

WHY CAPITALISM TRIUMPHS BUT FAILS ELSEWHERE

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ABSTRACT

This paper emanates from the occasional papers produced by the Centre for Development and Enterprise in November of 2001. It is basically a South African conversation with Hernando de Soto. The paper therefore, is a synopsis and summary of this important conversation. It bears immense relevance to development, entrepreneurship, the economy, politics, business, money, ownership, governments, states and the poor, including a host of other social issues. The paper is therefore, important to the management student, to the business environment, the success of governments and their failures, and to society as a whole, given the economic crisis that began in 2008 and, persists even today. It does not add to the debate, but exemplifies the importance of this discussion to contemporary society and to the developing world. The author uses his own insights, observations and experiences as a South African, born over six decades ago in the city of Durban, in the province KwaZulu – Natal, to add to the conversation.

Key Words: Capital, Capitalism, Investment, Titles, Property, Investment, Development, Poverty, Assets, Reform, Reformers, Legal, Political, Wealth, Strategy, Culture

Hernando de Soto is the founder and president of the Institute of Liberty and Democracy in Lima, Peru. He was involved in Peru's economic reform and was an advisor to the President of Peru. His current work is on the implementation of measures for bringing the poor into the economic mainstream. He has published the book – The Mystery of Capital: Why Capitalism Triumphs in the West and Fails everywhere else. In 2001, de Soto spoke at a seminar in Johannesburg, South Africa, hosted by the Centre for Development and Enterprise.

The author is mindful of the reality that such an article can be provocative and will be criticized. The idea is not to antagonize anyone, but to add to this important conversation. No apology is therefore made. The paper therefore is relevant to a host of societal issues, including politics, public administration and the economy.

INTRODUCTION

Imagine a country where nobody can identify who owns what, or for that matter people cannot be made to pay debts and resources cannot be turned into money, including a host of other variables of similar and vital importance. This is a scenario that confronts many citizens of the "Third World" or some developing countries or in the former communist Soviet Union. This is the general life of the majority of the historically marginalized population of South Africa, after 20 years of democracy and 20 years of the demise of apartheid and over three hundred years of colonialism. During this period the neoliberal agenda and the capitalist forces of the Western world, had consolidated their grip upon the developing countries, South Africa included. This subjugation has resulted in the contradictions of development, capitalism and so on. It has led to

a number of policy errors by both the former apartheid government, its homeland governments and by the democratic government, post 1994. The life of the poor, the deprived and deprived masses, in the majority, which make up large numbers in South Africa, is not what Westerners, and the South African bourgeoisie (White and black) and the predatory elite of the ruling classes, can imagine, because they live in their comfort zones, whilst this majority live in misery, squalor and are in reality impoverished.

In spite of their obvious poverty, even those who live under the most grossly unequal regimes possess far more than anybody has ever suspected. The value of their savings is immense, many times all the foreign aid and investment received since 1945. In Egypt alone the assets of the poor are 55 times greater than all foreign investment ever recorded, including the funding of the Suez Canal and the Aswan Dam. But the poor and lower middle classes hold their resources in defective forms: they have houses but no titles, crops but not deeds, businesses but not statutes of incorporation. They have no alternative but to live outside the law. Some 15 years ago the Institute of Liberty and Democracy, including hundreds of professionals from various countries went into the streets of developing and former communist nations to learn what real people were achieving inside and outside the underground economy. They closed their books but opened their eyes and, the results were dramatic. The data collected from Asia, Africa, the Middle East and Latin America, show that the world's poor and lower middle classes have accumulated all the assets needed for successful capital. The question arises with great concern, anxiety and perplexity – Why are these people so underdeveloped? Why can't they turn their assets into liquid capital, the kind that generates new wealth by increasing production and productivity?

THE MYSTERY OF CAPITAL

According to de Soto (2001) the answer is simple and therefore, to be useful in an expanded market, capital must first be represented in a property document where it can then be assigned a status that allows it to produce additional value. What most people possess outside the West is not 'paperised' in such a way as to produce capital." This is most difficult to visualize because it is hidden in numerous and cumbersome legislation that govern the system. The genius of the West he adds "was to have created a system that allowed people to grasp with the mind values that human eyes could never see and to manipulate things that hands could never touch." It devised new ways and legal mechanisms to represent the invisible potential locked up in the assets that people accumulate. The absence of this process in poorer regions of the world is not the consequence of some Western monopolistic conspiracy. It is rather, a case of Westerners taking this mechanism for granted that, they have lost all awareness of its existence. This is the mystery of capital. Solving this puzzle requires an understanding of why Westerners, by representing assets with titles, are able to see and draw out capital from these.

Capital is therefore confused with money, which is only one form in which it travels. It is wrong to equate capital with money. Money facilitates transactions, allowing people to buy and sell commodities, but it is not itself the progenitor of additional production. For obvious reasons the human mind wraps itself around 'money' more easily than capital. One needs a property right before one can make money. Money, therefore presupposes property.

A PERSPECTIVE FROM THE OUTSIDE

Massive extra legality is not a new phenomenon; it is what always happens when governments fail to make the law coincide with the way people live, conduct business and work. For example, a large informal economy covering a large percentage of the population does not mean that

people are not entrepreneurial but rather they do not, or cannot operate within the legal system. De Soto (2001) found serious obstacles such as:

- In Peru, for a business to become legal took more than 300 days, working six hours a day. The cost: thirty two times the monthly premium.
- In Egypt, the person who wants to acquire and legally register a lot on state – owned land must wend his way through at least 77 bureaucratic procedures at 31 public and private agencies.
- The process could take anything from 5 to 14b years. This perhaps explains why 4.7 million Egyptians have chosen to build their dwellings illegally.
- Faced with obstacle requirements and legal obstacles, the poor develop an alternative extralegal economy using informal arrangements to protect their assets.”

The formal property systems of the West produce six effects that allow their citizens to generate capital. The incapacity elsewhere in the world to deploy capital stems from the fact that most of the people in the ‘Third World’ and in former communist countries are cut off from these essential effects. 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 accessible to the poor.

NOTE: {The reader should consult the book: The Other Path: The invisible revolution in the third world. The book was written by H, de Soto.}

THE EFFECTS OF LEGAL PROPERTY RIGHTS (6 EFFECTS)

1. Fixing the economic potential of assets: Any asset whose economic and social aspects are not fixed in a formal property system is extremely hard to move in the market. Property is not a physical thing, it is legal expression and therefore, it is a question of how it should be held. It is the realm of identifying and combining them for purposes of linking to assets. Law is the instrument that fixes and realizes capital. In the West the law is less concerned with representing the physical reality of buildings or real estate than with providing a process or rules that will allow society to extract surplus value from these assets. What detaches value from a simple house and fixes it in a way that allows us to realize it as capital? What is it that fixes the potential of an asset so that it can put additional production into motion? Assets in developing and former communist countries serve immediate physical purposes, but in the US and Europe, the same assets lead a parallel life as capital outside the physical world... they act as collateral, as equity that is the basis for issuing shares against investment and as guarantees for credit. If one does not have this parallel life to the physical life of the assets one does not have a capitalist world. In the communist world, it is therefore, untapped stock of potential energy.

In the case of Latin America, for example, countries privatized state corporations as part of the ‘Washington Consensus’ of the 1990’s. People do not want to buy companies, they want to buy shares. The Peruvian Telephone Company was sold on the basis of shares and an amount of \$2 billion dollars was raised, 37b times its original value. That’s capital.

2. Integrating dispersed information into one system: The reason why capitalism has triumphed in the West is because of the assets in Western nations that have been integrated into a formal system. Integrated property systems came about a hundred years ago. The information was gathered and supported by the political system in the West and all property was recorded. This was undertaken on the basis that for knowledge to be functional, advanced nations had to integrate into one comprehensive system. People therefore did not have to see the asset in terms of economic and social qualities and did

not have to travel throughout the country to see their assets. It provided an opportunity to create surplus value and thus it has become easier to evaluate and exchange assets, enhancing the production of capital. Developing and former communist countries have not done this. The major problem in the developing world is the reality of many separate extralegal property arrangements that is, a characteristic of most Third World and communist countries. This integration is therefore of vital importance in both the Third World and former communist countries and, must be integrated into one all encompassing social contract.

3. Making people accountable: there has to be enforceable property systems because, it shifts the legitimacy of rights of owners from the politicized context of local communities to the impersonal context of the law. People must become accountable and therefore will no longer rely on neighbourhood relationships or make local arrangements to protect their rights to assets. Owners lose their anonymity once in a formal arrangement by now linking into the real estate and business that is easily identified and located. This anonymity has virtually disappeared in the West. They can all now be identified through records and therefore if debt is not honoured by a Westerner he can be identified and blacklisted. One has to play by the rules and this is accountability, because appropriate and defined sanctions apply in cases of transgression. All of this explains why people in the developing world cannot make profitable contracts, cannot get credit or utilities services, because they have no legal property to lose and by implication are trapped in the precapitalist world.
4. Making assets fungible: The formal property system allows for making assets transform from a less accessible condition to a more accessible condition, so that, it can do additional work. The asset becomes 'fungible' (to suit various transactions). Assets can be owned by different people, with different rights and to carry out different functions. Because of formal property, a single factory can be held by many investors and Westerners therefore, can adapt their assets to any economic circumstance, whereas their Third World counterparts remain trapped in the physical world of rigid, non – fungible forms.
5. Networking people: Business can be conducted with strangers, by making assets fungible, by attaching owners to assets, assets to addresses and ownership to enforcement and by making information accessible. This converted Westerners into a network as identifiable business agents. In the Third World extralegal property arrangements are often dispersed among dozens and even more communities. By contrast, integrated legal property systems destroyed most closed groups and thus creating larger networks and thus the potential of creating capital increased. In other words assets can be assembled into more valuable contributions.
6. Protecting transactions: one important aspect and reason as to why the western formal property system works like a network, is because assets can be tracked and protected. There are files with an appropriate administrative system that has been put into place. In addition public record – keeping systems have evolved to assist parties in fixing, moving, tracking for purposes of creating surplus value. It is a question of making transactions, such that assets lead a parallel life as capital. In the West large amounts of assets can be moved because of security arrangements and very few transactions are involved. How then can we explain in developing countries that people take their animals to the market and trade them one at a time, whereas in the West traders take rights to market. Thus

deals are made on huge quantities with little concern about the security of transactions. It is the radical flow of communication about assets that matters and their potential, thus mobilizing and using assets to advantage. In the Third World, it is difficult to create networks. These countries are trapped by early colonial and Roman law for purposes of protecting ownership. They become custodians of the dead and therefore, this explains in the developing countries why most of the assets have slipped out of the formal legal system in search of mobility, while in the West the creation of capital is easy. Thus leads to holding on to assets because they cannot insert their assets into the legal property system in the Third World. Those that can navigate through the red tape and the bureaucracy in the Third World are only in the minority. So in the developing countries capitalism becomes like a private club. Open only to a privileged few, and this stifles the emergence of billions standing outside looking in. thus the law is not on the side of the people, it's a law that assists the established capitalism of a few, an elite and not the majority. This capitalist apartheid will continue until we come to terms with the critical flaw in many countries legal and political systems that prevent the majority from entering the formal property system.

DISCOVERING THE LAW

For property law to be respected, it must reflect what is happening on the ground and must also include as many people possible. It is necessary that governments uncover the existing social contracts on property established by the poor and integrate them into official law... there has to be a common regulatory framework for all citizens. Any government that is serious about reengineering the informal agreements into one national formal property social contract needs to listen to the citizens. It needs to be found out what deals are being made in the black market by common people. A capitalist system may need to be created by sound interventions. Original research therefore has to be conducted. These must be assembled to build a property and capital formation system that will be recognized and enforced by society itself.

THE POLITICS OF REFORM

According to de Soto (2001) "Emancipating people from bad law is a political job and implementing major legal change carries a political responsibility:

- Change would be opposed and therefore requires committed consultants and talented politicians committed to serving the people.
- Norms must be designed that are rooted in people's beliefs for purposes of being obeyed.
- Governments must assure citizens and protect them. They must convince leftists who are in touch with people at the grassroots to produce capital are the best way to help them. That it would be less costly and more efficient.
- The property apartheid must be broken and that macro – economic reforms are not enough. Internal trade and private investment must be encouraged and balanced with the process of globalization. Capitalism must be limited because franchises like McDonald's and others cannot alone create capital. Without property most people would not prosper within a capitalist environment and will be economically invisible.
- The developing world is in the same position that Japan, Europe and the United states were a hundred years ago, therefore. An integrated property system is crucial. And must be addressed by the fungibility, bureaucratic machinery and networks required to produce capital.

- As capitalism falters in many parts of the world, the time is ripe to take the subject of property away from conservative legal establishments and put it in the hands of committed politicians. For purposes of progress.”

QUESTIONS FROM THE AUDIENCE

Note: These questions were posed by the audience to de Soto. De Soto answered them and to this end the article lists the questions, but does not provide de Soto’s responses. The reader is requested to consult the paper on pages 7 to 12 for the responses. The questions from the audience were as follows:

1. Is market orientation a pre – requisite on the part of politicians to recognize and take forward the kind of programme you’re suggesting?
2. After putting in place a parallel system in relation to physical and other assets that work and are recognized by people, is there a spontaneous development of capitalism? Do people become more productive because they realize they can retain ownership of what they are producing?
3. One of the greatest problems we encounter is that the market is inaccessible in South Africa. Whatever efforts are made to get excluded people into the mainstream of the economy, the fact of the matter is that this is a very difficult task and that never get to the centre. What is your view on this?
4. What do you do in a situation where there is no shared understanding that capitalism is the way? Do you start on this path or do you try to get some shared understanding about what path you want to go?
5. What do you do about competition?
6. How do you respond to those critics who say that you have a ‘single bullet’ theory of development?
7. Do you need one or two specific conditions that need to be in place for your exercise to be successful and enable people to accumulate wealth through the creation of titles? What are these?
8. There have been some problems that land reform in Latin America where many peasants received land but did not have the skills, knowledge or resources to work that land and some ended up selling land back to the rich people who owned the land before them. Can you reflect on these issues?
9. Even in countries where there are supposedly adequate legal frameworks and property rights and finds that the rich are getting richer and the poor are getting poorer. Are property rights the main issue?
10. Can you talk about the role of culture and the criticisms that have been made in your book?

CONCLUSION

This is an executive summary of the seminar. It is in the interest of the reader to read the books written by de Soto and to examine the answers provided by on the questions posed. It is a fascinating interpretation that must be utilized by governments in the developing world, in order to address the issues of property rights, their formal arrangements and so on. This could drive the trajectory of development and prosperity for the millions that live in poverty because they have no real rights and understanding of land that can allow for capital accumulation. The paper is aimed at students of politics, sociology, agrarian reform, public administration, politicians and the MBA student. It is hoped that they could stimulate discussions in their institutions on this important subject.

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