

The Poor Man's Capitalist

The most radical idea in the developing world isn't Marxism — it's 'titing' the assets of the impoverished, and it's the brainchild of a Peruvian economic theorist, Hernando de Soto.

I

t's Monday night in Haiti, and Hernando de Soto is talking about the barking dogs again. They're everywhere. In his book. In his slide show. In briefings at the palace for President Jean-Bertrand Aristide. In

sweaty sessions with threadbare villagers. They're peppered through the 60-year-old Peruvian's cocktail chatter, figure in his critique of the World Bank, sum up what he has done to date in Lima. De Soto came across the dogs in Bali, he says, not long after he had begun what may, in the fullness of time, prove to be among the more consequential crusades in economic history. It was a simple question: How do you know in Bali where one man's property ends and another's begins?

Throughout the third world, the formal systems of property rights taken for granted in advanced nations simply don't exist. Even after decades, few people officially own the land or homes they occupy; the notion of holding title to property is scarcely found outside of rigged schemes serving a handful of elites. But, as de Soto explains this evening in Haiti, his face full of fresh zeal although he is telling the tale for what must be the thousandth time, you know when you have crossed onto someone else's property in Bali because — a different dog barks. The dogs know.

It's de Soto's shorthand for the de facto property rights that rule the world, his crystallizing metaphor for the common law at work in the most lawless spots on the planet. And even if the story is apocryphal — and something in de Soto's relentless proselytizing makes you suspect it might be — that hardly matters. Like Ronald Reagan's infamous welfare queens, de Soto's barking dogs capture the heart of a profound social problem — in this case, the persistence of global poverty.

"Imagine a country," de Soto says, "where nobody can identify who owns what, addresses cannot be verified and the rules that govern property vary from neighborhood to neighborhood, or even from street to street." This is what life is like, he says, for 80 percent of the people in the de-

veloping world and the former Communist countries. Through "extra-legal" businesses and home building, de Soto reckons, the world's poor have accumulated assets worth \$9 trillion — 20 times the direct foreign investment in the third world since the Berlin Wall fell and more than 46 times as much as the World Bank has lent in the last three decades.

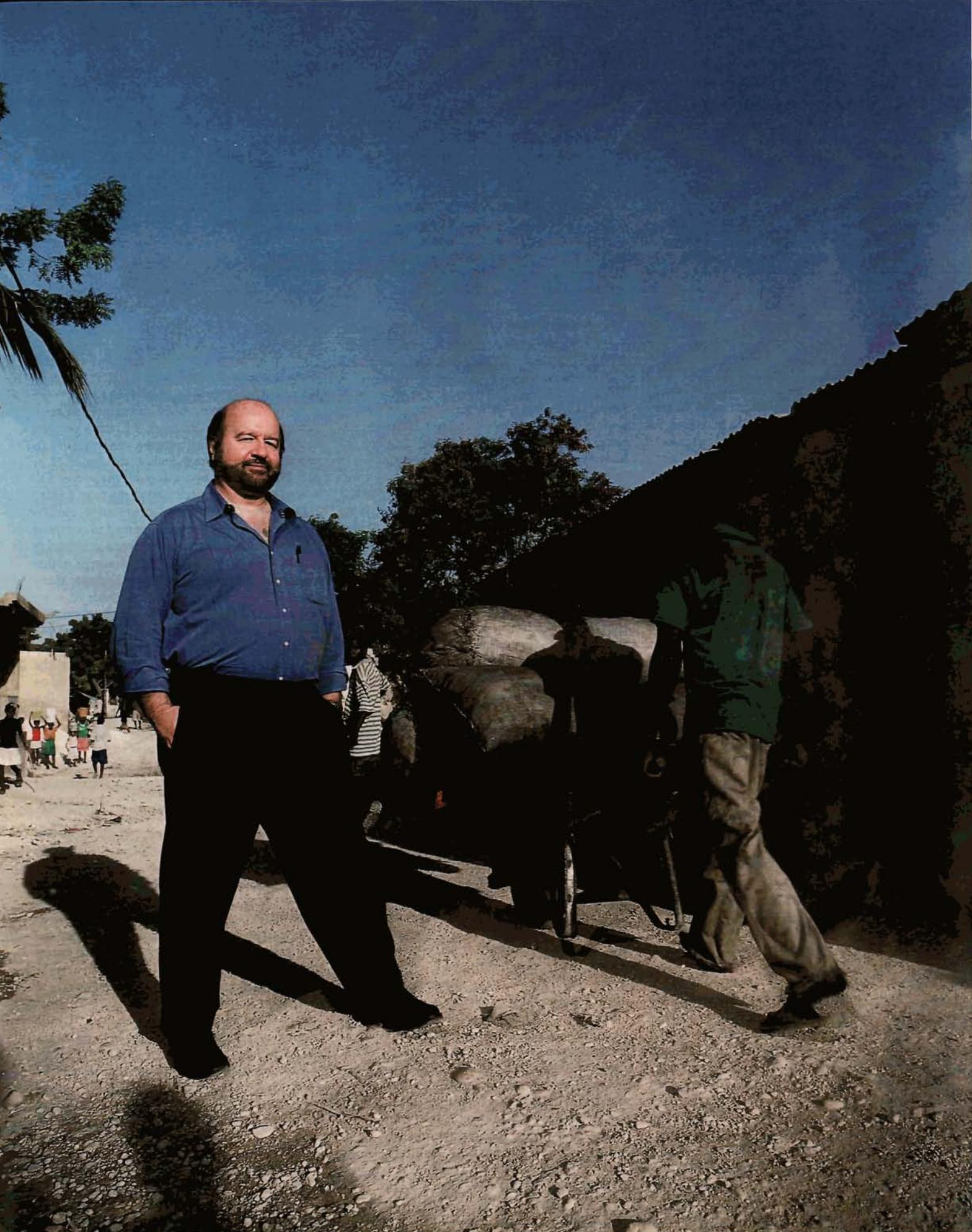
But because these assets are not "paperized" in the formal documents and legal structures common in the West, they can't function productively as capital. People can't use their homes as collateral for loans to expand businesses, for example. They can't trade things beyond the small circle where they're known and trusted. The poor live outside the law this way because living within the law is impossible: corrupt legal systems and warped rules force those at the bottom of the world economy to spend years leaping absurd hurdles to do things by the book. It's this "legal apartheid," de Soto insists — not "cultural" factors like religion or the legacy of colonialism — that explains why some peoples thrive and others don't.

What's more, de Soto adds impishly, the third world's pervasive denial of property rights resembles nothing so much as the United States in the 1800's. Remember the gold rush, when all those miners squatted and staked their claims with shotguns? Over the ensuing decades, Uncle Sam eventually ratified the ownership realities that had been recognized by communities on the ground. De Soto wants to do the same for the world's untitled masses, formalizing real-estate and business ownership in ways that turn "dead" capital into fuel for growth. This, in a nutshell, is de Soto's spiel.

While economists call him simplistic, third world leaders just call him. Back when Mexico's president, Vicente Fox, was governor of the state of Guanajuato, he sought out de Soto for advice. President Hosni Mubarak's son Gamal is his reform partner in Egypt. President Joseph Estrada of the Philippines brought de Soto in, and his successor, Gloria Arroyo, wants de Soto to press on. All this came before the publication last fall of de Soto's latest book, "The Mystery of Capital."

The book carries endorsements from the conservative icons Margaret Thatcher and Milton Friedman, as well as from Bill Bradley, last year's unfashionably liberal presidential contender. The book has sold 100,000 legal copies in Peru — the equivalent, adjusted for population, of a million in

Photographs by Michael Edwards



the United States. And with plans to translate it into a dozen languages, the book has taken Hernando-mania to a new level.

African presidents are faxing him. The president of the World Bank, James Wolfensohn, is taking him along to a conference in Russia. To the leaders of poor countries, de Soto's economic gospel is one of the most hopeful things they have heard in years, not least because it doesn't demand expensive solutions. "We show them that they already have a market economy," de Soto says. "There are such things as poor entrepreneurs."

BUT HAITI? THIS IS POVERTY ON A DIFFERENT scale. While there are few reliable figures on Haiti, it is generally thought that 80 percent of its roughly eight million citizens live on less than a dollar a day and that 85 percent of them are illiterate. Most children suffer from malnutrition, and life expectancy is around 50. In Haiti, naked men urinate in the streets. People get water at a community tap, storing what they can in unsanitized underground tanks and boiling the water before drinking or cooking. Ragtag vendors jam the streets in Port-au-Prince, hawking old tires, clothes, shoes and motor oil. Gas stations and funeral homes are the only decent structures in view. De Soto says that these woes make Haiti the perfect proving ground for his ideas.

I didn't expect to agree, but after rocketing around Port-au-Prince for three days, I became something of a convert. Little wonder that his fans say that the bearded, balding Peruvian is on to something big. Robert Litan, a Brookings Institution economist who consulted with de Soto in the 80's, until he decided it wasn't safe to hang out in Lima, hopes his friend never ascends to Peru's presidency. (De Soto seriously considered running in this year's election.) "It would really limit Hernando's global impact," he says.

In a simple church in the Carrefours section of Port-au-Prince, Alan Étienne talks about his dream. Like hundreds of thousands of Haitians, Étienne, 36, a soft-spoken man, came to Port-au-Prince from the impoverished countryside. He set up on the street selling auto supplies, built a small cement house on the state-owned land where everyone was settling and moved in with his girlfriend and their infant daughter. He saved enough to buy one of the rickety pickup trucks that serve as buses (called tap-taps because riders tap the side to signal their stops). Étienne has driven his tap-tap 11 hours a day for 10 years, but his dream is to open a small food market. He would like to borrow money to start it, but his house is worthless, he says, because it's on state land. He figures that it would command \$20,000 if it were officially his. He can't afford to borrow from the loan sharks: they

charge 25 percent a month. If you have collateral, the bank rate is 25 percent a year. Étienne isn't so much angry as resigned.

When de Soto and his Haitian partners explain their notion of giving folks formal title, Étienne nods and smiles. So do his neighbors. They get it at once. Of course, de Soto whispers to me, even if Étienne were to gain legal title to his property and use it to open a shop, he would still be on the wrong side of the law. That's because he would need a license, and obtaining one is so deliberately complex, it could take him years — if he ever gets one at all. This, too, has to be fixed, de Soto says. One mess at a time.

De Soto ended up in Haiti at the behest of a reform-minded business group, the Center for Free Enterprise and Democracy (or CLED, the French acronym), which was the inspiration of Lionel Delatour, a member of one of Haiti's leading intellectual families. After United States troops restored Aristide to power in 1994 (he had been ousted in a 1991 coup), Delatour began calling de Soto, but the Peruvian had no time. Two years of badgering later, he agreed to visit.

At a series of packed conferences, de Soto wowed every sector of Haiti's elite. He chided them for being "M.R.E.'s" — Morally Repugnant Elites. They needed to become Morally Responsible Entrepreneurs, he preached. While he encountered some resistance from entrenched landowners, de Soto was pleasantly surprised that a critical mass of Haiti's leaders seemed sincerely interested in his approach. And he liked the challenge that Haiti offered, a laboratory in which to prove to the skeptics once and for all that "culture" isn't a barrier to growth. If a voodoo-practicing nation descended from slaves could title its poor and grow, de Soto said, any nation could.

When members of de Soto's SWAT team enter a country, they spend a year preparing an exhaustive topology and valuation of informal landholdings. They also recruit dozens of local slum leaders to help catalog the byzantine rules that make doing business legally impractical for the poor. When they're done, de Soto presents officials with a picture of reality that can be eye-opening.

In Egypt, for example, de Soto likes to talk about a public-housing project that was built some years back. When it was erected, it was only three stories. Today, it has grown to eight — five floors have been tacked on, all off the books, and God help the residents if Cairo is struck by a serious earthquake.

In Haiti, de Soto first made the rounds with his trademark one-page summary in 1998. Haiti's poor have \$5.2 billion in dead capital, he announced. That pool, he added, is four times greater than the assets of Haiti's 123 largest private formal enterprises, 11 times greater than the deposits in Haitian banks and 158 times the value of all direct foreign investment in the country up to 1995. "The poor are not the problem," de Soto concluded. "The poor are the so-

lution." Once those facts are on the table, de Soto insists, things can never be the same.

HERNANDO DE SOTO DIDN'T START out planning to save the world. Born in southern Peru, he left early, after his father, a diplomat, took a post abroad, eventually ending up in Geneva. Returning to Peru for college, he was deeply struck by the overwhelming poverty. The gulf between Europe and his homeland was inexplicable, he thought, when "the quality of the people was the same."

After returning to Switzerland for his master's degree, de Soto went to work for the General Agreement on Tariffs and Trade. Soon he was lured away to run an organization of copper-exporting nations based in Paris. There he caught the eye of Swiss bank executives, and at 30 he became the chief executive of an engineering company controlled by the bank. His sales prowess won contracts ranging from nuclear plants in Turkey to ports in Congo, and by the age of 39 he had put together a comfortable nest egg. Divorced and bored, he felt it was time to go home.

De Soto soon became obsessively curious about the black market that seemed to comprise most of his countrymen's economic activity. He walked Lima's streets counting hundreds of illegal stalls. He drove out of town and saw thousands of squatters living in tents made of straw matting. And no one seemed to be studying the situation pragmatically. He got a small grant and brought in an obscure American anthropologist who had written what de Soto thought was the only perceptive thing he had been able to find on Lima's squatters. "He taught me how to walk a shantytown," de Soto recalls.

In 1983, de Soto decided to start an institute to study Peru's "real" economy and push reforms to help the poor. The Institute for Liberty and Democracy was controversial from the start because it saw poverty through a different lens than the one prevalent among Latin America's left. The Socialists told Peru's street vendors and bus drivers that they were exploited proletarians. De Soto told them they were small entrepreneurs victimized by legal discrimination. The Socialists focused on factory workers. De Soto said this was silly when barely 10 percent of the population earned its keep in such settings. Before long, de Soto reached the conclusion that the left was great on social justice but didn't know a thing about economics.

By 1986, he had readied a book on these themes, provisionally titled "The Other Path." It was a slap at the Shining Path, the Marxist guerrilla group then terrorizing the country. As the publication date approached, de Soto began to have second thoughts about that title. If he went ahead with it, he thought, "they were going to kill me." But friends (these are friends?) told him he couldn't turn coward now. So instead of dropping the title, he got a bulletproof car and learned how to use a gun.

The book became a sensation and made de So-

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With Alan Étienne, a poor Haitian whose dream of business ownership is de Soto's dream as well.

to's name across Latin America. As he had feared, it also made him a target — the institute's offices were bombed, and his car was machine-gunned. He and his second wife put off having children for fear of leaving them orphaned.

Real power came his way in 1990, when Alberto Fujimori won the presidency of Peru on a platform of economic efficiency and antiterrorism and made de Soto a top adviser. De Soto's formalization program titled 1.6 million of the country's 2.3 million extralegal buildings and brought 280,000 illegal small businesses in from the cold.

Unfortunately, the impact of these steps remains hard to gauge because Fujimori's interest fizzled before the credit-promoting phase could be enacted. These measures would have made it cheap and easy for banks to extend credit — using the new paper as collateral — and to enforce collection for nonpayment. Still, de Soto did manage to move much of Peru from barking dogs to paper — a serious, if incomplete, achievement. In a move that now seems prescient, de Soto broke with Fujimori in 1992 over the president's refusal to enact democratic reforms. De Soto found himself freer to answer calls from abroad.

WHEN PRESIDENT ARISTIDE WELCOMED DELATOUR and de Soto into his office at the presidential palace, a copy of "The Mystery of Capital" was on his desk. De Soto's relationship with Aristide had always been good, but Aristide was growing increasingly wary of CLED. De Soto was worried that the president's misgivings would poison the well for an economic plan that had taken years to develop.

The risk was that Aristide would want his bureaucrats to implement the titling process themselves, rather than contract with private groups organized by CLED. The private route, de Soto knew from experience, would title Haitians far faster and more effectively. But Aristide, a shrewd politician, knew that whoever went into the neighborhoods to bestow these new rights would gain enormous power.

De Soto and Delatour told the president that

the first step was to title poor squatters in places where there could be no conflicting claims: the 40 percent of land owned by the state. Once Aristide gave the go-ahead, they could recruit staff, prepare a huge communications effort and begin titling in nine months. Private land would be messier. They would need to create special arbitration panels to resolve ownership disputes; Haiti's judiciary wasn't up to it. Further reforms would then be needed to limit the countless steps required to open a business legally. The effort would take 5 to 10 years, they guessed.

Aristide said they would have to work to defuse potential opposition. He had ideas on how to entice the notary publics to the table. Corrupt officials who administered public lands would also have to be co-opted. Aristide said he would probably vest responsibility for the program with his ministers of finance and commerce; both men were from the private sector, he reminded de Soto and Delatour, and were friendly with CLED.

Afterward, the president confided that de Soto's "scientific" approach to development fit well with the human dimension he stressed in "Eyes of the Heart," his own recent book attacking globalization. "I know the political will I have," he said. "We can make it happen."

The United States ambassador, Brian Dean Curran, wasn't so sure. "Let me ask a fundamental question," Curran said later that morning, after de Soto briefed him. "It's not by chance that so much is in the informal sector. The formal sector is the enemy. You do it on the sly, you stay away from the authorities, work only with your family — that's how you get around in this country. How do you bridge that cultural gap?" The short answer, de Soto said, is that you work from the ground up. "We're going to write the blurbs for him," de Soto said of Aristide. "We're going to write ads for him. We're going to write jingles for him. But he's got to go out and sell it."

TO REACH THE DELMAS SECTION OF PORT-AU-Prince, we took roads so pitted that my tape recorder flew from my hand as we bounced along. A thin, grayish stream ran down the side of the street carrying effluent from people's washing. Improvised wires stole electricity from the main line. Flies were everywhere. In an informal gathering of 15 Haitians, a schoolteacher explained how he bought his home nearby for \$7,000. The seller didn't have any documents.

"How did you know you were buying the right house on the right land?" de Soto asked. The teacher said he knew the area and had sounded out the neighbors. Then, he said, he made up a sales agreement of sorts and had it witnessed by a few respected people on the block. In a court, of course, this document would have no value. In Delmas it did.

I asked the group how they would react if the government said it was starting a big new program to title their property. Would they trust them to do it right? "They never finish what they start," one man answered. "The people who work for the government are just out for themselves."

At our hotel the last night, I asked de Soto if he expected to see any country he has worked in turn around in his lifetime. If one nation succeeded with his plan on each continent, he told me earlier, it would set the continent on fire. This night there was less bravado. "I'll probably see it by the end of my life," he said, shrugging. "You don't know." One thing he felt sure of, however. If something like his agenda didn't catch on, a backlash against globalization was unavoidable.

"The social war is going to be terrible unless you do something," he said. "You can't wait 30 years, and it's not just Oliver Twist. It's Oliver Twist with James Bond's weapons." I asked about critics who say he's peddling an *idée fixe* that ignores the critical role of culture in development. De Soto could barely contain himself. "I'm not writing for Harvard students," he said. "I'm writing basically for Aristide and Hosni Mubarak and Gloria Arroyo and Fox. Political leaders know this isn't a one-shot idea. They know it amounts to a revolution."

De Soto took his napkin and poked one corner up through his closed fist, then pulled the whole thing through from that tiny corner. "Like any person with political qualities," he said, "I know how to put a whole program behind a very simple slogan." He is a former C.E.O., he reminded me. There's a strategy here.

But what about culture? I asked again. The expatriate Chinese seem to rise wherever they go. So do Jews. Doesn't that matter as much as getting property law right? De Soto smiled. "It's a little bit like saying, 'You can say whatever you want, but guys that are taller than six feet have a better chance of playing on the basketball team,'" he said. "This culture thing makes for good reading. But what do you do with it?"

"You see," de Soto said with his conspiratorial grin, warming to the pitch again, "I'm a plumber." By that he means that he studies the culture of the streets, to see how people's lives really work and how he can actually change a country. And as he sees things, it's just a matter of time.

De Soto said he recently read about a South Pacific island where the natives now worship in latter-day "cargo cults," with religious ceremonies built around documents like bills of lading and purchase orders. They've figured out that after these papers get handled, fabulous things start showing up in big ships.

De Soto loved it.

"They're close!" he said, laughing. "They just need to get a little more secular." ■