

*Economist Hernando de Soto, author of The Other Path and The Mystery of Capital, is the director of Peru's Institute for Liberty and Democracy and a champion of market economics and property rights. He has been called the most important economist in the Third World.*

*In this interview, de Soto explains his theory for the persistence of poverty in developing countries and discusses the failures and successes of capitalism, linking them to property rights and legal reform.*

## **Capitalism and the Road to Prosperity**

INTERVIEWER: Why does capitalism fail everywhere else and triumph in the West?

HERNANDO DE SOTO: Because the West has a property rights system, and property rights systems seem to be about ownership. What we're discovering more and more is that it's really the system that undergirds the system of values called capitalism. In other words, you have property rights in the West. In developing nations we do, too, but they're not legal. Once you legalize them and you have recordkeeping systems and you have tracking systems and you've got contracts and you're able to get all the information about somebody's ownership over an asset, all of a sudden you obtain enormous amounts of data that you do not have in developing nations.

In the West, that is captured in the property system. If you are somebody that is honorable and pays their debts, which is what somebody would be interested in, that's going to be captured in your records, and your records are linked to your property records. All of these are property rights, [but we don't have them] organized in a central system ... in Third World countries.

INTERVIEWER: Is this a possible change in the Third World?

HERNANDO DE SOTO: Yes, of course. ... You [The United States] were also a Third World country 150 years ago, and you transformed yourselves into a First World country. The same occurred for most countries throughout the world.

INTERVIEWER: And how long will that take in the Third World?

HERNANDO DE SOTO: If we don't do anything explicit about it and we follow your formula, which is to zigzag our way to prosperity, it could take 300, 500 years. From the prosperous Catholic city of Florence until [the time when] all of Italy started having a right to prosperity, not sometimes but all the time, it took 500 years. What we say in *The Mystery of Capital* is that there are shortcuts, and once we learn what you did, what was necessary, especially the importance of property rights beyond ownership, we should be able to get there very quickly. The Japanese did it, for example, under MacArthur's occupation. They converted from a feudal system to a property-ownership system.

### **The Influence of Developed Nations on Developing Countries**

INTERVIEWER: Why do you come here and go on American television? What are you hoping to achieve by this trip?

HERNANDO DE SOTO: A lot of the support we get for working in other Third World countries actually comes from the First World, from developed countries like the United States, so it's important to get our message out. It's important first for support [and] funding, and secondly to influence policy. So much foreign policy is mistaken as to where the challenges really are. We'd like to make sure that in developed countries, who have so much influence on what developing and former communist nations are, people realize what the real issues are about. So it's important to come here.

INTERVIEWER: Does the developed world realize what the issues are?

HERNANDO DE SOTO: I think that the developed world is beginning to realize the issues. A lot of things that have gotten in the way have to do with culture. Culture exists; it's important. I go to Paris because I want to [experience a different] culture. When I go to Paris, I know I'm in another culture. But I don't think culture has really very much to do with the fact that some people are desperately poor and others are wealthy. One has to get that out of the way. It's important for people in the United States to realize that they, too, were a Third World country one time, and regardless of the culture, they became as developed as Spain was once. We have to do the same thing. We have to let them understand that it's invisible things such as the law and institutions which have enormous amounts of things to do with prosperity, and it's

not easy to get that message across. You get a tractor, you get a big machine, and say these guys have got it and these other guys don't, and therefore these guys [with the tractor] are more prosperous than the second guys. That's easy to illustrate. When we talk about law, when you talk about institutions, it's very hazy stuff, so you have to go back and sink it in one time after another. It's a lifetime's work, I'd say.

INTERVIEWER: The idea that the U.S. was once an underdeveloped country is hard to conceive when you sit here in New York. This looks like it's been here forever.

HERNANDO DE SOTO: That's right. If you look at New York, there's a feeling that all of these buildings have been here forever, but in fact they haven't been here for that long. They certainly weren't here 100 years ago, not the ones you are photographing now. Enormous amounts of things can be done in half a generation. It's incredible. And when you go and see the United States, Williamsburg, which used to be a capital of the United States, and compare it with the way Mexico City was 120 years ago [or] what Lima was, we probably had bigger cities than you did in the United States, and all of this [growth] has been recent. A lot of it has to do with the right laws, with the right kind of institutions.

INTERVIEWER: When you come to New York and see the kind of wealth that's here and the kind of consumption that's here, how does that make you feel compared to the kind of people that you and your people work with day to day?

HERNANDO DE SOTO: The difference between being in the U.S. and being in Peru is that a very small number of people in the U.S. are concerned with development for the very simple reason they're already developed, while development is what we're all about in the Third World. We've got a lot of the human touch; we've got a lot of the human dimensions. What we're missing is prosperity. So naturally when you go to Latin America and you talk about development, it's a big issue. Here in the United States it's an issue for the foreign-policy types. I think they call them foreign-policy wonks, some multinationals who have investment abroad, some internationally minded citizens, but they're not the majority of people. They're the minority, and that's what we deal with—the minority, the ones who care.

INTERVIEWER: How much does the policy in the developed world actually impact what you're trying to do in the developing world?

HERNANDO DE SOTO: What happens in the developed world impacts what happens in the Third World and in former communist nations very much. First, because people from developed nations have got more money, so people on the left in the United States who want to press certain points of view can actually turn governments around. So can people on the right. The war for development is fought on both fronts, both in the Third World and in the First World. In the First World, if somebody thinks that a human rights issue is very important regarding terrorism and they actually can manage to sink that point in and make it a big issue internationally, it's all about whether you're getting funds or not. You can decide the cause of that war here in the First World because the funding for the weapons, the funding for the balance of payments stabilization, the funding for economic adjustment, it all comes from the First World. So when the First World blinks, the rest of us blink as well, and even harder. So the war is also here.

Let me give you an idea: Aid agencies which are extremely helpful are mainly concerned about physical things. How do we help the poorest of the poor? They give a lot of weight to them and relatively little weight to the changing of institutions or the changing of legal systems. That's a definite impact, because they pour money to those people taking care of the physical infrastructure stuff—that's also where the best brains in the Third World go to. And they don't go to changing a legal system. So what happens in the First World is very important to us.

INTERVIEWER: Do you feel like you're making progress?

HERNANDO DE SOTO: Oh, yes. I think we are definitely making progress. The press is the first indication. We've been out in the last few months and in a lot of the major magazines in the United States and in Europe and in the UK. It's catching on because we're also making sure that the way our arguments are structured is not only understandable by the right people in developing countries but also can be read by the right people in the First World nations. It's very important to make the argument relevant to everybody.

INTERVIEWER: Recently we were in Mexico and we interviewed Vicente Fox. He talked about your ideas and said, "We're listening to what de Soto is saying. We're also going to Egypt and trying to really connect with top leaders in developing countries...."

HERNANDO DE SOTO: What we're trying to do is talk to very important leaders in the Third World—not all of them, [as] there are about 160 nations between the Third World and former communist nations. What we're trying to do is to talk to some of those that are very relevant for a variety of reasons, but I would say that the principal one is so that the argument doesn't build up that what we're doing is a Latin American issue, or what we're doing has to do with former Spanish colonies. We think what we're doing has to do with human nature and the way societies get organized. So it's very important for us to be able to talk to the Cabinet in Egypt, which we do, because here we are talking with Muslims with a 6,000-year-old civilization, and the problems they've got are very similar to ours. It's important for us to be talking to Fox as well, because he's basically saying some of the things that the Egyptians have begun to say and the same things that Gloria Arroyo is saying in the Philippines. It's important for us to be in each different culture to indicate that the problems we're facing are standard and they are policy issues that can be dealt with.

INTERVIEWER: In Mexico, they've got a lot of optimism, but they've got a huge challenge. What do you think?

HERNANDO DE SOTO: Personally, I think that Vicente Fox and his people are doing excellent stuff. One has to keep one's eye on them very much because they're breaking an old monopoly tradition in politics, and so they've got a lot of difficult challenges to face. They're very credible now; the important thing is for them to continue being credible. They're also moving a lot of funds at the same time. They've got a very difficult task ahead of them, but we wish them well and we're going to support them as much as we can.

## **The Roots of Poverty in the Developing World**

INTERVIEWER: Let's talk a bit about your personal history. How did you get involved in these sorts of issues of capitalism, of poverty, and property rights?

HERNANDO DE SOTO: The way my involvement in these issues began was when I realized, after living in Europe for a long time yet traveling constantly back and forth to my native Peru in Latin America, that Latin America, and Peru of course, were very poor. I hadn't quite realized that as a child. I thought that my Peruvian friends, my cousins, my interlocutors when I came to Peru were just as sophisticated, as clever, as skilled as my European friends when I was a child. It only dawned on me about the age of 17 that I actually came from a poor country. And then I wondered why, since the skills seemed to be the same, at least among elites. So I told myself there must be something that isn't obvious that accounts for the relative wealth of the European, the North American, the West versus the nations of the Third World. Since then I've been interested in finding out what that difference is. And since I couldn't pick it up in the books, I thought it had to do rather in observation, with getting involved in the grassroots. That's how I got involved in this. And about the age of 39 I had made enough money so as to survive, hopefully, for the rest of my life. I started getting more involved in these issues.

INTERVIEWER: You're talking about grassroots, and we're now going to the town of Cajamarca [in Peru]. What message are you taking to Cajamarca?

HERNANDO DE SOTO: The reason we were invited to Cajamarca, like to all the other places we've been in Peru, is because of the book that I wrote, which has become Peru's number one best seller of all time. We've sold about 300,000 copies. It's called *The Mystery of Capital*, and it tries to give an explanation for poverty at a time when everybody is somewhat disappointed in the fact that since the fall of the Berlin Wall we've entered another model which supposedly was going to bring prosperity, the market economy capitalism, and it hasn't. I happen to believe in the market economy, and I believe that capital is the source, or explains to a great degree the capacity to great additional wealth of the West. I've come up with an explanation that says with the figures that we are bringing out that, in fact, the poor have worked a lot; that we're a very enterprising lot; that what is missing is a legal system and an institutional framework that allows us to leverage wealth.

The reason I'm going to Cajamarca now is because the universities, the association of Citizens Against Terrorism, and a few other organizations have invited us to talk about *The Mystery of Capital*. The curiosity stems from the fact that now, 12 years after the fall of the Berlin Wall,

and 11 years after Peru adopted pro-market policies, their situation hasn't gotten that much better, and they want to know why. *The Mystery of Capital* offers an explanation. It says that the system per se works in the West, but that in our country, like in much of the Third World, it isn't functioning, not because it is not adaptable, but because we have missed some of the crucial elements that the Westerners had in the 18th and 19th century, like property rights, without with this system [the Third World] cannot function. I'm going there to explain to them that they shouldn't lose hope, that there are elements missing, but they require the active intervention of public opinion, and that's why I'm talking to them. And the need for politicians to overhaul the whole legal system so that they, too, can have property rights according to law over the assets they possess and be able to create capital.

INTERVIEWER: Is Cajamarca like any other poor town in the rest of the world?

HERNANDO DE SOTO: Cajamarca, yes, is a very typical Peruvian village, mainly of rural characteristics, probably the 20th in size of Peruvian urban conglomerations. So it's very small, and it's pretty representative of a lot of what we call Latin America—that is to say, Latin America from Mexico down to Bolivia, that part of America where we are mostly a mixture between old Indian indigenous civilizations and the Europeans that migrated.

### **The First World vs. the Third World**

INTERVIEWER: Why should the First World care about the Third World?

HERNANDO DE SOTO: I don't think the First World needs to care about the Third World. As a matter of fact, I generally believe that most of the problems that need to be resolved in the Third World and in former communist nations cannot be resolved from outside. In other words, I don't think there's much Westerners can do about it. Therefore, the fact that most First Worlders don't care about Third Worlders doesn't actually depress me, because I think the solutions are a local affair.

Why would it be interesting for the First World to pay attention? Because we're a globalized economy. You depend very much on foreign oil. If you start working down to the crucial ingredient of your economy, you'll see that it's all interwoven. So in spite of the fact that you're not indispensable for the development of the Third World, the fact is that it is useful for

us Third Worlders to be in close contact with you, and [to] be able to use mainly your technical advice when needed. But there is no reason that I can think of why I should try to convince a First Worlder to be interested in the Third World, other from the fact that we're all part of the same family.

INTERVIEWER: You fly to a lot places. Where do you like to go? What sort of towns do you get more insight from?

HERNANDO DE SOTO: I have found out as we've been called to work in different parts of the world that every place brings something new. I was very interested, for example, when we were contracted to start helping redesign Egyptian legislation regarding property rights for the poor. I always thought that traveling to a different culture would make a great difference. It makes a difference, but not a great difference, and that's also interesting. What's interesting is to find out that we Third Worlders have much more in common than we have in differences. The cultural differences that would make for an interesting program on the Discovery Channel or an article in *National Geographic* magazine are cute, are interesting, but that's not where the basics are. The basics are that all of us Third Worlders have in common a very underdeveloped property rights system, a very underdeveloped legal apparatus, and that's what keeps you ahead of us. That's the part I look at. The fact that I'm able to find it in different cultures is first of all important to us because it indicates that there are basic principles that account for development, that there are general theories that one can bring together and that, therefore, there are solutions that one can devise on the basis of this information. But it's not the differences that make it interesting for me to go into any particular part of the Third World; it's the fact that we're so similar in spite of the fact that this might be manifested in different cultural forms.

### **Assessing the Success of Capitalism**

INTERVIEWER: You make a pretty amazing and sweeping statement: The moment of capitalism's greatest triumph is the moment of its greatest crisis. Why?

HERNANDO DE SOTO: The reason why this is not capitalism's best moment. I wrote the book two years ago, before it actually got published and started being circulated in Spanish, because it hasn't really worked for the majority of the people in former communist nations

and developing countries. We people from the Third World and from former communist nations are five-sixths of the world's population. There are about six billion human beings in total, and five billion are in developing and former communist nations. At the time of the fall of the Berlin Wall, we all decided to take the capitalist route. Right now it's quite obvious that about 80 percent of the people in developing and former communist nations have not benefited from the system. The fact that there's no alternative around for the moment doesn't mean that one cannot be created. It's obvious that people are trying to find other ways.

So the test is there. The test is, can the system actually work for the majority of the people? So this is capitalism's testing moment. This has happened before. It's not that this hasn't occurred before. In Latin America, we found that in at least five opportunities, all our countries put together since the 1820s, when we found our freedom from Spain, [have] actually tried to follow the U.S. model or the Western model. We've privatized railways and we have lowered our tariffs to zero and we've opened ourselves up to foreign investment, and five times we've had to go back because it made sense for a very small [group] among of people at the top of the pyramid, but for the majority it didn't work.

So our thesis is, basically, the reason it doesn't work for the majority is because the system can only work with property rights. Markets and capitalism are about trading property rights. It's about building capital or loans on property rights. What we've forgotten, because we've never examined the poor, we've sort of thought that the poor were a cultural problem, is that the poor don't have property rights. They have things, but not the rights.

And when you don't have the rights, you don't have a piece of paper with which to go to market. You don't have a legal system that undergirds that piece of paper and allows it to circulate in the market. The question now is whether we're going to follow the Western route—let's say that capitalism started 500 years ago—and go through one revolution after another, tremendous wars, social wars and then finally, four centuries, five centuries later the system comes together, or we're going to be able to learn from you and get it over with in the next five, 10 years.

But that requires for capitalism to understand that looking at the poor is not the task of the First Lady of the republic. It's the task of the president. It's not a question of just doing

macroeconomic stability, getting your accounts right, stabilizing money. It's about finding out why the poor can't use the legal system and revamping it. It's major surgery. That's why we're at a time where capitalism is going to be tested. Will it be able to cater to the poor, or will it continually be seen in places like Latin America as something that essentially relates to libertarian clubs and to people who are wealthy, in many cases who don't necessarily believe in capitalism. They just believe in helping their own wealth. Or are we going to make it inclusive and start breaking the monopoly of the left on the poor and showing that the system can be geared to them as well?

INTERVIEWER: You have alluded to it a bit, but I want to know if capitalism is really in trouble.

HERNANDO DE SOTO: Capitalism of course is in trouble, because as usual it is only catching on among the top 20, 10 percent of the population of Latin American countries that have got their property rights paperized in a way that they can enter the market. It's in trouble in the sense that it isn't working for the majority. I insist that capitalism doesn't work without property rights, so it only works among the Westernized elites of our country. You may have noticed that in all developing countries and even former communist nations there are always some people who have been to Harvard, that have taught at Yale, that are in touch. Elites all throughout these hundreds of years have always been in touch. Kings and queens from different countries have always been in touch. So the fact that the system works for an elite doesn't mean it's successful. We've always taken it as successful. We've always actually thought that the poor didn't [appear] for cultural reasons. We've always thought that the poor needed to be educated. That's why they didn't come in. And what *The Mystery of Capital* tries to tell you is that there are huge legal obstacles for the poor to come in. It isn't that they culturally don't want to come in. They're continually proving that they do want to come in because they're continually migrating to countries like the United States and Canada and western Europe, so they do want to come in. The problem in our countries, in Latin America, is we're not letting them in, and it's because we haven't gone around to finding out what is the cost of getting in it. We're starting to find out it's a very high cost.

INTERVIEWER: The elites are to blame?

HERNANDO DE SOTO: I always thought, at least in the case of Latin America, that elites have not accomplished their role. At the end, to create a revolution where the legal system and the market benefits everybody is a heroic task. We realize this the more we look into history and see what the foreign elites did back at the time, for example, of the American independence. They had a vision. And they had the courage to rebel against a status quo. What happens in many Latin American countries and Third World countries is that the elites don't do this, and [they] try to explain the economic backwardness of a large amount of the population—80, 90 percent of the country—as a cultural problem. "We need education," [they say,] instead of seeing it as essentially a problem of [invisible] obstacles that are put in their way ... and they're so set in their ways of thinking that the lower classes are inferior that they're actually acting a lot more like Russian elites in 1914, 1917, than American elites back at the end of the 18th century and beginning of the 19th century, who were open-minded. Many times, of course, [impoverished] Latin Americans become confused by looking at them, because they're able to talk about Hayek and they're able to talk about Milton Friedman. But it's not that they really believe in them; it's sort of like a shield. It's a shield they use. They use libertarianism and conservative ideas the same way communists used to use socialism to hide their real intentions. You have to always be careful about that, because undertaking a revolution in terms of liberty is a very revolutionary task. It requires lots of guts, and it requires going against a status quo. Nobody who really gets along with the status quo can be absolutely trusted to change these countries around from their backwardness to a prosperous society.

INTERVIEWER: We've been told for 50 years now that free markets bring freedom. Do you believe that?

HERNANDO DE SOTO: I believe that markets do help absolutely to bring freedom. I don't think that's enough, but I certainly do think that helps, because at the end good markets work with information. You need information, and that necessarily brings pressures on the political system to make people accountable, to provide the right kind of information, to provide the right kind of enforcement. They feed on each other. But it is also important to emphasize democracy as such. I am not necessarily a great friend of some Asian systems which went towards free markets but disregarded the democratic side. That may have worked in certain cultural circumstances and may not work in others. In the case of Latin America, where there

is such a cult to the idea of democracy, you also have to add an effort in terms of political freedoms as well as economic freedoms.

INTERVIEWER: There has been a battle of ideas that that the world has undertaken between communism and capitalism. What's next? Where are we swinging?

HERNANDO DE SOTO: Capitalism definitely won the battle against communism, but a lot of the main ideas or concerns behind the early communists and socialists are still around. They had to do with an equality. They had to do with inclusiveness. They had to do with fairness. These ideas will get back into the game, and I think it depends very much on the elite in developing countries to make sure that these are also incorporated into the capitalist or free-market argumentation. It's not enough to say that these are the leftist kind of things, human rights kind of things. We've got to bring them in. If we don't bring them in, the traditional leftist will come back. The traditional Latin American leftist is very different from the American liberal who respects democracy. I'm thinking about Latin American leftists who have no problem of carrying out reforms with no democracy whatsoever. If we don't incorporate all of these humanitarian values, all these humanistic values, all of these democratic principles within the capitalist agenda, it'll be born again in some other form that may not be the traditional communist one but will bring with it the same, and many, dangers that communism came with, which is a total disregard for the basic principles of economics that produce wealth and that at the end up solving material problems.

INTERVIEWER: It seems that globalization is the trend. Won't that make it worse for poor people?

HERNANDO DE SOTO: No, globalization is where we've been heading for ages. Look at me with the beard and no hair on my head. I'm a product of globalization. Latin American Indians, Peruvian Indians aren't bald, and they can't grow hair on their face. I am a product of globalization. I am the result of Spanish migrants having come to Latin America and probably mixed with some Indians, but not enough so as I can't grow my beard. So globalization has been going on. What we're finding out now is what the early economists, the classical economists told us, from Adam Smith to Marx, which is that the more we learn to divide work among ourselves, the more productive we get. The idea was not only to go for larger markets

in larger cities, but go for larger national markets and now larger international markets. And it's obvious that these are going to bring prosperity.

What we've just got to make sure of is that globalization also includes the underclasses. They have a lot to gain from it as well. But if I go with you through the obstacles that somebody that's poor has to go through to get an export license, or an import license, or be able to put together the kind of paper that'll allow you to globalize, you'll find out that it's a pretty exclusive club, those who can globalize. It's a club made of those people and places like where I come from, Lima, that know how to deal with the law firms, that know how to lobby for legislation that helps some, but doesn't help somebody else. In other words, a system of capitalism for only a few, because there's a legal apartheid that blocks the majority from coming in. Everybody wants to globalize.

And if somebody tells me no, the poor of Peru don't want to be globalized, the logical question that comes is then why have a million of them traveled to the United States over the last 12 years, not to mention those who have migrated to Mexico or migrated to Spain or other parts in Europe? The reason is because they want to globalize.

We are now in Cajamarca, and you have seen many people that still keep their old traditional Indian costumes and their ponchos and their big hats. Here we are really in rural bliss in Peru. But I'm sure that when you've been to Lima—not only Lima but most of the towns of Peru—you don't see that anymore. People have got sneakers, and they have trainers, and they've got Nikes and other things. They're already globalizing. There is no cultural resistance to getting in on the same wavelength. The problem is that they can't globalize in economic terms. They're not allowed to get into the international market except for touristic projects and for artisanry.

### **Property Law and Capitalism**

INTERVIEWER: You are trying to do something unusual, which is to get a message out to the people. What exactly are you trying to achieve by holding these symposiums?

HERNANDO DE SOTO: There's a message in my book which is the result of the research and the conclusions my colleagues and I came to as a result of very practical empirical experience

in many developing countries throughout the world. The general idea is that there doesn't seem to be a better system in the world than the capitalist system, and it's a very subtle one, too. It's much more sophisticated than what people think. What it has is the ability to pick up the value of people's work. It has the ability to be put on paper, to accumulate, to represent value, and to use it to further additional production.

What we think is that the reason it isn't working in the developing world and the reason it isn't working in former communist nations is not because people are anticapitalist or people are antientrepreneurial, but that the infrastructure of laws that make the carrying of capital possible are simply not in place.

The message here is don't despair; it's worked for the West; it can work for us. We know nothing better. But it's going to involve radical changes, and you being entrepreneurs are going to be the first ones interested in making sure that these changes occur, and they have to do with the legal system. Here's what we have to say about how the existing legal system in the Third World conspires against you, how it doesn't allow you to come in. Be conscious that that's the source of the problems, that it's not the capitalist system, it's not the free markets system, it's not your capacity as an entrepreneur; it's essentially a legal system that doesn't allow you to accumulate capital, to organize value, and to be able to transfer it.

INTERVIEWER: So the system is rigged against poor people?

HERNANDO DE SOTO: What happens is that over the last 11, 12 years, the recipes available in the international market were at the macroeconomic level. Look, free-market entrepreneurialism is possible everywhere. It's a question of having stable money. It's a question of having fiscal equilibrium—government doesn't spend more than what it gets. And it's a question of making sure that the government isn't the manager of enterprise, so you have to privatize things.

That and a few other adjustments called "structural adjustment." But what we're seeing now is that that's important, but it certainly isn't enough. It isn't even the beginning of the story. Of course you need stable money, and of course to have stable money you need a government that doesn't overspend, and of course you also need a government that isn't involved in

enterprise. But you also need, more important than other things, a rule of law that makes a market economy, the interdependence between millions of producers, possible through good contracts, through good administration of justice and through representations in paper that are capable of capturing value, so as to use that value to further additional production, i.e. capital.

The general idea here is that we haven't properly yet understood the capitalist system. It's much more profound, it's much more subtle than we all expected, and it has only partly to do with macroeconomic equilibrium. Most of it has to do with the rule of law, putting in place a system that allows all of us to prosper.

INTERVIEWER: And so far the system hasn't prospered. Why? Why doesn't it work?

HERNANDO DE SOTO: The system hasn't prospered so far because we've dedicated ourselves only to doing the macroeconomic side of the formula: stable money, fiscal equilibrium, and privatization. The majority of the capitalist system the way I understand it is essentially a legal property system. And in most developing countries and former communist nations you do not have a legal property system that can provide a framework for the majority of entrepreneurs. I'm talking about 80 to 90 percent of all the entrepreneurs that exist. As a result of it, you cannot produce wealth.

One of the things that always scares me is that secret little argument, not even intellectual argument, that little prejudice that is not only in the minds of Westerners, but is also in the minds of elites of developing countries and people that take decisions, that the reason the capitalist system doesn't work is because culturally we're not ready for it, whatever the word "culture" means. It may even have racist implications. What we're saying is well, maybe it's true. Maybe the capitalist system does work much better with Protestants and whites. Maybe. But before that, let's take away all these enormous legal obstacles that poor people have to face. Let's take away all the ignorance around law and let's put good law into place and then we'll just see whether it works or it doesn't. We're absolutely convinced it does work because people are actively [conducting] enterprise all over the world. The thing is, they can't make long-term contracts, and because they can't make contracts, they can't obtain credit, and they

have no way of constituting a company that can issue shares, therefore they have nothing to sell against investment. That's the reason it doesn't work. I don't think it's cultural at all.

INTERVIEWER: So education isn't going to solve anybody's problem?

HERNANDO DE SOTO: Education is important. Education is important; health is important; religion, beliefs are important; a civil society is important; a good democratic system is important. But there are many developing countries where you do have some kind of a democratic system. There are many of these countries where you've got education. You could even say that in terms of the indigenous needs of the Peruvian nation we've over-invested in education. Why? Because most of the people that we've educated have emigrated to the United States.

So I'm not saying that education is not important, but if you don't have a capital infrastructure that is capable of creating job opportunities and entrepreneurial opportunities as a first source, all that education doesn't help. What we're saying is we've tried education, and it's good that we continue. Health is also extremely important. Information is important. Roads, infrastructure, clean water—all of that is crucial. But the one ingredient that we haven't tried is property law. And we think that that's the missing part to make all of the rest of the investments in things like education start really working in our benefit.

## **Creating Property Law**

INTERVIEWER: So the new rules of the game that should govern the world economy [and] globalization should be property law. How would you put that into effect?

HERNANDO DE SOTO: First of all, property law is a national creation; it's a local affair. The Americans have a property law, and the Swiss have a property law. Even in the United States property law can sometimes differ from state to state. But there is a general coherence of the whole system.

If you're talking about the developing and former communist nations, the creation of good property law is essentially a governmental affair. In other words, it's governments that issue law. The first thing we have to do is put into place the instruments that allow us to put in good

property law. It isn't a question of copying statutes from developed nations, because we've tried that. We've tried that for centuries now. Latin American, Peruvian lawyers are famous for getting enthused with the Swiss law, photocopying it, translating it into Spanish, and more or less with a few adjustments putting it into place.

The important thing to keep in mind is that in Peru, like in every other developing and former communist nation, people on the ground with or without a property law have basically agreed on the distribution of assets among themselves. You go to any of the places we've been to, the hinterland of Egypt, of the Philippines, of Haiti, where there is no official law that is actually in place or being enforced, but there is another law in place. You step on somebody's territory, and somebody comes up and says, "Get off my territory," whether there's a law or no law. You walk down the street, and you walk into a garden, and the dog starts barking, and you start finding out that that dog is defending a consensually agreed determination of possession rights throughout a certain area. So there are property systems in place. The important thing is that they're illegal; they're extra-legal, to be more precise. They are free creations among local people with total disregard for the law.

So what does property law have to do to be created? It's got to be created on the basis of people's existing beliefs, on the social contracts, the understandings that exist among people of what belongs to who. The consensus, the social contract is actually the best way to express it. There are ways of picking up a social contract. It isn't just a lofty ideal. That's what my organization does throughout the world. We have a way of finding out where the dogs are barking, where the fences are, what people will agree to in terms of transfer of assets, what people think are good systems of finance, all outside the official law, the way it was in the [American] West 200 years ago. Many of these things just occurred outside the law. We know how to systematize it, we know how to professionalize it and put it in the context of official law.

What you have to do when you're going to create a new property system is understand that it cannot be done in an ivory tower. Law is a process of discovery. You've got to discover what it is that people are willing to abide by, what is it that people recognize as legitimate, and systematize it. Then it becomes self-enforceable. You don't even need much police to do that.

**Bureaucratic Barriers to Entrepreneurship**

INTERVIEWER: You've found examples worldwide of the obstacles that poor people have in setting up businesses. Can you walk me through some of the things you found?

HERNANDO DE SOTO: One of the things *The Mystery of Capital* does is it gives you examples of obstacles that exist to creating a legal property right in many developing countries. In Peru, when we began our work, we tried to calculate the amount of time it would take somebody in a shanty town around Lima to get a title to the land so the police would no longer disturb [them], that everybody basically recognized that the ground underneath their feet belonged to them. We drew up a whole flow chart, a critical path of all the steps that people would have to take to get a property title, and it came out to something like 207 bureaucratic steps. In other words, you had to sign something like 207 documents before you got the title. And the amount of time it would take you to pass these documents from one desk to another, working eight hours a day, was approximately 21 years.

We did the same calculation in Egypt of how much time it would take you to get authorization to build a house on a sand dune. There's plenty of sand dunes, and it came out to something like 17 years.

We did the same calculation in agreement with the Filipino government in the outside of Manila, and it was more or less 24 years to get the title, but before that you had to reform procedures, you had to overcome them as well, so in total it came out to something like 50 years.

We tried to get official authorization to set up a small little sewing factory, with two sewing machines, two of these Singer sewing machines, and it took us, working eight hours a day, 289 days to get legal authorization to operate a seamstress shop in the outside of Lima.

In Egypt, with our Egyptian colleagues, we put together an exercise of finding out how much it took somebody to get a license to operate a bakery. Once they had actually set up the bakery, they'd put the ovens into place, everything was according to law, it took them 549 days working eight hours a day to get authorization.

What we've been discovering is that there's a real huge paper wall that stops the poor from being able to develop private legal enterprise. These obstacles many times don't exist for the wealthier parts of the population, because they're continually plugged into lawmakers. Something goes wrong, you talk to your friend the minister, you're well organized in the chamber of commerce and the local manufacturers association, some kind of a guild. The poor don't have a voice, at least not a business voice. They've only got a political voice, and it's not a very precise one.

So over the years a lot of silt has accumulated inside the system that actually discriminates against the poor. Most developing countries are really economic apartheid or illegal apartheid. If you're wealthy you have found a way to circumvent the old obstacles, and if you're not wealthy it's practically impossible to legally carry out your enterprise, which is a reason why black markets prosper and people do their business and distribute property among themselves, if you can call it that, since at the beginning it's not quite legal, according to their own beliefs and outside the legal system.

## **Legal System Reform**

INTERVIEWER: So there is a bit of a fallacy in the world where we think that capitalism and free markets actually give people freedom?

HERNANDO DE SOTO: The idea that capitalism can give you freedom is correct. What we're discovering is that the process to obtain that freedom goes beyond giving macroeconomic recipes, or the president of the country declaring that he's a free-market libertarian. That's not enough.

The important thing is to realize that all the countries in the world today are old countries, so they've all got a history and a history of laws, whether they be patrimonial laws, feudal laws, mercantilist laws. But we're all old countries. Even we Latin American countries, which as nations have only existed for 200 years, we're very old countries. The old customs of the Inca empire are around, and the old laws of Spanish colonization are around, and the band laws of republicanism over the 180 or 200 years are still all around. It's not enough to say you want to do something. It's important to realize that a capitalist system is essentially rules of the game. It's a legal infrastructure that allows you to make deals, that allows you to take your

assets and always raise them to their highest valued use. If you don't turn the legal system around, you're not going to get capitalism.

What we're finding out now is that the job of undoing the past and creating the future in a legal perspective is an extremely arduous task. It's a major task and it needs recognition that it's a major task. It needs putting together all the leadership that is required to fight against the past, because elites, who are accustomed to the old system, even if it only benefits 5 or 10 percent of the population, are very reticent to change it. You've got to go out and bring in the statistics and say, your system is fine and dandy for you, it looks comfortable, but look what it's doing for the other 90, 95 percent of the population. Once you put your statistics into place and people realize that what benefits them actually prejudices 90 to 95 percent of the population, people will turn around, because it's unacceptable. It is not acceptable. But that means you've got to go out and collect the statistics, and you're not going to find them in World Bank reports and you're not going to find them in the IMF reports. You've got to pick them up yourself. That requires leadership. That requires having a head of state or somebody very close to them that is willing to bring the facts in and then do something about turning it all around. And it means not only sometimes changing the laws and the norms, but changing the procedures to change the laws and the norms. The metasystem, so to speak. The political system that creates norms, because the very problem of bad law may be the way laws are organized in the first place. And it may be that they're always organized in a non-democratic way.

This is clear when you read 17th-, 18th-, and 19th-century history. The whole idea of libertarianism, or liberal in the classic European sense, was a revolt against privilege, and it's still that. This idea of somebody saying, look, I'm going to give North Americans what they want to see in my country, which is all your principles, but I'm not going to go against my elites, and I'm not going to back them and I'm not going to confront them, because I know you also want stability, is not possible. That's very important for Western countries to realize, that when they call for creation of market economies in developing countries such as mine, they're calling for revolution, so they'd better get ready for a change in the status quo. You can't have the old status quo and at the same time have change. If you create change you're going to go against the traditional friends of the West in these countries, and realize that there's a lot more that can also be your friends, but we have to shake the system up. There's

no shortcut to revolution. The bringing in of markets, the bringing of capitalism, the bringing in of democracy into the West was a major revolution against the old vested interests. There's no way that's going to be any different in developing and former communist nations. And that means you've got to be prepared to see the old leaders and the old elites lose their privileges.

INTERVIEWER: Do you think the world is ready for these ideas?

HERNANDO DE SOTO: I don't think the world is ready for these ideas. If you look at *The Mystery of Capital*, all I'm trying to show is what's already happening. People don't agree about these ideas, fine, but then you've got, whether they like it or not, the city of Port-au-Prince in Haiti has grown in the last 30 years, 16 times. And here's all these people wandering around the city, taking everybody else's assets away, blocking traffic, whether the world is ready for these ideas or not. ...

What we have to decide now, if we're not ready to be moved by ideas, is what we're going to do about all these people, because these people have come to town. Oliver Twist has come to town, and he wants to be part of the division of labor on a larger scale, and you don't give a damn. He's poor, and he's got a TV set and he's able to see how you live as compared to how he lives, he's going to get very angry. So either you show him a capitalist route to do it and integrate him, or he's going to find another ideology. The fact that today there is no [longer] a Kremlin that is organizing revolt doesn't mean that they're not going to find another capital, because when these things happen, when people are unhappy and rebel against a system, they'll find another locus of power very, very quickly.

Besides, anybody that says he's a capitalist and doesn't agree with these ideas is not really a capitalist, because capitalism came together with democracy. It came together with the ideas of empowering people. If they say they're not, you're not fighting against capitalists. You're fighting against people who believe in capitalism for only a few, and that's called mercantilism. As far as I'm concerned, they can continue to be our enemies.

INTERVIEWER: You think the rules right now of free trade are more mercantilist than capitalistic?

HERNANDO DE SOTO: The rules of global free trade are all right. The problem is that they're only applicable to the West as a whole and to elites in my country, because most of the poor people in my country can't export or import.

The problem has very little to do with globalization. It may be that globalization has increased sensitivity to the issues of capitalism and freedom, but in fact it's not responsible. The problem is internal legislation and legal systems in developing and former communist nations which allow only the elites to globalize. The rest of the people in my country see globalization through TV, but it doesn't touch them. Of course there's always those people around to explain that globalization is the source of their problems. And it's not that. Globalization is not at the source of their problems. What is at the source of their problems is legal discrimination within their own countries.

### **Capitalism as a "System of Representations"**

HERNANDO DE SOTO: One of the big, hidden secrets of capitalism is that it's an invisible system. The first thing that strikes you about looking at a market in a developing nation and an advanced nation is that most markets in developing nations are markets where you see physical goods present. There are people there with their cows and their pigs and with their wares and with their machines, and they're selling them. When you look at the big markets of the West—Wall Street, the Chicago Commodities Exchange, the London Metal Exchange—these are markets where what you see is paper flowing back and forth. It's not like in the times of Jesus Christ.

One of the most interesting and sophisticated aspects of capitalism is that it's a world of representations. Let me explain. In the old days, like at the time when Jesus Christ was in the temple, he threw the merchants out because they had converted it into a market. So even Jesus Christ knew very well what a market was. The difference between the Palestine markets of 2,000 years ago and present modern markets, like Wall Street, like the London Metal Exchange, like the Chicago Commodities Exchange, is that as opposed to the times of Jesus Christ, nobody's selling cows one at a time. Nobody's selling little pigs one at a time, or a machine or a contraption or a wheel one at a time. People are selling property rights reflected in deeds, titles, or shares to each other. In other words, these are markets not of goods, but of representations of property rights.

What happens, therefore, is that it's a much more efficient market, because, among other things, you don't have to go like in Peru or Egypt to sell one cow at a time. What you can do is have a title to 10,000 cows at a time, 10,000 heads of steer, and you can sell them all in one go. Moreover, whoever sees the property papers on the steer will actually see more information by the description than they can by actually looking at a cow, because even if it's my house, the title of my house tells me many more things than those I can see when looking at a house. When I look at a house I see its color, I see its volume, I see how many windows it's got. But when I look at a piece of paper that's a title to the house I see other very important information which I don't get from a physical acquaintance with the house. Who owns it? Can it be rented? Has it got a mortgage on it? Are there encumbrances? All the economic stuff is not in the physical content of the house. It is in titles and in shares.

What capitalism is is a system of knowledge and contracts by description as opposed to the [physicality] of underdeveloped countries, where buying and selling is knowledge by contact or by acquaintance. You have to see things; you touch things. But it's a poorer way of knowing things than the one through paper.

The important thing about a capitalist system is that it's a system of representations. It's a little bit like when I go to the United States, people ask me for my identity, and I say: "My identity is me. Look at my face. I am Hernando de Soto. You want to see my fingerprints? Here they are, dangling from my fingers. They're at the tip of my fingers. You want to know who I am. Ask me. My memory is available to you. I'll tell you where I was born, who I was related to, who I'm married to. I can give you all of that information." But the man at U.S. immigrations just says, "Look, give me your passport." In the passport he gets all the information about me much quicker, in a much more direct fashion, in an organized fashion that is similar to the British passports he has to look at, or the Indian passports. It's got the same language and allows him to deal with thousands of more people than if he had to have an interview, which he has no way of verifying with me.

When I go to my hotel in the United States, and I've been going there in New York for 15 years, they know I pay, but they still want to see my credit card, because it's my credit card that's going to tell them if I have enough funds to pay for my stay in the room or I don't. And

when I'm going to make a phone call I use my AT&T calling card, and it's the AT&T calling card, the swipe, that's going to tell people if I can pay for the telephone call or not.

In other words, the reason that things travel so well in the market economy of the United States and values travel from one place to another is because they all have passports. The real value is like my identity—it's not in me; it's in my passport. Real value to pay the hotel room is not in me; it's in the credit card. What happens is that this system by representation requires that all the representations—the credit cards, the passports, the IDs, the property titles, and the shares—be organized by a system of law that allows people to be able to trust what they're dealing with. All these systems of legal trust don't exist for a least 80 to 90 percent of the population in former Soviet nations and in developing nations. We are not nations that are represented on paper. We are not nations where our assets, our values, and our talents are represented on paper by a property system. As a result, we are back 2,000 years ago. We have to show each little cow before we sell it and try and guess what's really behind the cow.

### **The Challenges of Property Law Reform**

INTERVIEWER: You were saying that what poor people own has value, but it doesn't translate in a capitalist market because it doesn't have property rights. So it's not capital, yes?

HERNANDO DE SOTO: Right. What I'm saying is that poor people in developing and former communist nations are not as poor as we thought they were. I'm not saying there are not cases of abject poverty and people that need assistance and need charity. That's understood. I'm just saying that most of them have actually been able to accumulate large amounts of physical wealth. Take the case of Egypt, in which we were able to calculate the amount of homes that the poor Egyptians have, the lower middle classes and poor Egyptians. It turns out that it has a value, a replacement value of about \$241 billion. And \$241 billion is 55 times the size of all foreign investment in Egypt over the last 200 years, including the Suez Canal and the Aswan Dam, and 30 times the size of the Cairo Stock Exchange.

The same sort of figures are true all over the world. The poor, over the last 30, 40 years, as they've migrated to the cities, have actually amassed amounts of physical wealth that are in

excess of the value of the local stock exchanges, all foreign aid, and all foreign investment in those countries.

So the question is, "Why can't they use that to create further prosperity?" And the reply is because all of these things are owned outside the law. And therefore, for everything they own there isn't a clear property title, nor a document that allows these things to become liquid. In other words, in the United States the moment you get a title to your home, or the moment you have the share to a production facility, you know you can make it liquid by going to capital markets where people will give you liquidity against it. Government may even create liquidity against it, or people will invent liquid forms to give you for that.

But what's [burdened] to create the liquidity is not the house and it's not the machine; it's the piece of paper. It's like with a mortgage. The mortgage is given against the title to a house, not against the house. When poor people don't have their things, or they don't possess their things according to law, they don't have all those documents and all those networks of enforceable rights and obligations that allow them to obtain additional liquidity from their homes.

Let me put it another way. In the United States and Western Europe and developed nations, whenever you have a house, you also have with that house a parallel life of the representation of that house as liquidity. You have two things. The house, plus a property right over future liquidity. In developing countries you've got your house, period. Why? Because it's outside the law and the legal system of representations, property titles, deeds, IOUs that can be enforced in the market that allow you to enter the capital markets. That's the reason why they can't leverage anything they've got. They can't leverage it, they can't sell it.

You can hum a tune in the United States, a little jingle for the radio, and you can create a property right on it in such a way that every time it's played on the radio or played on TV you get a remuneration against it. But the reason you get a remuneration against it is because there's a property right that can be enforced. In Latin America when we hum a nice little song, there's no property right on that song and anybody can go down the street whistling it and not paying you for it.

INTERVIEWER: But in some countries, you'd have to even change the agrarian reform laws to get this. The developing countries may not ever catch up.

HERNANDO DE SOTO: Developing countries are going to have a hard time adjusting to all of this. It's not an easy task to call for major legal reform, but it is the road to prosperity and it can be done. It has been done. The United States, whether [it] recognizes it or not, throughout the 18th and 19th century and even early 20th century essentially revolutionized its legal system. Americans are always under the illusion that they inherited the common law system from the British and they practically just applied it the way they found it. That's not the way it happened. They actually created a whole system of law. The Swiss completely revamped their property laws in 1908 and became a developed nation. They were a very poor nation before 1908. As a matter of fact, it was the poorest country in the Western hemisphere. Japan completely changed its property laws under the occupation of MacArthur and afterwards. That was what was required to create the infrastructure that allowed capitalism to function.

There's no shortcut; you have to do that. The fact is Japan did it in just a few years and the Swiss, once they decided to do the 1908 civil code at the beginning of the 20th century, also did it. We have to do it as well. And there's no reason for us not to do it. There's certainly a constituency in favor of all of this because the majority of the people in developing countries and former communist nations are outside the system and they're angry as hell, and they want it to be changed. It's actually the shortest cut to peace and prosperity.

### **Making Capitalism Work for the Poor**

INTERVIEWER: Do you think capitalism is in trouble, then?

HERNANDO DE SOTO: Well, capitalism is certainly in trouble if it doesn't adapt. Capitalism is essentially the economic system of poor people. That's what allowed the people that came from humble origins of the world to have economic rights the way only nobility and the high bourgeoisie had it before. So capitalism is essentially a tool for poor people to prosper.

The problem that's happened over these last years is that somehow or another people were capitalists in countries like the United States considered the real interlocutors are rich people

from developing countries. They've been touching the wrong constituency. The constituency of capitalism has always been poor people that are outside the system. That's the way it worked in the United States. That was the basis of the libertarian or liberal democratic revolution that occurred in Western Europe. I don't know why it is that everybody expects that when you go and you talk to rich people throughout Latin America or Asia or the Middle East you are in touch with people who have the same libertarian principles that you do. You don't. The real constituency is below, and until the people who consider themselves real capitalists realize that they're not real capitalists, they're talking about the systems of privilege that existed way before popular capitalism was in place. So capitalism just has to re-find its way or change names.

INTERVIEWER: Do you think there is going to be a backlash to neo-liberal policies in the Third World?

HERNANDO DE SOTO: A backlash to what are called neo-liberal policies is already on its way. People marching against globalization are a sign of it. Governments elected to repeal neo-liberalism are a thing of the present today in many developing countries. So backlash is on its way, and it's not because capitalism doesn't work, it's because we have misunderstood what it takes to make a capitalist system work. We have misunderstood that if you don't get the poor and the middle classes in on the game by giving them the adequate property rights, they will rebel against the system, not because they don't like the system, but because it isn't working for them. Not everybody picks up a book to find out what Adam Smith said was good market economics, or what Milton Friedman says are really good market economics. Most people try and find out if the system works for them, and it's not working for the majority of people because they don't have property rights. It's as simple as that. If we don't give them property rights, whatever there is that's called capitalism in developing and former communist nations that is only working for a minority is bound to fall and be replaced by something else. If it's going to be replaced by some of the principles that are dear to our hearts like freedom for everybody and the right of everybody to own property, it really depends on us being able to put together a model that is also receptive to the needs of the poor.

INTERVIEWER: And what will that model be called?

HERNANDO DE SOTO: Names don't really matter. I'm not one of those people that believes that you have to fight for names. If the word "capitalist" is a bad word in many developed countries, which is it, you might as well drop it. Why try and bring back respectability to a bad name? For example, the word "neo-liberal" is already a bad word, definitely a bad word throughout the Third World. I wouldn't defend it. Just drop it and say that it is what it is, which is macroeconomic policies that were insufficient to change countries around. Drop it. Drop the word.

The important thing is that by capitalism or free-market economics we are talking about systems that allow the majority of people to work in capitalism, and if we're going to call that the Third Way, or we're going to call that Popular Capitalism, or we're going to call that the People's Economy, it doesn't really matter. I wouldn't fight over words.

INTERVIEWER: You have these famous words: "The moment of capitalism's greatest triumph is the moment of its greatest crisis." Why do you say that?

HERNANDO DE SOTO: Today capitalism has obviously triumphed in the West. It's given it an unprecedented prosperity. But at the same time that Americans look at each other and realize that they're more prosperous than they were ever before, even though values on the stock exchanges as a result of the business cycle are today dropping in most of the world—that is to say, in developing and former communist nations, which are five billion people out of a total of six billion—it hasn't been working for us since the fall of the Berlin Wall. We have all basically decided to follow the capitalist route. And during all of this time at the level of the elites we have gone prosperous and have seen our standards of living rise. But the majority of people are probably as poor as they were before, or some have prospered, but certainly capitalism hasn't shown its promise.

So this is a time of crisis. It's a time of crisis because most people will probably tell you in developing countries that, though they still hold hope for capitalism, they're not quite sure the way it's going to work for them. And the fact isn't that capitalism hasn't worked for them, it's that capitalism hasn't been tried because there's no such thing as capitalism without property rights for everyone, or for most people. Most people in developing countries own things, but have no rights to them, and therefore they have no way of entering the market, they have no

way of getting credit, they have no way of getting official investment, and of course they're disappointed. This is a time of crisis for the cause of capitalism worldwide because for the moment, it has only meant giving the elites of developing countries additional opportunities and not being able to get down deep into where the real majority interests of people in any developing country are, which is among the poor.

As you may have seen from one of the book presentations that you saw, mainly poor people came in, and they came in by the thousands. Every time we're on television we can talk about them being there in the millions. I make no mystery about the fact that I'm talking about real capitalism. I actually use the word capital in capitalism. And as you will see these people react. They understand that there's not many options in the world.

They've tried socialism, and it hasn't worked. They've tried all forms of national protectionism, and it hasn't worked. There [were] a lot of illusions at the fall of the Berlin Wall. Everybody thought that these were the good times that were coming. As you can see, they still want those good times to happen. And all our presentations are with the popular classes of Peru. So they are obviously reacting very favorably. They understand that something isn't working in the system and they need explanations, [but] nobody's providing explanations. The only explanations I see, which I think are dreadful, are those that trickle down from some types of U.S. literature that says well, basically this is cultural. Us white guys, Anglo-Saxon Protestants, have a way, a culture for making this work that you don't.

Now whatever culture is you'd better change it. What are recipes for changing culture? What we're trying to say is that you haven't got the appropriate institutions. Look at how they're turning out. It's obvious that we've touched some kind of a fiber. We are obtaining a response to the message.

## **The Institute of Liberty and Democracy**

INTERVIEWER: You say "we" a lot. Can you just explain what "we" is?

HERNANDO DE SOTO: Sure. We are the Institute of Liberty and Democracy. We're a think tank—probably more than just a think tank. We're an activist group that looks at these issues of why markets don't work in developing countries because we believe in markets and we

believe in capital. We think these are good systems; we know of nothing better for the moment. We've thought about these things and we've learnt to analyze things, [not] only to analyze it but to draw up legislation and to lobby for legislation, and to draw up strategies for transition and change. We're also capable of running government organizations, like the recordkeeping offices, and all those instances that are needs for people that were originally in the underground economy to come into the legal economy. That's what we are, a nongovernmental organization, a think tank.

INTERVIEWER: You invited Hayek and Friedman at one point to Peru. Tell us that anecdote.

HERNANDO DE SOTO: About 20 years ago, when we started getting organized and Peru's left-wing military dictatorship had just finished, we invited them to two different symposiums where there were thousands of people present, both Friedrich von Hayek at one point and Milton Friedman at the other. The objective was for Peruvians to see firsthand that these people who had been called monsters by the previous government weren't monsters and they had a very intelligent way of thinking.

The traditional way of looking at them in left-wing or Communist circles in Peru, or the propaganda they gave out, was that capitalism was the law of the jungle. It was very useful to have both Hayek and Milton in town because people all of a sudden realized that the philosophers of freedom were very sophisticated indeed, and probably much more sophisticated than the old socialist philosophers they'd been taught to revere. That gave us a starting point, because it gained respectability for the word freedom on the one hand, and secondly because both Friedrich von Hayek and Milton Friedman, when we showed them what wasn't working among the poor and we said the law was important, it isn't getting to them, basically reacted very positively. That gave us a bearing. They said, "You're right, it doesn't sort of work automatically, you've got to install the rule of law. It's got to work."

The same thing happened when we talked to people like Ronald Coase. They said, "You're right; it isn't only a question of creating law for rich people. I didn't realize that the laws were only made for the rich, you've also got to make it for the poor."

It had two effects. One is that the Peruvian audiences started becoming aware of the fact that these people were not monsters, that these people were very sophisticated. That they had the best of [intentions]. And the other thing it gave us was confidence in the fact that when we had seen that the system didn't automatically apply, that it required major surgery, we weren't far off from the truth.

INTERVIEWER: Do you think a lot of people are shielding themselves behind the words of Friedman and Hayek nowadays?

HERNANDO DE SOTO: One of the problems that you see mainly in Latin America, which is the area I'm most familiar with, is that people who have created special legal niches of privilege among themselves and who have no way of justifying the privileges that they have created for themselves have a tendency of quoting a lot of Friedman and Milton, but all sorts of libertarian writers, to justify their privileges. One has to be careful of that, because ideas aren't only used by the right people. Ideas can be used by the wrong people. The Communists, in many cases, Marxist Leninists many times used the shields of softer socialist models to disguise what they were really up to. It's the same thing on the right. On the right there's a tendency for people who have libertarian thought to be used by people who are only intent on defending their privileges. One has to be very, very careful about that.

So if you are about to open a libertarian club, or NGO, or think tank in Latin America, and all the guys that sign up have got pinstripe suits and nice silk ties, you'd better be careful. You'd better start suspecting that something's wrong.

If what you've got is a universal message, some poor people and lower-middle-class people should also be present. That's an indication that you're really getting a message to the right people.