

THE DE SOTO DELUSION

Peruvian Economist Hernando de Soto's ideas for helping the poor have made him a global celebrity. Now, if only those ideas worked. =85

John Gravois

Friday, Jan. 28, 2005, at 9:33 PM PT

It's Davos week, which means it's time for the world's most influential people to bask in the catchy wisdom of Hernando de Soto.

Author of *The Mystery of Capital* and *The Other Path*, armchair consultant to numerous heads of state, and white knight for the cause of property formalization=97Hernando de Soto is practically the patron saint of the global elite. At last year's annual meeting of the World Economic Forum, Bill Clinton, the event's unofficial king, publicly declared that de Soto was "probably the world's most important living economist." For the left, de Soto has formulated the most seemingly practical ideas for reducing global poverty. For the right, de Soto offers the most compelling way to market capitalism to the poor.

Beginning with his first projects in Peru in the mid-'90s, de Soto's ideas have been packaged and peddled all over the Third World=97by the World Bank, by the U.S. Agency for International Development, and by de Soto's own Lima think tank, the Institute for Liberty and Democracy=97as the new conventional wisdom for fighting poverty. On the white board, de Soto's ideas flatter the imaginations and sensibilities of Davos-types (particularly the American ones). But on the ground, it turns out that de Soto's ideas are doing very little to solve the actual problems of poor people.

De Soto's vision of the Third World is instinctively appealing. He sees industrious, entrepreneurial slum-dwellers, toiling with boundless ingenuity, yet living in homes and owning businesses that are theirs only by de facto possession and jury-rigged local agreements, not by de jure deed and title. De Soto calls all this informally held property "dead capital," because it can't be leveraged to produce growth=97it can't be mortgaged, because it lacks a proper title to guarantee it as collateral. He says there are gobs and gobs of this dead stuff out there: \$9.3 trillion worth, by his estimate, skulking in the ghetto.

Mindful of the fact that "the single most important source of funds for new businesses in the United States is a mortgage on the entrepreneur's house," de Soto's plan is, quite simply, to make homeowners out of the world's poor squatters. Neighborhood by neighborhood, slum by slum, he wants to formalize the vast extralegal world by dotting it with individual property titles. Once that's done, he promises, the poor will have access to credit, loans, and investment, as their dead assets are transformed=97voil=E0!=97into live cap= ital.

De Soto is right to point out the importance of legally sorting out who owns what in the Third World. Secure property rights probably are indeed, as he puts it, the "hidden architecture" of modern economies—or something like that, anyway. On the level of gee-whiz metaphors and moving rhetoric, de Soto deserves a lot of credit: He's brought an unprecedented degree of attention and funding to the vital and fascinating issue of squatters and informal economies. But he has botched the details, especially by pushing one solution—individual property titles—for all different kinds of poor people in all different kinds of poor places.

From the field, the verdicts are rolling in: In some corners of the world, the land-titling programs inspired by de Soto's work are proving merely ineffective. In other places, they are showing themselves to be downright harmful to the poor people they set out to help.

First, the merely useless:

In various parts of the Third World, newly legalized squatters on the outskirts of cities are discovering that a property title supplies little of the benefit de Soto projects. Government studies out of de Soto's native Peru suggest that titles don't actually increase access to credit much after all. Out of the 200,313 Lima households awarded land titles in 1998 and 1999, only about 24 percent had gotten any kind of financing by 2002—and in that group, financing from private banks was almost nil. In other words, the only capital infusion—which was itself modest—was coming from the state.

Reports from Turkey, Mexico, South Africa, and Colombia suggest similar trends. "In Bogota's self-help settlements," writes Alan Gilbert, a London professor of geography who has done extensive research on land issues in Colombia and other parts of Latin America, "property titles seem to have brought neither a healthy housing market nor a regular supply of formal credit."

This is probably because banks realize they don't stand to gain much from repossessing shanties in rotten locations. Faced with a massive surge in legalized but tenuous properties owned by poor people, banks have simply adjusted their criteria for lending, and in some cases care more about stable employment than a land title. Not only that, but the actual real estate markets in many of these shantytowns on urban outskirts are stagnant, which puts a serious damper on any potential gains on capital—live or dead.

"You cannot accumulate capital if there is no market in which to trade your asset," Gilbert writes.

Now for the downright harmful:

In places where real estate markets are buoyant, titles turn out to be quite a hot commodity. Too hot, in fact. In June of 2002, for example, the World Bank kicked off a several-year project to distribute over a million titles throughout Cambodia. In

Phnom Penh, the capital, untitled land near the city center has been selling for about \$20 to \$30 per square meter over the past few years. Titled properties nearby have been selling for around 10 times that much. For a poor squatter in the middle of the capital city, the promise of a title would seem to be a road to riches. In practice, it's more like a sign taped to his back that says, "Kick me."

In the nine months or so leading up to the project kickoff, a devastating series of slum fires and forced evictions purged 23,000 squatters from tracts of untitled land in the heart of Phnom Penh. These squatters were then plopped onto dusty relocation sites several miles outside of the city, where there were no jobs and where the price of commuting to and from central Phnom Penh (about \$2 per day) surpassed whatever daily wage they had been earning in town before the fires. Meanwhile, the burned-out inner city land passed immediately to some of the wealthiest property developers in the country. (Prominent among them was this guy, Cambodia's richest thug.)

Since then, a similar pattern has continued elsewhere in the city, says Alain Durand-Lasserve, a land-management expert who has worked in Cambodia during the last couple of years. Investors have been buying squatter-occupied state land from various government officials in Phnom Penh, who pocket the money, thus looting the land both from the state and from the poor. In other cases in Phnom Penh—and also in Manila, in the Philippines—speculators or middle-income groups went out before titling programs took effect and bought land at slightly better than informal prices directly from the squatters, who happily sold off for a bit of cash. Then the investors just waited for the titling program—and the attendant leap in value and legal security—to come their way.

It turns out that titling is more useful to elite and middle-income groups who can afford to bother with financial leverage, risk, and real estate markets. For very poor squatters in the inner city—who care most about day-to-day survival, direct access to livelihood, and keeping costs down—titles make comparatively little sense. These poorer groups either fall prey to eviction or they sell out, assuming they'll find some other affordable pocket of informality that they can settle into. The problem is, with titling programs on the march, such informal pockets are disappearing fast. So, the poor sell cheap or are evicted, then can't find a decent new place to settle, losing the crucial geographic advantage they once had in the labor market.

What to do? Here's one idea: Geoffrey Payne, a British urban planning consultant with years of experience working on land-tenure issues in Cambodia and elsewhere, recommends temporarily insulating slums from the commercial land market by granting informal neighborhoods groups land rights for some period of time. During that period, he says, the neighborhood can be upgraded and basic services brought in, allowing land values to inch up toward parity with the surrounding real estate market. Then, after a number of years, the neighborhood gets a full, group land title, which can then be subdivided into individual titles if

people are willing to take on the costs. By taking these incremental steps, he says, you shelter the poor from the shock of a titling gold rush.

But sadly, the Davos set doesn't have a crush on Geoffrey Payne, and de Soto has never sat down for a debate with him. Nor, in fact, does de Soto seem to pay attention to any of the lawyers, urban planners, geographers, sociologists, or economic development experts who have catalogued the real-life flaws in his ideas.

I did catch up with de Soto myself just after Davos a couple of years ago, and I asked him for his own solution to the squeeze on poor squatters brought on by formalization. He told me wealthy land-grabbers should know that it's in their best interests to have the productive power of the poor brought into the economy. When I replied that those elites don't seem to be aware of that, de Soto simply offered: "I can make them aware."

John Gravois is staff reporter at the Chronicle of Higher Education and a contributing editor at Sixbillion.org. He can be reached at jgravois@fastmail.fm.