

Hernando de Soto

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Hernando de Soto is a revolutionary Peruvian economist and winner of numerous enviable awards. The son of a Peruvian diplomat, he left Peru with his father after the 1948 military coup and fled to Switzerland. He did not return to Peru until he was 38 and had established himself as an economist. Currently the president of Institute of Liberty and Democracy in Lima, de Soto has published *The Other Path: The economic answer to terrorism*, and *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. The ILD is considered by *The Economist* to be one of the two most important think tanks in the world. He is focused on developing programs to help the poor in developing world become self-sufficient and prosperous. Thirty heads of states have asked him to conduct such programs in their countries.

De Soto's principle thesis is that in order for developing countries to succeed economically, property rights must be given to the poor and enforced. This allows greater independence for individuals to protect their assets and property, standardization of property rules, increased trust in government, greater availability of loans, easier access to information necessary for business, and increased openness in the country's economy, according to de Soto. His thesis states that people in developing countries lack such an integrated formal property system, leading to only informal ownership of land and goods. De Soto argues that the reason for the economic success of American and Japanese capitalism was a clear system of property rights created during the frontier period in America and in post-World War II Japan. Without property rights in developing nations it is impossible for the poor to use their informal ownership into capital (for example, using land as collateral for a business loan), which de Soto claims would form the basis for entrepreneurship. Without property rights, he claims developing nations will remain dependent on subsistence agriculture and black market economies. He argues:

“Extra legal businesses are taxed by the lack of good property law and continually having to hide their operations from the authorities. Because they are not incorporated, extralegal entrepreneurs cannot lure investors by selling shares; they cannot get low interest formal credit because they do not even have legal addresses. They cannot reduce risks by declaring limited liability or obtaining insurance coverage. In fact, the only 'insurance' available to them is that provided by their neighbors and the protection that local bullies or mafia are willing to sell them. Moreover, because extralegal entrepreneurs live in constant fear of government detection and extortion from corrupt officials, they are forced to split and compartmentalize their production facilities between many locations, thereby rarely achieving important economies of scale. With one eye always on the lookout for police, underground

entrepreneurs cannot openly advertise to build up their clientele or make less costly bulk deliveries to customers.”¹

The greatest hope for developing countries is that by enshrining property rights, entrepreneurs can be brought out of the black market and into the open.

De Soto advocates for the poor businessmen of developing nations and considers them the key to change. He argues that in order to create a productive, successful economy, you need to get rid of beneficiaries, politicians, and bureaucrats that protect the status quo and resist change. To help developing nations, the West must open up communication with these poor entrepreneurs, not the Westernized elites that the West usually talks with, argues de Soto. The majority of resources in developing countries do not come from their governments or from foreign aid, but from the people, who have created a thriving economy, but in the black market. In order to get the economy out into the light, the West must focus on giving the poor property rights and rule of law to protect their property rights. If you're a small businessman with a plot of land, and the rule of law protects your land, you will respect rule of law, says de Soto. Once you understand that law is supreme, you will become interested in how laws are made, and begin to respect the political system. Property rights are the origin of rule of law and rule of law will create prosperity. These are the key steps to creating prosperity in developing countries, argues de Soto. His programs have been very successful so far, and his theories are a beacon of hope for the developing world.

Bibliography

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¹ Hernando de Soto, qtd. in Gerald P. O'Driscoll Jr. and Lee Hoskins, “Property Rights: The Key to Economic Development,” *Policy Analysis*, No. 482. 7 August 2003.