

## ON THE MYSTERY OF CAPITAL AND THE MYTHS OF HERNANDO DE SOTO: WHAT DIFFERENCE DOES LEGAL TITLE MAKE?

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Hernando de Soto's new bestseller, **The Mystery of Capital**, attributes the failure of capitalism in the Third World to the lack of property titles. While this is hardly a new argument, it is likely to acquire renewed momentum because his is a very influential voice within Washington. Latin American governments, which have already been busy distributing title deeds, are likely to continue this policy on an even larger scale.

My question in this paper is to ask what difference the 'gift' of a title deed actually makes to the life of the poor? Does it permit them to borrow money from the formal sector as de Soto and the World Bank claim? Does it open up a new world of capital accumulation for the poor because it now allows property to be transferred legally from one 'owner' to another? Or, does it in fact make so little difference that the whole argument about legalisation is a sham?

Using data gathered in the now legalised self-help settlements of Bogotá, I will question each of the main benefits of legalisation. I will show how sales are sometimes more frequent when people lack legal title, how informal finance is available at the commencement of an illegal settlement and how little formal finance is forthcoming after legalisation. Most importantly, I will show that there is little sign of a secondary housing market developing in legalised settlement. It is hard for the poor to make money from homeownership when they are unable to sell their houses.

### **A few words about Hernando de Soto**

Hernando de Soto seems to have the knack of repeating what people have been saying for years but convincing decision-makers that he has invented something new. The novelty of 'his' ideas is exaggerated by his less than honest habit of failing to cite virtually any of his sources. His first best seller, **The Other Path**, was published in Spanish in 1986 and in English in 1989. Its key message was that the downtrodden slum dwellers of Lima were victims of the state. Inappropriate and excessive government regulation made their lives unnecessarily difficult. They were not to be condemned for their consistent failure to obey Peruvian law. Rather, they were to be applauded for the initiative that they showed in struggling against the damp hand of bureaucracy. As the laws they were breaking were generally unjust, and they were breaking them only to survive, they deserved no moral blame. The sensible answer to informality was not better policing so much as changing and removing the regulations. Such an argument was popular in Peru where few appreciated the oppressive bureaucracy as well as in Washington where the message was music to the ears of the Reagan administration. The latter like the thesis that the informal sector was made informal by the formal sector. Arguably, de Soto's ideas also supported the message of the World Bank and the IMF with respect to structural adjustment (Bromley, 1990: 331). They provided a cloak of respectability for conditionality if 'people down there like what we are recommending here in Washington'!

De Soto was also highly influential in Peru. Panizza (2000b: 189) argues that “de Soto’s (1989) apologia of free-market economics as a crusade in favour of ‘the little man in the slums’ and against the country’s political and economic oligarchy set up the ideological ground for Fujimori’s neoliberal reforms” (Panizza, 2000b: 189). But his role in Peru is far more complex than that because he has worked both with and against supporters of structural adjustment. During the 1980s, it is said that he was invited to be prime minister or vice-president by three different administrations and to be mayor of Lima by a fourth (Bromley, 1990: 342). His admirers ranged from the political right to the left. If he was influential in Peru, he was only marginally less so in Washington. One source in DC tells me that he arrived as a fully-fledged star in the 1980s and that, for a while, **The Other Path** was the recognised bible. “He was able to penetrate Washington society more effectively than any other person I have seen.” His “right wing romanticism” was very popular with the Reagan administration.

USAID backed him strongly and one confidant in Washington reports that he brought a political cachet to us rather than the other way round. “He was beloved by the administration” of AID in the late 1980s because the issue of titles and credit have always been very important in the housing arena here in AID. Later, however, others within that organisation began to question his arguments and cut off his funding. Another source argues that de Soto was eventually recognised as “a fraud” and admits to being “quite embarrassed that AID has supported him for so long”. Clearly, different departments in the organisation developed very different views of him.

The new book, **The Mystery of Capital: Why capitalism triumphs in the West and fails everywhere else**, is in the same mould as the first but is even less modest in its aims. It is a book about how to solve the problems of all poor people throughout the Third World. It is clearly populist in tone and does not hesitate to attack neo-liberalism and conditionality: “with varying degrees of enthusiasm, Third World and former communist nations have balanced their budgets, cut subsidies, welcomed foreign investment, and dropped their tariff barriers. Their efforts have been repaid with bitter disappointment. From Russia to Venezuela, the past half-decade has been a time of economic suffering, tumbling incomes, anxiety, and resentment...” (de Soto, 2000: 1). His remedy is to offer opportunity in place of suffering. He promises to help the poor through the existing economic system. A revolution is not necessary because capitalism clearly works in the west and can work with a little bit of tinkering in the Third World. The United States as a society has got the message right and what is needed is to turn the Third World slum dweller into a typically American small businessman.

No doubt the new book will be as well received as the first. Late last year de Soto was making presentations at several forums in Washington, and his message will no doubt be warmly embraced by the new president who applauds that key American value: ownership.<sup>1</sup> The list of famous names on the cover of the book show that de Soto appeals to a wide and highly influential audience: a former British prime minister, an ex-British Foreign Secretary, a

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<sup>1</sup> As President-elect George W. Bush stated, when introducing his new HUD secretary Melquiades R Martinez on 20 December: “He understands American values. He’s grown to appreciate them. And there’s no greater American value than owning something, owning your own home and having the opportunity to do so.”

former US Ambassador to the UN, a former Secretary General of the UN, an ex-Chairman of Citygroup, two Nobel Laureates in Economics, and the founder of The National Review. Any book with the names Margaret Thatcher, Milton Friedman, Jeanne Kirkpatrick and William F. Buckley on the cover is likely to command immediate attention under the new regime.

### **The ‘new’ conventional wisdom about legal title**

According to de Soto very little needs to be done to make capitalism work well in Africa, Asia and Latin America. Because the poor save money and have developed many business skills all that is needed is to give them the tools to expand their enterprises. The key element required to convert them into successful business people is access to formal credit and they will get credit if they are granted a legal title to their property. Give a business or a household a legal title to their capital assets and the world is their oyster.

As de Soto (2000: 5) puts it: “Even in the poorest nations the poor save. The value of savings among the poor is, in fact, immense – forty times all the foreign aid received throughout the world since 1945.” “But they hold these resources in defective forms: houses built on land whose ownership rights are not adequately recorded, unincorporated businesses with undefined liability, industries located where financiers and investors cannot adequately see them. Because the rights to these possessions are not adequately documented, these assets cannot readily be turned into capital, cannot be traded outside of narrow local circles where people know and trust each other, cannot be used as collateral for a loan, and cannot be used as a share against an investment.”

Give them titles and they will have access to credit and that will improve the functioning of the land and property markets. Of course, there is nothing particularly new or controversial about this policy. De Soto himself pushed this message very hard in his earlier book and has been actively involved in regularisation and legalisation programmes in Peru for some years. Nor is it a new message in Washington for both the World Bank and the Inter American Development Bank have been saying this for some time. Indeed, both were active in sites and service and upgrading programmes as early as the 1970s (World Bank, 1984; Grimes, 1976; Laquian, 1977). While the World Bank is today disenchanted with sites and services programmes, it is heavily into upgrading and legalisation plays a critical role in that process. As the World Bank’s housing policy paper stated in 1993: “The registration of property rights in squatter settlements is... important in making land and house transactions possible and giving occupants legal protection. It encourages the buying and selling of housing and makes it possible for households to move to a dwelling that suits their needs and their budgets. It also increases the choice of tenure available to households, allowing them to own or rent as they see fit” (World Bank, 1993: 117).

Many governments in Latin America have been practising this approach for some time. The last couple of decades have seen both legitimate and illegitimate regimes giving out titles to large numbers of illegal settlers. The military government in Chile gave out more than 500,000 land titles between 1979 and 1989 and the two democratic governments that succeeded it, distributed a further 150,000 titles by 1998 (Chile, MINVU, 1990; Rugiero,

1998: 31 and 51). In Peru, the new Commission to Formalise Informal Property (COFOPRI) managed to register some 500,000 urban land titles from 1996 to 1999 (Conger, 1999: 8).

Such a policy is generally a vote winner with electorates. Who in principle is going to object to being given legal title to their property? It is an apparently unchallengeable recipe for popularity with ordinary people and as such governments have been anxious to pursue it. It is one policy area where, today, if not in the past, national and local governments are in full harmony with developmental Washington.<sup>2</sup>

### **Concern about illegality: to what extent is illegality a real problem in Latin America?**

Much has long been made of the way poor people invade land in Latin American cities and how in some cities it has become the customary way of obtaining a plot. And, it is true that most low-income housing areas in the lowland cities of Ecuador, Peru, Central America, Colombia and Venezuela have been formed through invasion. In other places, land invasions have only occurred at particular times, usually when the government authorities have been prepared to turn a blind eye to the process. Such has been the case in certain Brazilian cities, in Santiago (Chile) before 1973, and in parts of Mexico.

What is usually left out of the account is that governments have sometimes been among the principal actors encouraging land invasion. In Lima, for example, the invasion of public land on a large scale was first stimulated by the Odría administration in the 1940s (Collier, 1976). Similarly, in Venezuelan cities, the main political parties have facilitated the invasion of public land over many years (Ray, 1969; Gilbert and Healey, 1985). In Chile, land invasions were encouraged by every political party in the build up to the strongly contested and highly politicised 1970 election (Kusnetzoff, 1987; 1990).

However, invasions are not the normal way in which poor people obtain land in every city. In most of highland Colombia, Ecuador, Mexico and Peru, and in the south of Brazil, most self-help settlements are founded on land for which the families have paid money (Doebele, 1975; Gilbert, 1981; Gilbert and Ward, 1985; Beijgaard, 1995). These settlements offend the planning regulations but are not illegal in the sense that the land has been taken from the owner. The state of illegality consists of a lack of services, something that could easily be resolved by the provision of infrastructure. Elsewhere, perfectly decent and well-serviced homes simply lack properly registered title deeds; they are illegal only in a technical sense. In Mexico, the situation has traditionally been more complicated because much urban growth has occurred on ejidal land. Because the agrarian communities that controlled the land could not legally sell it, it has been more difficult for the authorities to issue title deeds to the occupiers (Azuela, 1989; Jones and Ward, 1998; Fernandes and Varley, 1998).

Many of these illegal forms of land development provide the occupiers with plots from which they will never be removed. Despite their regular calls for legal title, most purchasers of land

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<sup>2</sup> By developmental Washington, I mean the World Bank, the IMF, the Inter American Development Bank, USAID and the assorted developmental consultancies and lobbies like PADCO and the Urban Institute.

in illegal subdivisions know perfectly well that they are the owners from the day that they pay their deposit to the illegal sub-divider. Such owners proceed with the building of their house unconcerned about the dangers of eviction. The occupiers of invaded land are less certain about their tenure rights but where they have the backing of powerful political patrons, they too know that they are safe. It is only settlements that threaten powerful vested interests, for example, because of their geographical proximity to elite residential areas, which are likely to be removed. Most of the notorious eviction programmes, in Caracas, Rio de Janeiro, Mexico City and Santiago de Chile, affected communities that were located close to the city centre or to elite suburbs (Coulomb and Sánchez, 1991; Dwyer, 1975; Hardoy and Satterthwaite, 1981; Scarpaci et al., 1988; Valladares, 1978). The other common denominator underlying evictions was that a military or authoritarian government was in power; over the years democratic governments have been more reluctant to send in the troops.

But, in practice, demolition has never been the norm. If it had been, the vast areas of informal housing that surround most Third World cities would not be there. Most governments leave self-help housing alone; they are more likely to service it than destroy it (Gilbert and Gugler, 1992). The reasons why are obvious. First, politicians need the electoral support of the poor, or at the very least, their acquiescence. Destroying self-help housing is likely to upset social stability. Second, self-help housing reinforces rather than undermines the idea of private ownership, fostering conservative values among the poor. Insofar as any land is actually stolen, it tends to be public rather than private land, and is rarely located in anything but undesirable areas.

### **The need for a land title**

Hernando de Soto is correct in believing that at times the lack of a legal title can inconvenience the poor. The occupants of newly formed settlements often feel insecure and even in long-established neighbourhoods, particular kinds of family may feel at threat without a formal title: female-headed households, immigrant communities, minority groups. Later, the lack of a legal title can complicate the process of buying and selling property and obtaining credit. No doubt, this partially explains why so many Latin American governments have mounted massive land-titling programmes (see below).

But, it is by now well recognised in the literature that security of tenure does not require the issue of full legal title (Durand-Lasserve, 1986; McAuslan, 1985; Fernandez and Varley, 1998). In practice the vulnerability of informal settlements varies considerably. It depends on a multitude of factors including the identity of the original owner, the location of the land, the alternative uses of the land, the nature of the government and whether or not an election is nigh.

As such, many argue that massive titling programmes are being conducted for reasons other than helping the poor. Titling programmes are popular because they constitute housing policy on the cheap; it is much less expensive to issue property titles than to provide settlements with services. Not only that but the authorities and the international agencies can actually make money from titling programmes. The World Bank long ago recognised that the profits made by a government agency could be used to finance other upgrading programmes

elsewhere (McAuslan, 1985: 62). Indeed, many in Washington argue that the mass issue of legal titles is only justified if the beneficiaries are prepared to pay the full cost.

The problems come when the cost of titling is high. In Guayaquil, Lanjouw and Levy (1998: 47) find “that the estimated costs of obtaining a title represents, on average, 102% (s.d. 12.4) of household annual, per capita, consumption. Although the costs may be spread out over time, they clearly represent a substantial expense for squatter households.” If the poor understand what the real cost of obtaining legal title is likely to be and are able to refuse the option of buying a legal title, then there can be little objection. The parallel with the debate about charging for the installation of services is obvious.

However, whether the full costs of legalisation are made clear is less than obvious. Certainly, the granting of legal title may bring additional unexpected costs like property taxes (Ward, 1989; Durand-Lasserve, 1986). It may also raise the living expenses of others who are not direct beneficiaries, for example, tenants may be hurt by rents rising in legalised settlements. Legalisation may also create problems within the family, particularly for common-law or second wives (Varley, 2000). Some on the far left even argue that owners will lose out through rising property values, by opening up poor settlements to downward raiding from higher income groups (Burgess, 1982). But, in my opinion, the real problem in the debate about title deeds is whether issuing them actually makes much difference to the lives of the poor.

### **Legal title and housing improvement**

Does the issue of a legal title accelerate the process of housing improvement? In practice there is plenty of evidence that settlers improve their homes without possessing anything resembling a title deed (Payne, 1989; Razzaz, 1993; Varley, 1987). As Payne (1989: 44) puts it: “perceived security of tenure is more critical in releasing investment for housing consolidation than legal status as such, and clearly the provision of public utilities is regarded by residents as strong evidence that they are officially accepted and enjoy de facto security of tenure.” The perception of security is the key and Razzaz (1993: 349) argues: “empirical evidence points to a continuum of security in illegal settlements that depends less on the exact legal status and more on occupants’ perceptions of the probability of eviction and demolition (enforcement); as well as the availability of services and passage of time.” In Guayaquil, Lanjouw and Levy (1998: 1) “find that informal sources of property rights confer many of the same advantages as formal rights. Thus, as a policy matter, it is not possible to assess the importance of formalizing rights without scrutinizing the other sources of rights available to owners.” Even in the **barriadas** of Peru, legal tenure seems not to be critical: “Tenure matters, but for the average squatter with 10.4 years at a site the chance of eviction around Lima was known to be low” (Strassman, 1984: 747).

In settlements not threatened with removal, illegality seems to have little effect on the willingness of poor people to build (Varley, 1987). In the **pirate urbanisations** of Bogotá, security of tenure seems to be assumed from the start as settlers build homes when all they have is a receipt for their payments for the plot of land. The majority are prepared to build without holding title to their land. Insofar as they have doubts they are reassured when the

authorities provide services to the settlement. Once water and electricity is available, there is no real barrier to self-help construction. Two- or three-storey buildings will appear despite the lack of a legal title (Skinner *et al.*, 1987: 236).

Although there is no doubt that legalisation is sometimes necessary to provide assurance to particularly insecure settlers, the direction of causality is often reversed. Not infrequently, it is housing investment that brings about the granting of legal title (Hirschman, 1984; Razzaz, 1993: 350).

Even where legal title has been granted, complementary measures are required to bring forth investment. Service provision has unleashed housing investment in Cartagena and Medellín (Colombia), Lima, Lusaka, Nairobi, Rawapindi and Tunis has been urban infrastructure. As Strassman (1984: 751) puts it: “infrastructure investment kindles employment and brings forth housing”.

### **Legal titling improves the functioning of the housing market**

According to de Soto (2000: 47): “any asset whose economic and social aspects are not fixed in a formal property system is extremely hard to move in the market.” In my experience this is simply wrong. In Latin America, informal and illegal markets function effectively for a wide range of products, including invaded land, contraband imports, stolen goods and drugs. Illegality rarely stops a market developing; it merely affects the prices in that market. In the case of drugs illegality increases the transaction price; in the case of low-income land, it reduces it.

In Bogotá, an active market for plots of land exists without a legal title being issued and similar kinds of market have developed in most poor countries. In Mexico, ejido land is sold despite the threat of legal sanction (Azuela, 1989; Gilbert and Ward, 1985; Varley, 1987). Even in settlements founded by invasions, land transactions occur. In Valencia, Venezuela, for example, most inhabitants in two invasion settlements had bought into the settlement: 23 per cent of the total settlers had bought a house, 32 per cent had bought a plot with shack and 11 per cent had bought an empty plot (Gilbert and Healey, 1985: 122).

In his normal contradictory way, de Soto recognises this fact. Why is a formal property title so important? Because with “no property to lose”, sellers “are taken seriously as contracting parties only by their immediate family and neighbors. People with nothing to lose are trapped in the grubby basement of the precapitalist world” (de Soto, 2000: 56). They can buy and sell but at reduced prices. Despite these low prices, “the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least US\$8.3 trillion” (p. 35).<sup>3</sup> If a property market of such importance already exists, what is the point of having title deeds?

What title deeds do is to offer additional guarantees that increase the market price. The property price will rise for three reasons: because the transfer process is simplified; because

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<sup>3</sup> How does he know that property is worth so much? Because it is easy to work out the real estate value of informal property: “You can ascertain their value simply by surveying the cost of the building materials and observing the selling prices of comparable buildings” (p. 31).

the buyer has proof of ownership; and because the transaction can be facilitated by access to a formal loan. According to De Soto (2000: 46): “It is formal property that provides the process, the forms and the rules that fix assets in a condition that allows us to realize them as active capital.”

The widespread availability of property titles in the many developed countries where “capitalism triumphs”, has seemingly underpinned the development of an effective property market. However, it is important to note that where transaction costs are very high house sales are rare; Belgium for example has much lower rates of residential mobility for this reason. But, where transaction costs are reasonable, the formal market offers property owners a means of accumulating capital. In Britain, Saunders (1990: 117) argues that “home owners tend to buy in the first place out of financial considerations” and his calculations show that their judgement is correct. Similarly, in the United States, Rohe and Stewart (1996: 44) contend that homeowners “hope to build wealth through property appreciation” and Megbolugbe and Linneman (1993: 660) report that “about 80 per cent of Americans view owning a home as a good investment”.

Of course, not every commentator is convinced that homeowners make money from their ‘investment’. Timing is critical and home-ownership may well cost the unfortunate buyer a great deal of money in the short term. In the Netherlands, home prices plummeted in the early 1980s and in Britain the late 1980s was a very bad time to buy with a mortgage. The possibilities for accumulating capital are also highly dependent on location. While homes in some areas rise in value, others do not (Edel et al., 1984; Smith, 1987). Similar factors operate in Latin American cities. In Bogotá, Jaramillo and Parías’s (1997) calculations show that the housing boom of the 1990s mainly benefited people living in the affluent north of the city. Even there, however, prices between 1989-96 were stable in real terms. Since then house prices have plummeted by around 40 percent. Like the stock market, buying property does not always yield profits even for the rich and middle class. The property market can be fickle.

The situation of the poor is identical insofar as the outcome of their housing ‘investment’ is unpredictable. They spend money on building and improving their home and do not know what price they will receive in return. However, homeowners in Bogotá believe that they are making an excellent investment (Gilbert, 1999). One declared that “buying any house in Bogotá is a good investment”, another likened his house to a fruit tree; it needed care and harvesting.

My own view is that such owners are overoptimistic in their estimations. While I have no doubt that buying a home makes sense in a number of ways, and can help families financially, capital gains are not likely to be high. The reason why is simple. Research in Santiago, Chile, and Bogotá, Colombia, shows that owner families almost never move house and that the market for used housing is very limited. Very few low-income families move in Santiago even though they have formal title and the majority of houses have been built by the formal sector (Gilbert et al., 1993: 92; Richards, 1994: 136; Crespo, 2000; Pérez-Iñigo González, 1999). A survey conducted in Santiago in 1995 remarked on the extremely limited residential movement among the middle and lower classes and on the “virtual



absence of a housing market” (Cade Consultores, 1995: 2). Although a considerable number of families would like to move, most people seemingly remain in the accommodation ‘for ever’. Indeed, the problem had become so severe by the middle 1990s, that the government of Eduardo Frei introduced a special programme to encourage housing mobility (Held, 2000; Pérez-Iñigo, 1999; Almarza, 1997; 2000).

The mobility of owners in consolidated low-income settlements in Bogotá is also extremely limited. The average tenure of owners living in four settlements more than twenty years old was 19 years (Gilbert, 1999). This average, of course, is an underestimate of residential stability insofar as most of the families will continue to live in the same dwelling, perhaps for many years. Only four owners, out of 276, had moved into the settlement during the last year and only 14 had moved in during the last five years. Similar signs of immobility are found in Caracas and Mexico City (Gilbert et al., 1993) and the World Bank Housing Indicators Study shows that by international standards mobility within the large cities of Latin America mobility is very limited (Persaud, 1992: 46-7).

Despite poor homeowners possessing title deeds, the market is extremely flat and possibly dead. This is true even in cities where land and housing markets are very buoyant in high income and in commercial areas. You cannot accumulate capital if there is no market in which to trade your asset. If title deeds are not the problem, what is?

### **Does legal title improves poor people’s access to formal finance?**

The sale of property in self-help settlements can be quite common even when ‘owners’ lack legal title and have ‘stolen’ the land. The problem with self-help settlements is not the lack of a market but the limits to it. Many buy and sell plots of land, shacks and even two room houses. What is uncommon is to find cases of households buying two or three storey homes in these settlements. You don’t need much money to buy a shack but you need a lot to buy a two- to four-storey house. In the low-income areas of Bogotá owners of such homes were asking between US\$20,000 and US\$50,000 in the summer of 1997. The reason why there were few sales is that no one could afford to buy them. Self-help home-owners can sell quality homes only with great difficulty and/or at a very low price (Gilbert, 1999).

According to de Soto, possession of a legal title should remove this problem by unleashing a flood of formal financing. Support for this belief comes from experience in the United States where “the single most important source of funds for new businesses ... is a mortgage on the entrepreneur’s house” (de Soto, 2000: 6). Banks will lend to the poor because they now have a property title to lend against. They have something that they can repossess in the case of default. Lanjouw and Levy (1998: 45) agree: “just as transfer uncertainty limits a household’s ability to sell its property, it limits a bank’s ability to repossess property, lowering the value of property as a collateral asset.”

a) **Bankers and slums:** My evidence from Bogotá, fully supported by studies from other parts of the world, suggests that possession of a legal title makes little or no difference to the availability of formal finance. In Turkey, Ozuekren (1998: 11) recognises that “there are very few opportunities for households to obtain homeowner loans from financing

institutions”. Mexico’s “sophisticated housing finance system” also has a poor track record in terms of progressive options and community-based finance (Siembada and López, 1998: 22) and experience in recent years in South Africa has been very similar (Bond and Tait, 1997; Goodlad, 1996; Tomlinson, 1998). Even the World Bank and the Inter-American Development Bank recognise how difficult it is to reach poorer families (Rojas, 1995; World Bank, 1993: 121). Even government efforts to lend to the poor have proved an embarrassing failure with most funds ending up in the hands of middle-income groups or favoured labour groups (Bhattacharya, 1990; Daniere, 1999; Laun, 1976; Persaud, 1992; Rakodi, 1995; Struyk, 1989; Datta and Jones (eds.), 1998).

Formal financial systems face various difficulties in reaching the poor. “Regulations governing mortgage lending are usually biased toward completed owner-occupied housing, making it unattractive or impossible for financial institutions to lend for the purchase of rental or condominium housing, or for house improvements or unfinished core houses on serviced sites” (World Bank, 1993: 118). In addition, “mortgage lenders have difficulty verifying self-employed income and developing an accurate estimate of self-employed income from analysis of tax returns” (Ferguson, 1999: 187) In Bogotá, few lending institutions have rules that can deal with independent workers. Lending procedures are based on the need for potential borrowers to be able to demonstrate that they have a regular income. Of course, few independent workers are able to do this. In addition, lenders lack confidence in poor people repaying their loans and the final straw is the low profitability of lending to the poor (UNCHS, 1996: 370).

In Bogotá, perhaps the most serious problem facing formal lenders is not the lack of legal title so much as the nature of the property on which the poor wish to borrow money. Colombia’s savings and loans corporations have strict rules about the kinds of building and area on which they will advance loans. Even the socially progressive Colmena ‘red-lines’ certain areas of Bogotá.<sup>4</sup> Those who live in what are considered to be risk zones will not get loans. If the lender has doubts about the value of the property, it matters little that the evidence suggests that poor families can be extremely reliable in repaying loans.<sup>5</sup>

Even micro-lending programmes have failed to make much impression on the poor’s need for housing finance (Almeyda, 1996). Micro-finance has tended to follow the practice of the Grameen Bank and built up the lending portfolio on the basis of frequent small loans; an approach that is more difficult in the case of housing which requires much larger sums of money. Even when cooperatives are prepared to finance low-income housing their programmes are severely limited by financial constraints and by their preference for funding

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<sup>4</sup> Colmena is the CAV that has done most to extend credit facilities to the poor (Vejarano, 1997). Nevertheless, Colmena has real problems lending to self-help areas. It has a list of settlements in Bogotá ineligible for loans, principally because of the severity of the inclines on which they are built. Many of the low-income settlements are located in just this kind of area.

<sup>5</sup> In any case, the major problem with most Colombian institutions’ mortgage portfolios is the money owed by 700,000 middle-income families.

housing construction (Avila, 1995: 26).<sup>6</sup> None lend for either upgrading or for the purchase of used housing, seemingly a worldwide problem (Ferguson, 1999).

b) **Do the poor want to borrow?** If the banks are reluctant to lend to the poor, it is less than certain that the latter want to borrow. Certainly among the recipients of housing subsidies in South Africa, those “who said they did not want a mortgage loan outnumber those who did by three to one” (Tomlinson, 1999: 1357). Perhaps, as the World Bank admits (2000: 74-5): “Poor people are often discouraged and simply do not seek loans since they believe that they will be denied credit or will not be able to fulfil bank requirements.” But, this reluctance may be due primarily to fear of what might happen if they cannot pay back the loan. For many very poor families, repaying a loan is a burden that may endanger the household’s whole financial viability. As Rogaly and Johnson (1997: 119) put it: lending “can harm as well as enable poor people. Financial relationships, especially those of debt, are one way in which the powerlessness of groups of poor people is entrenched.”

Admittedly, recent experience in Lima suggests that titling can lead to an increase the incidence of formal sector loans. According to the local land-titling agency, some 45,000 families in Lima had taken out loans guaranteed by their property out of a total of 300,000 new title-holders (Conger, 1999). But, if that is the case then Lima appears to be a very different city from Bogotá where many fewer families seem prepared to borrow against the title of their house and where lending agencies seem to be less convinced of the virtues of land titles (Gilbert, 2000).

Most poor families build and improve their housing using personal savings and loans from informal sources (Boleat, 1985; Renaud, 1987; World Bank, 1993; Macaloo, 1994; Napier, 1999; Ozuekren, 1998; UNCHS, 1996). Such informal sources “include individual and group savings, windfalls, fabrication of their own building materials, sweat equity, small loans from neighbourhood money lenders, barter arrangements and communal self-help, and remittances from family living abroad. These funding sources share a common problem. They dribble in unevenly and, often, slowly because they remain unconnected to formal institutions and markets. The overall result is that much of the built environment in cities improves unevenly and slowly” (Ferguson, 1999: 189).

Ironically, the largest property loans made in Bogotá’s low-income areas are those that finance the purchase of land. These are unsupported by any sort of collateral or property title and are provided by illegal sub-dividers. Sub-dividers tend to sell plots on the basis of a down-payment of 10% with the remainder payable in monthly instalments over the next three or four years (Gilbert and Ward, 1985). In a survey in four older settlements that I conducted in 1997, most of the families that had occupied an empty plot received informal financing through the illegal sub-divider (table one). Very few of the 33 buyers of empty plots who participated in the survey had paid the whole amount in cash. Of the 29 who

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<sup>6</sup> In Bogotá, institutions such as FENAVIP (National Federation of Popular Housing), SERVIVIENDA, Association for Popular Housing (AVP), Compartir and FEDEVIVIENDA do operate in the housing field and were responsible for the production of around 30,000 housing units between 1990 and 1996 (Vejarano, 1997).

provided details 75% had paid a deposit and the rest over time. Of the remainder, only 3 said that they had paid the whole sum in one payment.

**Table one**  
**FINANCING PURCHASE OF THE PLOT**

Source of finance	Number
Inherited plot	2
Paid with cash or savings	6
<b>Cesantía</b> or loan from work	11
Sold plot or house	2
Family loan	2
Credit from sub-divider	21
Don't know	4
<b>Total replies (households)</b>	<b>48 (33)</b>

Source: Bogotá survey

In Bogotá, the limited number of households that had bought a house rather than a plot had never used formal finance mechanisms (Table two). Insofar as credit of any kind was involved there were two common forms. One was that the vendor would provide the finance by allowing the purchase to be completed in instalments. The second kind of informal credit was a loan from the extended family or friends of the home purchaser or improver.

**Table two**  
**FINANCING THE PURCHASE OF A FINISHED OR SEMI-FINISHED HOUSE**

Source	Self-help settlements	Formal settlements	Total
Formal loan	0	7	7
<b>Cesantía</b>	0	5	5
Inheritance	4	0	4
Swopped other property, business, etc.	2	0	2
Credit from owner	3	1	4
Sold other house/land	3	0	3
Family loan	1	1	2
Debts/lottery	2	0	2
Own savings entirely	5	2	7
<b>Total replies (households)</b>	<b>20 (13)</b>	<b>16 (13)</b>	<b>36 (26)</b>

Source: Bogotá in-depth survey

The informality of the financing of purchase in the informal settlements was mainly due to the lack of any real alternative, although it is also true that few of the transactions required a great deal of finance. Most of the homes purchased were in a semi-finished state, indeed,

only 7% were living in a house in the same state as they had bought it. Even this group were often living in very modest structures.

In short, therefore, the largest loans in Bogotá are made when there is no semblance of legality and when families have acquired a title deed they borrow little or nothing through formal financial institutions. Their sources of credit would be much the same without a title deed.

### **Legal title stimulates the rental housing market?**

According to Lanjouw and Levy (1998: 3-4) owners in self-help areas of Guayaquil are deterred from becoming landlords by their lack of a legal title. "Having strong non-transferable rights improves a household's ability to transact by lowering the likelihood that difficulties are encountered in trying to reclaim property from a renter after the period of the rental contract." In Valencia, Venezuela, in the 1970s a similar tendency was apparent. Owners feared renting out property to tenants in case the tenants made a claim to the house. To avoid this problem, landlords only rented to illegal immigrants, the latter would not dare to make a claim to the house in case they were deported (Gilbert and Healey, 1985).

But fear of the law does not seem to deter most landlords from following practices that could lead to legal sanction. In Latin American cities, very few landlords issue written contracts (Gilbert et al., 1993; Gilbert and Varley, 1991). Few know what the rental legislation says and even fewer obey it. Even de Soto (2000: 21) admits that illegal renting. According to him, in Brazil, "there are no rent controls in the favelas; rents are paid in US dollars, and renters who do not pay are rapidly evacuated." If the evidence is that landlords are such mavericks, why does de Soto argue that they will not rent unless they have a legal title?

Rental housing in most low-income areas develops well before land titles are given out. Landlord-tenant relations seem to operate largely outside the formal requirements of the law. Arguably, this constitutes little in the way of problems because the rental market seems to function reasonably well. There are excesses on both sides but no doubt some landlords and some tenants would misbehave even if they had signed a formal rental agreement. The fact that legal titles are rather thin on the ground in West African and Indian cities but the majority of families rent accommodation suggest that the issue of legal title does not make much difference to the average landlord. It is unlikely that landlords would get much formal credit to expand their rental housing stock even if they had a title.

### **CONCLUSION**

Most urban families in Latin America are glad to receive a title deed. It is this popularity that explains why so many governments have taken up this housing option. No doubt governments are also attracted to this approach because it is cheap, particularly when the poor are prepared to pay the costs or will start to pay property taxes once they receive their title deed.

Nor do I believe that poor families face many dangers by being offered title deeds. There is unlikely to be much 'down-raiding' and, even if there were, some poor families would

appreciate being given the opportunity to make capital gains. In Africa, parts of Asia and even in rural Latin America, the situation may be different particularly when customary rights are overridden by a new commercial logic. But in urban Latin America title deeds cannot a great deal of harm.

But, if I am little concerned about the dangers of title deeds, I am worried about the rhetoric of Hernando de Soto and his advocacy of the supposed advantages of legalisation. In Bogotá's self-help settlements, property titles seem to have brought neither a healthy housing market nor a regular supply of formal credit. The uncomfortable truth is that in practice, granting legal title has made very little difference.

If granting legal title has made little difference, then, why worry about de Soto? The answer is that de Soto is dangerous insofar as he is conjuring up a myth about popular capitalism. He is fanning the delusion that anyone, anywhere, can become a fully-fledged capitalist. Although he offers little or no empirical evidence in support of his assertion, that has not stopped Washington from, once again, rallying to his call. The danger inherent in his myth is that it will persuade policy makers that they need to do little more than offer title deeds and then leave the market to do everything else. The market will provide services and infrastructure, offer formal credit and administer the booming property market. In the process every household will get to own their own home and even make money from it. A form of utopia is nigh.

It is my belief that, even in the unlikely event that the property market were to flourish, there is little reason to believe that the poor would be major beneficiaries. Successful estate agents always claim that the three secrets of high property values are 'location, location and location'. The consolidated self-help settlements of the poor are rarely recognised as desirable locations. As such, the promise of property wealth is as mythical to them as it is to the low-income families of Boston (Edel et al., 1984). Those who make money from property are likely to be mainly drawn from the ranks of the middle class; those who make the real money tend to be the really affluent.

Thus, without wishing to deny the advantages that the poor can derive from home-ownership in a self-help suburb, de Soto's argument is dangerously flawed. Were anyone else to have made the same argument it might have been better to ignore it. But because de Soto is a big name, his message will be taken up by some powerful people. As such, the argument needs to be shown up for what it is. Instead of offering an answer to the mystery of capital, he is generating a myth about capitalism based on a populist dream.

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