

PROPERTY LAW AT HEART OF GLOBAL FINANCIAL CRISIS, HERNANDO DE SOTO

Posted on 29/12/2008



Category: [Opinions](#)



The move away from the fundamentals of property ownership has brought on the financial crisis now affecting the West and which is endemic in much of the Developing World, says Hernando de Soto of the Institute for Liberty and Democracy.

Over the last 60 years the world has grown more prosperous than the previous 2,000 years

combined. It is a time to feel good but still around four billion people, two-thirds of the global population, are not doing as well as the rest.

Un alejamiento de los fundamentos de la ley que regula los derechos de propiedad ha provocado la crisis que afecta a Occidente y que es endémica en la mayor parte del mundo desarrollado, opina Hernando de Soto, del Instituto para la Libertad y la Democracia de Lima. Las titulaciones en EEUU de la mayoría de los activos inmobiliarios ha planteado, y sigue planteando, la duda sobre quién recaen las responsabilidades. Con seis billones de personas en el mundo, el único camino que podemos recorrer es el de la claridad jurídica. Una vez que desaparece la transparencia de las leyes que regulan la propiedad, el mercado queda expuesto al caos

The sub-prime crisis that has impacted the West may, we hope, pass, but many of the world's developing countries, including my own Peru, suffer, in effect, a chronic sub-prime crisis. For what is essentially a credit contraction, a liquidity and risk-pricing issue is also fundamentally a legal problem. So is poverty: burdensome and discriminatory laws have excluded most of the world's people from the legal tools essential to prosperity, such as property rights to access credit.

A global economy is essentially about anonymity, dealing with people that you may never see or know. What identifies people and brings them together is the law, through which we are able to identify both facts and risks.

But property law has more to do with commercial connections than any asset itself. If I have an apple there is nothing intrinsically about it that will tell you it is mine. But if I buy it, sell it, lease it, rent it or collateralise it, my connection will be demonstrable through the law.

While we can see the physical thing we can't see the relational thing, which is what allows the whole economy to move. The word "credit," which comes from the Latin verb credere, means, in effect, "I believe you". Without an apple, without an asset, you cannot get credit and without that you get a "crunch".

The law, however, can instil value. Peru's national telephone company, Compañía Peruana de Teléfonos, was valued at US\$53 million before the rewriting of Peru's property law. Subsequently, it was sold to Spain's Telefónica for US\$2bn. Giving it a property title raised its value 36 times, because it was then connected to its shares, its investors, everybody.

The world hinges around the information that property law brings into place. But facts, according to the philosophers Ludwig Wittgenstein and Bertrand Russell, come in what they called "atomic proportions," though people never actually see things that way. The Officer at the airport wants to see my passport – the legal document that connects me to society – not the very many documents that enabled me to obtain my passport.

That connection is what produces the fact, and laws and lawyers make pictures of facts in legal documents. Without facts, the global economy doesn't work. But these facts have to be precise and standardised; otherwise they cannot be recognised. Property has to be accountable, recorded and protectable. The law thus lets you know who owns what and who has whose hand in whose pocket, rightly.

If you leave this recording system, you are out of the economic and financial system, which is what happened in the sub-prime crisis. Traditional property law concepts were cast aside for securitisation, which has no respect for any of these key elements.

It is not that we lack money; we just don't know who holds what toxic paper, claims or property in the US market. Banks do not want to lend to each other because they don't know who owns what. Once you take away the clarity that property law brings to human connections you bring havoc to the market.

Law gets to the facts. Property law wants to know who owns what, what your name is and where you are located. Securitisation, by contrast, tells you whether documents are valid; it doesn't tell you whether it's the truth. The only people who can ascertain this are those who know law.

It is when legal documents cease to represent the truth – when my passport ceases to represent me – that we get into problems. With six billion people in the world the only way we can know each is through the law. That's the challenge for lawyers in the future – to bring the majority of the world's people into the legal marketplace where they will have a chance to prosper.

Hernando de Soto is the President and founder of the Institute for Liberty and Democracy in Lima, Peru. – considered by The Economist as one of the two most important think tanks in the world. This is an extract based on a speech given at the Opening Ceremony of the International Bar Association's Annual Conference 2008 in Buenos Aires.