos). Since the publication of the book, criticism poured in. Especially the academia sought publicity to render scientific evidence that de Soto's solution will not work, such as 'de Soto's solution not for South Africa' (B. Cousins), 'The De Soto Delusion' (Gravois) or 'The wrong prescription for the wrong malady' (Bromley) to name a few. This paper aims at collecting the critical remarks published since 2000 and at analyzing whether the ideas of de Soto still stand today.

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## 1. INTRODUCTION

What is the way to provide the poor an escape from poverty? It is a question that regards both the victims of poverty, the 3 billion people living below a poverty line of 2.50 \$/day (WDI 2008) and the people trying to offer solutions, like governments, NGO's, academia, and the national and international donor community. Since development aid started in – say- the 50s, the ODA funds sum up to 2.3 trillion \$ (2.3 billion \$ Europe figures), of which 1 trillion went to Africa. Did we find the way out? Obviously not everywhere, when we look at the well known statistical figures coming from UN offices.

This makes economists as Mrs. Dambisa Moyo say: *'cut aid: aid only increases African problems; governments should find money through the financial markets. In order to borrow, they need to get good ratings, so they are forced to be transparent and prudent. Large inflows of aid money reduces governments to feel accountable to their own citizens'* (Moyo, 2009).

We observe a striking similarity of her views with those of Hernando de Soto (de Soto, 2000): when the poor are facilitated by a transparent and prudent recognition of their situation, they can potentially rely on the financial market to generate funds for further capital formation, as Moyo says states should do.

Also similar for Moyo and de Soto is the praise both authors receive and the criticism they face.

This paper focuses on de Soto, as the issues of property rights, land administration and land management are paramount professional activities of land surveyors. After all, we are land administrators, not development economist, so Dambisa Moyo is beyond our reach. And: reviewing the views of de Soto based on all the critiques is already difficult enough.

We will now briefly summarize de Soto's views (referring to the pages in his book). Despite the fact that we are not the only ones who did this, we believe it is necessary here, because too often de Soto's view is described by many as *'give the poor a property title, then they will have credit and escape from poverty'*: so summarized, it does not give judgement to his wider line of thought.

## 2. THE IDEAS OF DE SOTO SUMMARIZED

De Soto's starting point is that nowadays –after the demise of other political ideologies- capitalism is the only realistic way to rationally organize a society (p. 1). Although in the past, many countries attempted to introduce a capitalist policy, they apparently failed (p. 3), because -as de Soto believes- they could not tackle the biggest obstacle, which is the inability to produce capital (p.5). In the western world, where capitalism works, the process of describing possessions on 'paper' allows possessions for an invisible life parallel to their physical existence (p.6). Developing and transition countries don't have this paper world, which makes them undercapitalized (p.6), like companies which cannot issue shares and bonds, making them unable to generate capital stock (p.7). Neither citizens in those countries, who surely have possessions, have access to such a process of describing, making them unable to generate capital (p. 7). De Soto calls such a process a conversion process, needed to make the invisible visible. The inability to create a conversion process is caused by the lack of a necessary legal infrastructure, which is implicit to the system of property rights (p.8). Property rights are just the tip of the iceberg, important is the other and biggest part of the iceberg, namely the whole of processes to convert possession (and labour) into capital (p.8).

Why did earlier attempts to introduce capitalism fail? It is, says de Soto, because 5 aspects were forgotten, namely (1) the role of 'paper' information, (2) what 'capital' is (3) impact of lack of political consciousness, (4) lessons learned from development US and Western Europe and (5) the effect of failing laws (p. 13). When it comes to the first aspect, information, de Soto analyses that the effort poor people must do to acquire formal property or to start a formally recognized business, is so tremendous, that their only choice is to live in informality. By consequence, the informal sector in developing and transition countries is the standard way of living, while the formal sector is de facto marginal (p.37). Living in the informal sector means for 80% of the world population that their savings, investments in housing and businesses cannot be used to generate capital, which they can use to create a better living and to escape from poverty (p. 37). De Soto estimates that the resulting undercapitalization ('dead capital') equals an amount of 9 trillion USD (p. 36, American trillion = European billion)). Rural values are 2,6 billion USD (American billion = European milliard), only 0.02 % by the way.

When it comes to understanding what 'capital' is, de Soto refers to renowned economists as Adam Smith and Karl Marx, who understood that capital is the part of a country's possessions that can be used to generate extra production capacity and extra productivity (p. 41). Capital is not equal to money, as money in itself does not generate added value: money is just a way of expressing value, not generating value (p. 43). When citizen in the informal sector need capital for housing or business, their only sources are people in their environment with whom they have a relation of mutual trust (p. 48). When their possessions would be described on paper (property rights, shares, contracts etc) then they would have instruments to generate added value out of their physical possessions.

Property rights therefore are not just a description of the physical features of a possession, but particularly of its economic and social characteristics (p. 50).

In the past, legal pluralism was an obstacle also in the western world, but history shows that integration into one single legal system provided an opportunity for people to generate capital in a much wider circle than only their relatives (p. 53). Legitimacy of their legal rights became manifest not only in their own community, but in society at large; the consequence was, that also their liability became visible: without liability however no formal contracts, credits, utilities, insurances, de Soto says (p. 55).

When distinguishing the economic characteristics of a possession from its physical existence, the description allows for economic transactions, such as –in the case of a factory- dividing the property into shares, which can generate capital for investments (p. 57). However, when such descriptions are not standardized, transaction costs remain too high to be economically beneficial (p. 58). The makes, that the description of possessions for the case of land tenure security, is not the single main item here, as there are many other ways to protects one's property than by describing it (p. 59). Therefore describing properties makes no sense (like in the Domesday Book 1086), unless a mechanism is in place that allows people to access wider networks than their own circle (p. 60). Also, western formal property systems put emphasis on the protection of transactions, being more important than the protection of the property itself, making it possible to create safe market exchange of descriptions in stead of the physical objects themselves (p. 63).

Again, capital should not be confused with money: with money as such one doesn't generate money: to earn money, one needs property (p. 64). A great deal of the marginalization of the poor is caused by their inability to benefit from their possessions: they live outside the 'bell jar' of the formal economy, under which the privileged few and the elites are protected to let their assets grow (p. 66). But why is it that governments are not aware of the reason why 'bell jar's exist? It is because the formal legal system is incapable to cope with reality: therefore citizens are forced into informality, where they have to rely on their little circle of people they can trust in stead of wider networks (p. 71).

The informal sector in developing and transition countries is enormous, a sector where making a living is expensive, because of continuous payment of bribes, payment for desired or forced protection, payment to informal leaders, payment of high transaction costs for everything, payment of high costs for obtaining capital for innovations and higher productivity; a situation worsened by the rural-urban migration, partly caused by failing land reform projects in the rural areas (p. 82). Every developing and transition country actually has some form of formal property system, however: a majority of the citizens don't have access to it. The law protects the elites under the 'bell jar' (p. 156).

Nevertheless, governments in these countries attempted to enhance access, but failed because of misunderstandings. For example: citizens prefer to live under informality because of reasons of tax evasion, while governments don't understand that living in

informality is likely much more expensive than just paying taxes (p. 155). For example: registration and surveying of possessions is only possible with modern technology, which historically is proven to be untrue (p. 156). For example: when creating a formal property law, the lawmakers can ignore what happens on the ground, while laws can only be successful when they take into account the social and psychological processes that exist in the informal sector (p. 157). Registration and surveying as such is of no use, when formal law inside the bell jar and informal conventions outside the bell jar are not integrated (p. 157). Lifting the bell jar, by consequence, is in particular a legal challenge, however not a matter for lawyers, but a matter of major political responsibility (p. 158).

The strategy to create a situation of integration of formal and informal rules has 4 components. First, a 'discovery' strategy: to -amongst others- investigate the relationships between the formal and informal sector and to identify the informal norms that regulate possession and property in informal communities. Second, a political and legal strategy: to -amongst others- create political support at the highest level and to achieve consensus between formal and informal sector about legalization of informal possessions without compromising formal property rights. Third, an operational strategy: to make lifting the bell jar possible and fourth a commercial strategy: to create opportunities to capitalize on ones possessions (p. 160).

Overall, de Soto urges for the creation of a property system that gives judgment to how in the informal sector people deal with possessions, their attitudes and informal arrangements (p. 170). When the new laws do not comply with informal arrangements, the poor will not be willing to comply (p. 175). It is a matter of codifying informal rules (p. 178). Therefore, a legalization process starts with a lot of fieldwork (p. 183). It is necessary to be aware, that the bell jar is protected by 'guards', in particular lawyers and technocrats (de Soto means: land surveyors), who tend to maintain and defend the status-quo (p. 201).

It is not fair, de Soto argues, to ask the poor to be patient because once they will benefit from globalization and capitalism: it will never happen and they will remain poor for ever, unless they have means to be part of the formal economy and capitalize on their possessions (p. 210). When countries are not able to integrate informality into the formal economy, they will be doomed to muddle along (p. 213).

Reading de Soto's own explanation to the IMF (2001), he emphasizes the 'entrepreneurship' of people in the developing and transition countries, and that they miss the mechanism to deploy new production based on their accumulated stock of assets. Much of the marginalization of the poor in developing and former communist nations comes from their inability to benefit from the effects that formal property provides. The challenge these countries face is not whether they should produce or receive more money but whether they can understand the legal institutions and summon the political will necessary to build a property system that is easily accessible to the poor'.

In (2002a) de Soto emphasizes that formal property is more than titling, recording and mapping of assets. It is an instrument to bring the poor into social contracts where they can cooperate to raise society's productivity, while in (de Soto, 2010) more emphasis is put on the 'linkage to institutions that need to secure the value of titling: it's not just land recordation anymore, but also tying it to the whole system of a country. 'Bad' titling continues in two thirds of the world, where titling is neither related to maps and registries, nor backed by the law nor plugged into the financial system. Stand alone titling is not sustainable over time'.

Although de Soto himself does not explicitly state that 'formal property' is equivalent to individual, private property, *Cousins et al* (2005) observe that this is clearly the assumption. *Bruce* (2012) also believes that -given the idea to capitalize 'dead' capital through mortgaging- the formalization de Soto talks about, appears to have become a strategy for the creation of private individual property.

### **3. SUMMARY OF THE SCHOLARLY AND BOOK-REVIEW CRITIQUES: 'A SILVER BULLET'?**

We tried to collect as much reviews on de Soto's ideas as possible, using our university library catalogue and other search facilities (e.g. Web of Science, Scopus) and to see whether a mainstream floats to the surface.

This mainstream appears to be as follows.

#### **1. The experiences so far.**

De Soto neglects that experiences from the past demonstrate that titling does not work. (*Woodruff*, 2001), (*Reeve*, 2001), (*Gilbert*, 2002), (*von Benda-Beckmann*, 2003), (*Home*, 2004), (*Royston*, 2004), (*Granér*, 2005), (*Bledsoe*, 2006), (*Cousins*, 2005, 2007), (*P&DM*, 2007), (*Sjaastad*, 2008), (*Payne*, 2008), (*Siegel*, 2009), (*Rutten*, 2009)

#### **2. Customary practices (legal pluralism).**

De Soto neglects the role of customary tenure and management as existing legal institutions, although not under the formal 'bell jar'. (*Bourbeau*, 2001), (*Fernandez*, 2002), (*Gilbert*, 2002), (*Nyamu-Musmebi*, 2006), (*Sjaastad*, 2008), (*Assies*, 2009), (*Bruce*, 2012)

#### **3. Land distribution**

De Soto neglects the skew access to land in many countries. (*Rawson*, 2001) (*Payne*, 2001), (*Madrick*, 2001), (*Benjamin*, 2003), (*von Benda-Beckmann*, 2003), (*Home*, 2004), (*Granér*, 2005), (*Cousins*, 2005, 2007),

#### **4. Codification**

De Soto neglects that formalizing is not a simple confirmation of informal rules. It legalizes thievery, dispossession and colonial grabbing and neglects the gender

issue (*von Benda-Beckmann*, 2003), (*Granér*, 2005), (*Nyamu-Musmebi*, 2006), (*Joireman*, 2007), (*Sjaastad*, 2008), (*Bruce*, 2012)

#### **5. Role of the State and the rule of law**

De Soto relies on political will and functional governments, while current statutory legal frameworks exclude the poor and lack of enforcement hampers providing protection. (*Alvarado*, 2001), (*Fernandez*, 2002), (*Alcindor*, 2003), (*von Benda-Beckmann*, 2003), (*Royston*, 2004), (*Joireman*, 2007), (*Bromley*, 2008), (*Besley*, 2009), (*Otto*, 2009)

#### **6. The poor**

De Soto neglects that the 'poor' are not an homogenous group (there are 'rich' poor, and "poor' poor) so that single solutions will not work. (*von Benda-Beckmann*, 2003), (*P&DM*, 2007), (*Bruce*, 2012)

Furthermore, there are two more issues, when it comes to the evidence base.

The first is, that in general most reviewers reproach de Soto of not providing any evidence for his statements (*Bromley*, 1990 (*Madrick*, 2001), (*Gilbert*, 2002), (*Royston*, 2004), (*Granér*, 2005), (*Bruce*, 2012).

We believe these critics have a point. The book would have gained strength when more evidence was provided to the reader. Now we face a situation where *Woodruff* (2001) says that 'reader is asked to accept on faith that titling unlocks capital, a leap he found himself unwilling to take'.

And the second is: how did it work out in the *projects in Peru*, in which de Soto was involved, himself. Do they provide evidence of the chain title-credit-income? The answer is 'hardly' or even 'no' (*Woodruff*, 2001), (*Field*, 2004), (*Caldéron*, 2004), (*Gravois*, 2005), (*Corzo*, 2005).

We believe also this aspect constitutes a problem of evidence for de Soto's theory. The reader of the book expects that -at least- in de Soto's own home country, being involved himself in the formalization projects, some form of evidence can be built for the validity of the theory. Now the reader fears: when it is not quite successful in Peru (as the reviewers say), why would it do work elsewhere?

We argue that de Soto's ideas would have gained better acceptance, when some points would have been better elaborated and explained, such as his requirement of a strong government while this appears not to be the case in many countries, such as 'discovering the law' in countries where customary tenure is the major tenure arrangement, and such as the lack of an emphatic banking sector.

#### **4. NO POSITIVE COMMENTS?**

Aside the praises of the VIP's, as mentioned in the introduction, the attention de Soto mobilized for the land question, is well appreciated (*Madrick*, 2001), (*Royston*, 2004), *Gravois* (2005), (*Nyamu-Musembi*, 2006), *Bruce* (2012).

We conclude that indeed de Soto is a better 'marketing man' than we as collective scientific community. Bruce cites a World Bank officer: 'I gave copies of the Bank's policies on land to the Minister and there never came a reaction; I give him the book of de Soto, and a few days later he wanted to talk about it' (Bruce 2012). We believe that many scientists, who are dedicated to the case of the land question, will recognize this: we perform research, do fieldwork, publish relevant scientific output, but which politician listens?

## 5. DISCUSSION.

The assumption that western development industry believes that 'confused tribes are waiting to be saved by their former colonizers' (de Soto, 2002b), brings us to the issue of international cooperation. One of the main arguments against aid, as viewed by Dambisa Moyo, is that through aid the West is patronizing Africa: 'scarcely does one see African officials or policy makers offer an opinion on what should be done....' (Moyo, 2009). In the de Soto-discourse, a similar opinion was expressed (Bromley, 2008), namely 'the advocacy for formal titles is an example of the persistent quest for ideational hegemony; were African politicians to set up an international commission (Bromley refers here to the Commission for Legal Empowerment of the Poor) to impose African cultural and legal practices on the 'developed' world, there would be profound surprise'.

Now it is a very remarkable circumstance that, of all people, it is precisely somebody from a developing country who comes with the formalization propositions: Hernando de Soto, from Peru, while many of his critics are from Western universities (not all).

Having reviewed all the critiques is what rests a matter of 'belief'? There is much evidence that 'titling' doesn't work, that having a property title as such does not bring the titleholder in a better position for a loan, that borrowing money does not automatically reduce poverty and that everything easily might fail: the poor ending up as the landless poorest of the poor. But: where it all failed, was there enough political will? Was the reform not too narrowly focused? Did the reform align with the practice on the ground? These unanswered questions make it difficult to extract a clear picture out of all these evaluations. De Soto (2000), by the way, criticizes 'bad laws' and 'bad titles': he is fully aware that laws and titles, when not embedded in social practices, tend to fail.

The last question still to be answered is by consequence: if we so well know what it is that *not* works, 'what is it then'?

Is African society so complex that westerners better stay out and -for the same reason- also stay out of Asia and Latin America? That would be stupid: is sharing knowledge and

experience not a moral duty for everyone? Isn't the crux here, the word 'sharing', different from 'imposing'?

And: talking about morality, can we -on one hand- say that local cultural norms and standards are to be respected such as 'codifying social contracts on the ground (de Soto 2000)' and -on the other hand- feel that these local cultural norms have to change in order to meeting international agreed standards, such as 'it might be necessary to *undermine* customary law to promote an alternative understanding of customary land ownership that protects women's property rights' (Joireman, 2007). In general: 'when individuals are granted a title and some improvement can be shown in the lives of the poor, does it justify imposing to all of them a way of life that has only emerged, after many centuries, in the West', asks Del Mar (2009).

We argue that the conflict between paying respect to one's cultural norms and values when they do not comply with internationally accepted principles, must be seen. Severe poverty for rural and urban poor, unemployment, landlessness, gender inequality in land possession, land grabbing by white and black elites, failing states: many things are not at all acceptable. Definitely, not enough knowledge can be shared to bring this to an end.

That 'nothing works', brings in a certain element of 'policy': what does one believe what will work, what is the advice?

We argue that it is a matter of basic human rights, that the poor are known by their government, that they can be citizens as anybody else (their '*formal brothers*'), that their properties are protected against government agencies and against the powerful elites, that they can earn money in a recognized business environment, that there are jobs, and that - when they need money for an investment- they can save or borrow whether from family, microcredit, or from formal banks and that they have a government which is accountable to them.

Much of that, we do see back in de Soto's approach and in the still wider approach of CLEP (2008), we even see it in some parts of *Dambisa Moyo* (2009), for example when she speaks about the need for governments to be accountable to all of its citizens.

To answer the question posed in the title of this paper: yes, despite all criticism, we argue that much is left from the ideas of de Soto, but not particular from the angle 'give the poor a title and they will get mortgages and escape from poverty'. Indeed, after all critiques this appears a 'silver bullet' that does not exist. We see it more likely from the angle of fair and accountable government, which aim at good performance and at demonstrating political will.

Yes, much is left from the ideas of de Soto, we believe: further marginalization and negation of the poor is not acceptable, their life cannot remain in the informal sector, provided that governments are capable and willing to create a formal sector that can provide also the poor and the marginalized with opportunities to escape from poverty and to enhance their livelihood using their land assets, labour and savings as a vehicle.

For us, by consequence, that does not mean ‘titling at all cost’; what it does mean is that the institutions in society are such that they also are beneficial for them. That the poor can be fully recognized citizens, that their properties are protected by a ‘representation on paper’, so that they can live without fear to loose land and other production factors; that access to credit in whatever form (microcredit, formal banks) is an option for those who have confident that repayment is within reach (the entrepreneurs); that they can be subject to states and local leaders who have the political will to inspire confidence in human rights also for the poor and a will to develop the capacity to enforce such rights.

Although Moyo (2008) states that emphasis on good governance is a neoliberal concept, still it appears to be a truism that without political will not much can be gained. Indeed, governance is not synonymous with government (World Bank, 2010), but a matter of government, private sector and citizens together: issuing title assuming titleholders can achieve credit, while a banking sector is not in place, makes no sense. Assuming farmers to improve productivity without providing an infrastructure and market mechanisms, makes no sense.

Also de Soto (2000) makes this implicitly conditional when he urges for strong leadership. ‘I am putting much more emphasis now on linkages to institutions that need to secure the value of titling’, he declares (de Soto, 2010). May be de Soto suggested too much a quick replacement of existing tenure forms on the ground by a formal individual tenure. Discovering the law on the ground is not a quick operation. And land law reform is necessary: ‘when it comes to existing land laws, de Soto argues that the official legal systems are not attuned to the types of relationships and transactions that they should be able to facilitate’, says Del Mar (2009).

Why not adopting a more gradual approach, supported by the concept of continuum of rights (Habitat/GLTN) and the Voluntary Guidelines of Responsible Governance of Tenure (FAO), and supported by emphatic system support through domain modeling (Lemmen, 2012). It might work, seen the outcomes of the Leiden University research on legalizing land rights (Ubink, 2009), (Otto, 2012). Adopting such an evolutionary approach also pays respect to the paradigm shift from replacement towards adaptation, as proposed by the seminal work of Bruce & Migot-Aholla (1994) and the stance that ‘one would expect to see a move towards more individualized forms of property rights with economic development’ (Deininger, 2003). Codifying existing social contracts as they exist in the customary and informal reality on one hand and to integrate these arrangements in a coordinated legal framework tends to be an ongoing process, given the observation that many developing countries currently attempt to develop such land laws (Knight, 2010).

With this in mind, we believe both an adequate development policy and a land policy is within reach.

## 6. CONCLUSION

To conclude: when governments show political will to develop their state, land law can be developed to recognize both statutory tenure and other tenure arrangements (customary, informal), which require sound field work to identify the nature and characteristics of those other forms of tenure. When this takes place without creating a broader development policy, it makes no sense. The making of laws without capacity for secure enforcement, is doomed to fail. The creation of a mechanism (the 'conversion') to generate a 'representation of physical objects' appears to be helpful for further development. Mortgaging cannot be assumed when no formal jobs exist and when the bank sector refrains. In a customary environment individual property rights can be introduced, when people ask for it. Governments should be capable to adopt normative frameworks to deal with skew access to land assets and to finish with property rights acquired through violence and threat and through discrimination of women and vulnerable groups. Adopting adequate pace is necessary in order to avoid the introduction of property right arrangements that are far from people's perception. So, it comes back to the condition of good governance.

'De Soto': yes, but governments which demonstrate political will and which adopt the principles of good governance, are a prerequisite. When this is not the case, formalization - in whatever form - is without meaning and likely will harm the poor.

For us, land surveyors, it means a further reflection on property rights arrangements as they exist on the ground, create mechanisms to wisely convert those in rules, on inventing registration and mapping facilities that can cope with different kinds of tenure and in a quick and cheap manner, and on thinking how to make our land information system compatible and part of a wider information architecture for the state and its citizens. To say it more sophisticated: land reform, land tenure reform, land law reform, land administration reform, and land information reform.

That is where we as professionals stand for, now and in the future. The profession should show to the world community that it is neither the obstacle for the establishment of land administration systems as Adlington (2007) argues, nor the guards of the 'bell jar' as de Soto believes it is (de Soto, 2000).

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