

# Understanding the Processes of Prosperity

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***The Mystery of Capital:  
Why Capitalism Triumphs in  
the West and Fails  
Everywhere Else***

Hernando de Soto

Basic Books, 2000, 276 pp.  
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Most human beings in most societies in history have lived in poverty, generally in grinding poverty. Over the last two centuries, a remarkable thing has happened. For the first time in human history, societies have been created in which most people live prosperous lives.

Those of us who live in these unusual societies so take our mass prosperity for granted that much commentary seeks to blame these successful societies for mass poverty elsewhere—thereby blaming the exceptional for the normal. In *The Mystery of Capital*, Peruvian thinker Hernando de Soto provides a powerful explanation for the peculiar triumph of the West.

The explanation is provided by looking at history and at practice. It is economics which starts with observation—very much in the style of Nobel Laureate, Ronald Coase. Indeed, the book itself begins with a quote from Coase. The connection goes further, for the book is about property rights. More particularly, it is about systems of property rights which reduce transaction costs—identification of the significance of which is Coase's great contribution to economic thought—and thereby liberate assets so that they can become capital.

De Soto makes a very powerful point, based on results from his international network of researchers. The poor are not poor because they lack assets. They already have assets—de Soto estimates that if the US increased foreign aid to 0.7% of national income, it would take the world's richest economy 150 years to transfer to the poor of the world income equal to the value of assets they already held. The poor are poor because they lack access to capital, as they cannot turn their assets into capital.

The reason they lack access to capital is due to the failure of property law in their countries. In Lima, Peru, for example, it took 289 days to get the legal approvals required to set up a small textile business. In Haiti, it takes 19 years to get legal title to land—and there is no guarantee that one will retain such title. In the absence of sensible property rights laws, people live extra-legally, outside the 'bell jar' of formal legality. But that denies them access to credit and loans and forces them to trade, for important items, only with people personally known to them. All this massively reduces their economic prospects.

De Soto identifies the characteristics of a good property rights system. A well-ordered system of property rights:

- fixes the economic potential of assets;
- integrates dispersed information;
- makes people accountable;
- makes assets fungible;
- networks people; and
- protects transactions.

Western societies developed property rights systems with these features, other countries did not. De Soto points out that this achievement of Western societies is relatively recent. Colbert's technocrats in France executed thousands of extralegal manufacturers. Adam Smith bought goods in black markets outside the control of the city guilds, smuggling them past the guards at the city gates.

De Soto uses the US as a case study of how extra-legals were brought within a legal property system. This is very important for de Soto, as his purpose is to say to the developing world 'you can get there from here'. The proof is that the US did.

De Soto goes through how complex the property laws were that the American colonies inherited from Britain, how there were many overlapping claims to single pieces of land, how many settlers were squatters not properly included within the formal property system and the conflicts over property rights that resulted. Slowly, under pressure of events and through the operation of democracy, the formal property laws were brought into alignment with what people were actually doing. People came within the formal property laws because those laws reached out to incorporate them and what they were in fact doing.

A particularly revealing tale is how the gold rushes saw miners develop their own effective property laws which the US state eventually simply recognised. This pattern occurred throughout the 19th century.



When the US Supreme Court, in *Green v Biddle* (1821), made a ruling greatly hostile to the interests of ordinary settlers, the ruling was simply ignored (or even specifically repudiated) by local judges and legislatures who had to deal with the practical realities on the ground (and angry voters and neighbours).

The normality of mass poverty, and of high transaction costs, poses a disturbing thought—that the natural tendency of human politics is towards increasing transaction costs. After all, there is a lot of income—both financial and psychic (moral vanity and other status games)—from raising transaction costs. Occupational health and safety, environmental issues, employment security; the justifications for raising transaction costs are endless. Demands for social justice are, like all wants, just conjurings of the mind and so unlimited. When one compares the operation of wage arbitration systems, or indigenous title, to the characteristics de Soto identifies of good property laws, they do not stack up well. And our labour market has more than a few ‘extra-legals’ within it.

How does one combat these tendencies? The original success of Europe was fundamentally based on the failure to unify. Competition between princes and states forced restraint on the possessors of the coercive power of the state. *Globalisation*—the deepening of international markets—provides a powerful weapon against the rent-seekers. *Internationalisation*—the enmeshing of states in ever more international treaties and agreements—easily provides tools for them. Which is why so many prominent rent-seeking groups, starting with union officials and green advocacy groups, hate globalisation but embrace internationalisation.

But clear understanding of the processes of prosperity, and what is at stake, is also a great weapon in the endless fight against the rent-seeking enemies of prosperity. By providing such clear understanding, de Soto’s powerful and immensely readable book is a very great weapon in the armoury of freedom.

**Reviewed by Michael Warby**

***Exasperating Calculators:  
The Rage Over Economic  
Rationalism and the  
Campaign Against  
Australian Economists***

William Coleman  
and Alf Hagger

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The American conservative William F. Buckley Jr. once remarked that he would sooner be governed by the first 2000 names in the Boston phone book than by the 2000 members of the faculty of Harvard University.

Readers of *Exasperating Calculators*, William Coleman and Alf Hagger’s highly enjoyable demolition of academic and intellectual contributors to the economic rationalism controversy, will well understand what Buckley was getting at.

This is the best exposé of academic incompetence since Alan Sokal’s famous *Social Text* hoax, and his follow-up book with Jean Bricmont, *Intellectual Impostures*. Readers may remember that Sokal successfully submitted a nonsensical parody article about physics and

mathematics to the academic cultural studies journal *Social Text*, greatly embarrassing its gullible editors when the hoax was exposed.

When Michael Pusey’s book *Economic Rationalism in Canberra* came out in 1991 some might have hoped that Pusey was a Sokal-like hoaxer. What better way to expose the dismal standards of academic publishing than to submit an atrociously written, ignorant and illogical text to Cambridge University Press and see if you could get away with it?

After ten years, though, all hope is gone that Pusey will reveal himself as a hoaxer. All that can be done is to show, as Coleman and Hagger do in a chapter called ‘The Pusey Event’, just how bad his book was in its analysis of Treasury economists’ views and his ‘iron determination to make something out of nothing’.

Joining Pusey on the left-wing dishonour roll are Hugh Stretton, ‘the undisputed master of the utterly mysterious and absolutely unaccountable factual claim’; Eva Cox for her ‘misrepresentation of what Economic Rationalism is all about’; the Australia Institute’s Clive Hamilton, whose ‘florid irrationalism will impress few and dismay many’; and the late Russell Mathews, whose ‘performance is perhaps the most singularly fact free of any of them’.

Fault is also found with John Ralston Saul, John Gray (those two making cameo appearances for the favour their work finds here), John Quiggin, Fred Argy, Peter Self, and H.C. Coombs. The third way writers Mark Latham and Anthony Giddens are chastised for repudiating economic theory.

While most of these people identify with the left, the authors argue that economic irrationalism, as they call the opposition to economic rationalism, is fundamentally a conservative movement in its nostalgia for the recent past. Some economic irrationalists would not object to the conservative label.

The main targets in the ‘Enter Stage Right’ chapter are, as you might expect, Robert Manne, John Carroll and B. A. Santamaria. Manne makes one remark to which Coleman and Hagger are ‘willing