

Property: What Europeans Sometimes Take for Granted but Others Do Not Have

By Hernando de Soto, 1995

First of all, let me tell you how honored I am for having received this prize together with my friend Muhammad Yunus and Prime Minister Cavaco Silva of Portugal. Let me also say how pleased I am to have received it from the hands of my friend Stephan Schmidheiny. Thanks to all, the Max Schmidheiny Foundation and the ISC for the opportunity to be here. The objective of the sponsors is to find ways of making bridges between cultures and people and between generations as well. This is something that I am trying to do too. But here I am going to offer a somewhat unexpected variation. I am going to make a nexus with a generation that has long since passed from the scene, namely, with that 19th century generation of Swiss who devised a successful strategy to establish formal property in Switzerland. This seemingly unobserved event took place less than 100 years ago when you were a developing country. Indeed, not only a developing country, but also Europe's poorest country at that time.

The matter of property is related to the interests of previous speakers concerned with the new security challenges that face the world. Why do the Swiss, in spite of divergences regarding their participation in a

broader political framework, not settle their problems like the former Yugoslavs? After all, you too are composed of at least three different ethnic groups and have four different languages. The "Röstigraben" border is nothing more than an acceptable frontier between two cultures.

I believe it is because, though your cultures are different, the way you relate to "things" is the same: you look at assets in terms of consensually agreed upon rights over things. Land in Switzerland thus is not an issue related to sovereignty rights, rights that are difficult to settle peacefully. In the Balkans, by contrast, disputes about land are treated as sovereignty problems between different ethnic groups. The difference is that in Switzerland you have property rights problems, which are solved peacefully and piecemeal within private law. What I am saying is that until the issue of formal property is addressed, difficult situations like that of the Balkans will continue to arise.

Today there is optimism throughout Latin America and elsewhere in the world that structural adjustment programs are being successfully implemented. Countries are now obtaining international credit, and people have begun to believe that they have made it across the divide that separates market from non-market economies. But the unfortunate truth is that there is a good chance that the economic pendulum may swing back toward a non-market system.

Take my country of Peru as an example. Like many South American nations we have an apparently successful stabilization and structural adjustment program in place. The fiscal deficit is shrinking, the money supply is under control, and economic growth has been restored.

But this is not the first time we Peruvians have started down the path of macroeconomic stabilization and structural adjustment. Since our independence in the 1820's, we have restructured our debt, implemented macroeconomic adjustments, overhauled our tax system, and formed steering committees with our creditors on seven separate occasions. In the course of these different adjustment programs, we have also capitalized interests, sold off our resources, given our infrastructure projects to the foreign private sector, and privatized our public assets in an attempt to create market economies. That is how, by the way, the British came into mining and into the railroad system and the Swiss came to own the concession for Lima's light and power company.

Seven times, however, we have gone back and nationalized our foreign interests and returned to nationalist and centralized economies. Why? Because the underlying problem persists. Which means that, unless we want the pendulum to swing back once again, the time has come to identify what this problem is and finally address it.

To begin with, the problem is not protecting a free market economy. Free market economies have always been with us.

If you remember, Christ threw merchants out of the temple precisely because they were trying to convert it into a market. Two thousand years ago we had markets. The people that Muhammad has been talking to us about are people who go to markets, as he said, "to try and find a good price". So markets have always existed everywhere from the Middle East to Bangladesh.

But the fact is that markets only create prosperity when they are expanded; that is, when they facilitate massive, low-cost exchanges. For these massive, low-cost exchanges foster specialization, greater productivity and ultimately produce economic growth. And so the question becomes: how do we expand markets?

Property is what we exchange in markets, and thus the more property there is, the more the market can expand. But property requires rules, rules that create security for holding and exchanging it. What developing countries lack are these rules. As a result, what exists is possession, feudalism and sovereignty. Property either does not exist or exists only for a few. Indeed, this point is so important that I believe we should distinguish between those economies that have such rules, which I call "property economies" and those, which do not.

While developing countries have markets, they are not property economies. The reason is that they do not have the rules, which create security for holding and exchanging property. In effect, they do not have property.

Property is the missing ingredient in the process of successful development. This ingredient is something that Switzerland successfully implemented less than a hundred years ago, when you were a poor country. There is really nothing new to invent. One just has to remember, to read history.

When it comes to property in the developing world, land is by far the most important asset. The value of land for North American families, for example, amounts to 40 percent of their total assets, and the figure is even higher in the developing world. We estimate that 90 percent of the poor's assets in Peru, or for that matter in Brazil or Colombia, consists of land. For this land to be exchangeable, it must have a legally registered title. A title is an instrument of exchange, which represents one's rights to the land. It also protects the holder from uncertainty and fraud.

The principal obstacle to development, whether we are talking about Indonesia, Peru, Brazil or even Bangladesh, is that 90 percent of the people living in rural areas do not have registered titles to their land. Furthermore, 60 percent of our cities are inhabited by squatters who also do not have registered titles to the land

either. Without a title, the poor have only possessions – not property. They have the right to use the land, but that is all. Land without a registered title is worth only a fraction of that which carried a legally registered title. Furthermore, land which is not titled cannot be used as collateral. This affects the banking system since it cannot be used to guarantee loans. We recently implemented a massive land-titling program in Peru during the administration of President Alberto Fujimori. My institute, the ILD, carried out what is now recognized as Latin America's largest land titling and registration program. We brought in the assets of the poor to the formal sector, by legally registering both informal businesses and land. That is, we brought them into something similar to your Grundbuchsystem, where there is no doubt about who owns what. Therefore, both the banking system and the poor can now benefit from secure credit.

The results of this recently completed titling program have been stunning. The last report was handed in a few days before I came to Switzerland. It shows that, in urban areas, from 1990 to 1993 the value of those houses that were titled and registered went up approximately 200 percent on average. Formal loans have increased by 340 percent because now we know who lives where. Land transfers in urban areas have increased three-fold.

In rural areas, citrus fruit production has increased dramatically by more

than 40 percent during the first year after registration. To confirm these results, we brought in citrus fruit experts from California to make sure that it was the title, and not special growing conditions, nor a different type of fruit, which made the difference.

We have brought in some 408,000 enterprises from the informal sector, which maybe you would define as the black economy. These enterprises have voluntarily paid an additional US\$ 335 million in taxes to the treasury every year from 1990 to the present. We arranged things in such a way that it was cheaper to pay taxes than to pay off bribes or incur the transaction costs created by remaining outside the law; that is, by remaining informal.

One of the reasons why our program has been so successful is the cooperation we received from the people. They cooperated because we did not try and impose a system on them. Instead, we incorporated their own informal customs and laws into the formal legal system. We paid close attention to their norms and then designed a system that would make it easy to mesh these norms with official law.

The difference between formal and informal property is not widely understood, either in the developing or in the developed world. If the concept of formal property is not known as it should be, it is because it is quite recent. Even in Switzerland, it is only about a hundred years old. Also,

sometimes prejudices hold back its progress since it is perceived as an argument to defend the rich when on one level it is essentially an argument in the defense of everyone.

I think the reason that this lag in understanding occurs is because when the concept of property arose, many Europeans, like North Americans, basically studied the concept when it had already been born and had already left the nursery. They were not really looking at it at the time of its conception. Consequently, they took the genesis for granted, as if it had come about through spontaneous generation. However, the genesis was not spontaneous. It was the result of a deliberate human action.

In essence, property is how we think about things. It is what philosophers would call an intentional stance. Property is not a thing. It is a concept about a thing, and because it is a concept about a thing, it is what gives meanings to things. It is what represents, if only in our minds, the constraints of the physical.

What the poor have are physical goods. Today, in my country, they own 80 percent of the physical goods, but they do not exercise property rights over them. That they do not have property means that they do not have this "aboutness" of things in property, and this is what gives a market economy the order and structure with which it can work.

Whatever technical legal definition of property you choose, you must recognize that property is not a relation

between an owner and a thing. It is a relation between the owner and other individuals in reference to things. Therefore, for example, if you have a title to a pied à terre in the middle of New York City, you have something that defines your relations with all the others who live in New York with reference to that apartment. Among other things, that relation says that you can live there undisturbed, but at the same time, you may not operate a smelter out of it.

Property comes with a set of constraints that society imposes on its holders. If my pied à terre is not property, I have no enforceable right to keep others from living there, and by the same token, others have no right to keep me from polluting the air. And in the developing world, without property, if taxes do not work, if charging rates for electricity and water and expanding infrastructure is difficult, it is because you cannot attach things to addresses, addresses to people and people to an enforceable law. Property is at the center of allowing for things to function. That means that everybody has got to think about it in the same way. Property must be a shared concept, and it must be embodied in representations about which there is a shared agreement.

A land title is a way of embodying the shared ideas about landed property in a commonly accepted representation. However, property titles were not always the same. They certainly were not in Switzerland back at the end of

the 19th century. As a matter of fact, you had, according to Eugen Huber, between 50 and 100 different types of property systems, depending on what part of Switzerland you came from. As a result of this, you did not have a shared mental representation or legal representation of goods inside Switzerland. And without such a shared representation, you did not have the tools with which you could create a prosperous market economy.

To understand this, it is necessary to think of concepts and of the way in which they become representations with currency value as one of the most important things that reason has given to Western societies. When you have a concept that you can put into a symbol, it multiplies its value.

For example, a representation other than property is numbers. If I want to calculate dimensions, if I want to calculate quantities, and I ask any one of you, "Please multiply 394 by 286. You have got five seconds," most of you will take out your pencils and you will write your representations out on your pieces of paper. Then, once you have finished your calculations, you will bring the result back into your minds, because there is no way of handling concepts unless they are embodied in socially accepted representations. If we had not adopted Arabic numbers, which contain a zero, in the seventh century, we would have had great difficulty creating the wealth that we have today.

This is why Albert Einstein always said, "My pencil is smarter than I am".

In other words, when you are able to take your concept embody it in a symbol understood and accepted by the rest of society, it starts having a multiplier effect. You know the value of your representations. To the point that one of the things that most interested me about Europeans, Germans, and I suppose it is also the case of the Swiss, is that you wash your bills (your symbols of wealth). This is something I had not known. In my country we do not do that. Bills, soles, pesos, etc. is money that is handed around. It is greasy. It is only a representation of real wealth that is in the bank, in the form of gold, or whatever other kind of deposit. But you know the value of representations well in Europe. That is why you wash your bills.

Therefore, shared representations of things, which are what you do not have in developing countries, are very important for a market economy. You could not have a market economy if you did not have representations of the things it contained. Yet, land as property, the most important representation of them all, is the most unregistered and untitled thing in the world.

Now, the interesting thing about all of this is that you would say, "Well. This is a poor country's mentality. What does it have to do with Switzerland?". Well, probably not much today, which is why I said I would rather linkup with your 19th century generation.

Switzerland in the 19th century was very poor. In your 1848 constitution,

in article 34, which I believe is still in your constitution, it says that it is the Confederation which will decide which travel agencies will be allowed to operate in Switzerland and under what conditions the Swiss will be allowed to migrate. At that time, the issue was not Peruvian or Chilean or Salvadorian maids coming into Switzerland: It was Swiss going to Latin America. And you were exported and exploited by travel agencies like Mexicans wanting to travel to the USA today. So much so that the Confederation had to come out and protect you. This was, by the way, at the same time when there was no property in Switzerland.

Another sign that you were poor at that time is that the constitution itself also talks about military capitulations; that is, about the fact that many Swiss were forced to sell themselves and their bodies to fight for other kings and other causes because they were so poor. And so your constitution had to come out and help you.

Not only that, but some time at the turn of the century, when Alfred Escher, the founder of the Schweizerische Kreditanstalt, went to try and fund the Swiss part of the tunnel for the Gotthard between Germany, Italy and Switzerland, he had to go to France, because there was no capital in Switzerland and this was only 100 years ago.

Thus, you were a very poor country. The question is therefore, if you were so poor, what did you do in the last 100 years to become so rich? I think

you owe it all to a series of fore-sighted men who, before the end of the 19th century, when you had principally Roman law, established, common property representation in Switzerland.

With property, you can get mortgages; you can get into the secondary market; you can then make other forms of debentures; and, you can get all the way into derivatives that continually are being discounted on the market because you are able to attach goods to performance.

However, at that time, you could not because, you see, you had different legal systems governing property throughout Switzerland. To the point that when a mission came from abroad (where at that time the great Roman law was being taught especially at the University of Lombardie), and they tried to convince the people of Frauenfeld in Thourgovia about going into a better system that was structured for trade, the authorities of the tribunal of Frauenfeld said: „Hört Ihr, Doktor!“. "Listen here, Doctor. We citizens of the Swiss Confederation do not ask you, or any other doctors, about our things. We have our own customs and special laws." You were then adamant about your differences. You had "kofens" which are areas where people have the right to forbid you to alienate your land if all members of the constituency are in favor. You had the "Fertigung" which were predominant in Berne, Argovia, Solothurn, Zurich and Schaffhausen. They involved conveyance with ceremo-

nies. It was totally different from the other systems that existed then, including the transcription which was mainly used in Geneva, in the Valley in Fribourg, and in Neuchatel. You also had, of course, the Grundbuch. However, that was prevalent mostly in the Grison, in Glarus, in Nidwalden, in Schwyz and in Basle. In other words, you had many different laws for property depending on where in Switzerland you lived. You had no shared concepts about property.

In this respect, you were not really very different from my country today. Right now, we have all sorts of property laws. The law in Cuzco is one thing, the one in Arequipa is another, and that of a pueblo joven in Lima another still. To be sure, our formal law is the same throughout the country, but the law that controls how most people live, work, and hold property, is the "informal" law. And this informal law varies from region to region, and even from village to village.

What you, one hundred years ago in your country, called ethnic diversity in law making, we call today, in my country "informality". This is the law of the poor, which runs parallel to Government law. When you have more than two institutions defining rights to property in one country, I think you have an acceptable definition of anarchy. Anarchy is about not having one good set of rules in order to be able to understand each other as a big human family or as a big national family.

Therefore, when we talk about the informal sector in Latin America, we are not talking about things that are too distant from European reality of one hundred years ago. We are talking about things you changed so as to become a wealthy market economy. Because, believe me, we have everything else. We have got access to money. We are educated in your schools. We have got brains. We know how to manage currencies. Some of the most brilliant technocrats in macroeconomics today probably come from Latin American countries. We have got most resources required to take off economically, but we lack property.

The man who made the difference in Switzerland was a man called Eugen Huber. He received a mandate from the Bundesrat to try and bring all the different property systems of Switzerland together. It took him from 1880 to about 1893 to accomplish this task. In that time, he accumulated 3,000 pages in four volumes that basically delineated, in the same way we have been doing in Peru through our property formalization systems, what the customs in each village were, how they represented property in the minds of their constituencies so that all of these different representations could be brought together inside a common legal language, a language that would allow all of you to communicate as economic agents.

On the basis of his four-volume study, he brought together the different laws, customs and the various regula-

tions that were enforced by practice or by law in the 25 different Swiss Cantons. Then he drafted the civil code. That took him from 1893 to 1899. The Bundesrat then proposed the text to the parliament in 1901, and parliament adopted it in 1905. And from 1905 to 1912, in seven years, the Cantons were given time to enter the Grundbuch, le registre de foncier. To us, what is so remarkable about Huber is that he realized that for law to work, it has to come from people. "The law must come from the mouth of the people", he said. And because the law was legitimate and it came from the mouth of the people, it actually worked. Just as we have done with our titling program in Peru.

Getting back to the present, as I was coming from the airport to the hotel today, and as we were driving down the road, my driver and I talked about the differences between Switzerland and Peru. When we came across a house, I said that in Peru a house would just be a house, but in Switzerland it can also be the source of a mortgage, it can serve to guarantee a payment.

When you see a parcel of land in Peru, you see something that can be tilled, sowed or harvested. In Switzerland, it can be used for all of these activities, but it can also be used in a series of commercial and financial transactions. Likewise, when you see merchandise in my country, it is for consumption only, while in yours it can be put in the form of receivables and used to create capital.

When you look in my country, you see objects in one dimension only. When you see an object in yours, you see it in two dimensions. It is the physical thing on the one hand, and it is also the representation of the thing in the eyes of the community. In economic terms, the majority of assets in my country are "dead" capital, because they cannot be put to work to generate more capital and thus more wealth. By contrast, in Switzerland, thanks to Huber, your assets are "live" capital. Goods can be used to generate additional economic activity, to guarantee loans and so forth and thus to add to the nation's wealth.

To end, I would just like to support my friend Muhammad Yunus in saying that the agenda has got to be changed. Yes, indeed. The poor people are not the source of the problem, but the solution. When you remember poor people in Switzerland's past, you will be better able to identify with the poor people of Bangladesh and Peru today, and hopefully coincide that poverty is to a great degree the result of bad law. The solution lies in meshing the laws of all into one legal language, of inserting informal law, into formal law, of creating a shared consensus about representations.

This is what property is all about. This is why we are making an effort for everybody to have access to formal property. Property is more than just possessions. It is the language of the market economy, and indeed the one a civilized society requires so as to prosper and live in peace.