

Book Review

**CAPITALIZATION OF ASSETS AS THE “MYSTERY”  
BEHIND CAPITAL**

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Reviewed by **Lilis Mulyani**<sup>1</sup>

Title of Book : The Mystery of Capital  
Author : Hernando de Soto  
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There is much research on poverty reduction program in Third World countries, particularly those supported by the World Bank. De Soto's research, highlighting the need for a legal property system reform in these countries, is indeed important and beneficial. As he argues in his latest book, *The Mystery of Capital*, the Western countries 'capitalist approach' on property can be used to reduce poverty in Third World countries (De Soto, 2000). This book is one of the series he had written on extralegal sector, particularly in Peru. He tries to disentangle the 'mystery' behind the 'successes' of the Western countries to maximize the surplus value of their property and create capital. To achieve this condition, there is a need to build an integrated and mighty formal legal property system. De Soto believes that the potential assets in the Third World countries have not been "identified or realized" (De Soto, 2000: 29) or he calls it "dead capital" (De Soto, 2000: 15).

In other words, the poor in these countries are not really 'poor'. They have property (although mostly with unrecorded rights) and they have business (although mostly extralegal businesses). For this reason, a formal legal property system can become a means to shift the potential assets, that the people in the poor countries 'have', into productive assets or capital (De Soto, 2000: 6-7). Once the abundance of these assets is recognized and

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'secured' in the formal system, it will support the effective mechanism of property markets. This means that, assets with formally recognized titles will better help the people in the Third World countries, not only in terms of legal representativeness, but also in the ability for them to manage their assets in the market economy. The latter includes the mortgage system to borrow money for business and investment. With this idea, De Soto tries to present the concept of property, which is embedded within the Western concept of capitalism (Reeve, 1986: 3; Girling, 1987: 69; Carter, 1989: 10; MacPherson in Parel and Flanagan (eds), 1979: 3-9; Pipes, 1999: 53), as a liberating force from poverty and enabling development, instead of a negative subjugator force.

Nevertheless, De Soto has given little attention to the condition of a country where communal rights over land still exists; or where there is widespread land apartheid and land conflicts. In a country with complex land law practices, such as Indonesia, there is a growing concern that individualization of property, in particular land, instead of creating wealth among the poor, will only open opportunity of a free land markets. A situation that eventually will transfer these people's land to the hands of larger capital owners. The concern also includes the transfer of agricultural land into industrial areas, mining, plantations and real estate (KPA, 1996). In other words, the concern lies in the prediction that this formal legal property system will smoothen the way for larger capital owners to confiscate land and other natural resources in Indonesia merely for commercial purposes (Barnes, 1997; Proudhon, 1993; Pipes, 1999: 50).

Besides, in Indonesia, land has been a 'conflict sensitive issue' in many provinces. The largest number of land conflict has been the conflict of land between the people, whether individuals or communal, with the State (Fauzi in KOMNAS HAM, 2001, 207). This is due to unclear and weak land law; distorted implementation of land law; corrupt land administration system, which serves the corrupt government; and eroded court system. Many agrarian activists believe that land reform through deconcentration and equal distribution of land is a first major step to be taken before entering the creation of a formal legal property system.

De Soto has made an important argument on the need of a formal legal property system, to better help the people in Third World countries in their economic and social relation, to which argument I had agree. However, considering the condition of Indonesia's land law, there are other key elements to consider in creating wealth and eradicating poverty using a mighty formal legal property system. These elements include: a clear and just land law; a clean and strong government; and adequate land administration with a fair dispute resolution mechanism. It is important to remember that integrating complex and conflicting situations of land law into a formal legal property system cannot be that simple. In this review, I would like to answer the question as to what are the other elements needed by 'a mighty and complex' formal legal property system to serve to break down 'capitalist apartheid', in particular land apartheid, and enable development. I will discuss the matter with particular emphasis on Indonesia's land law and practices.

De Soto writes his theory, to disentangle the mystery behind capital, in a strong point. De Soto 'revisits' one of the core concepts of capitalism theory: property. He reminds that the real benefits of property derives not only from its physical appearance; but most importantly derives from its "potential value" (De Soto, 2000, 42-44). Physical benefits of assets or property can only be generated through labour, while the real benefit of this asset is actually derived from its legal representativeness. With this legal entitlement, asset can work in 'a parallel' (De Soto, 2000, 36-37) world, beyond its physical world, creating surplus capital for the owner. However, this proposition of the relation between property and prosperity and the rise of the Western countries's capitalism has also been emphasized by Pipes. According to Pipes, "[o]ne of the main reasons for the rise of the West in the position of global economic pre-eminence lies in the institution of property, which originated there and found there its fullest development" (Pipes, 1999, 286).

De Soto's study on legal property system in Third World countries has different findings, because he directly shared the experience –the hardship and resilient- of the poor in these countries. He finds that the majority of these people work or involve in an extralegal sectors including extralegal transactions (De

Soto, 2000: 23). Engaging within this extralegal sector is actually a rational choice of these people, based on their comparison of the costs and benefits of inflowing into the formal system (De Soto, 2000, 18). In many Third World countries, this situation is partly due to the excessive administration and bureaucratic system. The cost to follow legal regulation or formality cost, usually higher in these countries.

Economists have used the term extralegal or informal sector since the late 1970s (Mattera, 1985; Smith (a), 1986; Alessandrini and Dallago (*eds*), 1987; Harding and Jenkins, 1989; Feige (*ed*), 1989; Roberts in Smith (b), et.al (*eds*), 1990: 23-48). Nevertheless, they have used it in a different approach and emphasis than De Soto. Different terms have been used to point out the 'other system' outside the formal one. The terms range from neutral ones such as: informal; unrecorded; extralegal; unofficial (Alessandrini and Dallago, 1987); hidden economy; (Skolka in Alessandrini, 1987: 35-59); or shadow economy (Smith (b), 1990); to more negatively correlated terms such as irregular; illegal; underground (Feige, 1989) or black economy (Smith (b), 1990). The difference between these previous economists and De Soto is that they use the terms merely with a labour approach; and which point out *economic activities*, that are not included within the formal system. These 'extralegal' economic activities are preferred by these people in Third World countries based on social, economic, political or criminal reasons. The reasons include the desire of people to increase real income in short time (Alessandrini, 1987: 42); institutional constraints; to evade taxes (Mattera, 1985: 1); to establish a false entitlement to social security (Smith (b), 1990, 1); and to avoid compliance to the state regulations (Mattera, 1985, 1). Some economists, such as Jagannathan (1987), discussed the term in relation to property rights. For this reason, De Soto's approach in the *Mystery of Capital* is actually not a novel one.

This extralegal or informal sector comprises more than half of the Third World's economic activity. This situation is certainly not a desirable one. De Soto sees the potential of these poor people in the Third World countries to carry out economic activities, but their steps are mostly restricted. This is firstly, because of its informality or extralegality; and secondly, because these people cannot generate surplus capital from their informal, unregistered,

and (therefore) 'dead and unproductive', property. De Soto and his team even made a calculation on the amount of dead capital in the Third World and former communist nations. This comprises a huge amount of about US \$ 9.3 trillion (De Soto, 2000, 32). It is for this reason that in De Soto's account, the most important step for Third World countries is to integrate these extralegal systems into one system, through a formal legal property system.

Although De Soto has made many strong points, there are also some issues, which are not emphasized. Firstly, De Soto pays only little attention to the initial process that forced people to the cities; they built their huts on State land; and became informal city dwellers (Moore, 2004: 98). The situation is that most of these people move to the urban areas because of rural poverty. The main causes of rural poverty, include: no access to land, land apartheid or State's excessive control over land; lack of skill except to farm and unattainability of land; and lack of capital. In the Indonesian context, for example, research has shown that more than 75% of the poor in Indonesia are living in the rural areas, and more than 60% of the Indonesian poor work in the rural agricultural sector (The SUSENAS, 1999).

Secondly, De Soto advises the government of the Third World countries to seek for "the people's law on land or property" (De Soto, 2000, 170-171). This is, he says, the first important step to discover the informal sectors that the people engaged with. In a country like Indonesia, where it has a plural legal property system, this is certainly not an easy task. This is not only because the people's law is very diverse from one place to another; but also because of the process to find the law is difficult, due to the unwritten characteristic of the people's law –or called the *Adat* law.

Thirdly, building a mighty and complex formal legal property system needs a support from the ruling government. For this objective, the government must be clean and mighty, represents the majority of the people; and has aims to generate and distribute wealth fairly for all citizens. This has become the main political problem of many Third World countries that mostly characterized by a corrupt and authoritarian government. For this reason, the realization of De Soto's theory will face a great challenge from the government structure.

This book is indeed important and beneficial, particularly for Third World countries. Since the idea in this book is in line with many World Bank's programs, this institution has been the main supporter of the theory. This relates to many land administration programs the Bank had been working on in many Third World countries. Despite its controversy, the book is very interesting and offers a new perspective in seeing the informal sectors, a sector which had increasingly grown in Indonesia within the past five years.

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