The Mystery of Hernando de Soto: How To Generate a New Financial Bubble

by Luis Vásquez Medina

The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else
by Hernando de Soto
New York: Basic Books, 2000
276 pages, hardbound, $27.50

Amid great media fanfare, Hernando de Soto recently released his new book,[1] in which the author, unrestrained by any modesty, claims to have finally unveiled the "mystery" of capitalism.

The book's release was preceded by bountiful praise from numerous mouthpieces of globalism and international finance. Former U.S. President Sir George Bush, who while President had called De Soto "the Third World's most brilliant economist," commented: "Hernando de Soto's prescription offers a clear and promising alternative to the economic stagnation of the Third World." Milton Friedman, the guru of neoliberalism (i.e., free trade), said that De Soto "offers politicians a project which could contribute to the welfare of the country, while simultaneously increasing his political standing, a marvelous combination."

The book's release has also served as a political trampoline for the author. While De Soto remains frustrated in his aspiration to become a Presidential candidate in Peru, his book has won him a nomination as adviser to President Vicente Fox of Mexico, where his proposals for the "informal economy" already seem close to implementation. President Fox has announced the imminent "boom of mom-and-pop shops," given that his government will supposedly encourage the banks and mutual funds to reorient their portfolios toward the marginal sectors of small and micro-businesses. This reorientation will presumably take place, on De Soto's advice, as soon as an adequate registering of property is organized, which will enable these sad little "businesses" to become subject to credit checks.

In Peru, social democrat Alan García, who will be challenging Alejandro Toledo for the Presidency in the upcoming election runoff, and who pushes the neo-Thatcherite program of British Prime Minister Tony Blair's "Third Way," recently named De Soto as one of his most important advisers. And in the United States, Steve Forbes, the former Presidential candidate, owner/director of one of the country's largest financial publications, and champion of drug legalization, insisted that De Soto should be tapped by President George W. Bush to become head of the U.S. Agency for International Development (AID), and be given supervision of U.S. relations with the International Monetary Fund (IMF) and World Bank.

Why such praise? Because the essence of De Soto's new book is an outrageous scheme to mortgage the misery of one-third to one-half of the population—not just of Peru, but of the entire world—to thereby generate a new financial bubble of more than $9 trillion, in a desperate attempt to save the most bloated financial system in history. De Soto says: "We calculate that the value of real estate, but not of legally held property, in the possession of the Third World poor and those who are emerging from Communism, adds up to no less than $9.3 trillion."

Quite a Swindle!

A Peruvian lawyer educated in Switzerland in economics, De Soto's career was launched by the famous Peruvian pervert Mario Vargas Llosa, who wrote the prologue to De Soto's first book, *El Otro Sendero* (*The Other Path*), in which De Soto proposes the "legalization" of underground or informal economies, as part of the process of deregulating economies in general. De Soto specifically argues that the informal sector, which includes street vendors, micro-businesses of all sorts, and other forms of the underground economy, constitutes the most "dynamic" sector of the national economy, and that the government should incorporate it into the formal sector, through registering and deeding property, amid a general deregulation of the economy. His thesis is that, with these "legal-institutional" changes, economic growth would take off in the countries that implemented them.

However, rather than leading to improvement, his ultraliberal prescriptions, as applied in Peru, have aggravated

1. Although *The Mystery of Capital* was first published in English, all of the citations used in this review are translated into English from the Spanish edition, *El Misterio del Capital: Por qué le Capitalismo Triumpha en el Resto del Mundo,* Mirko Laver and Jessica McLaughlin, trans. (Lima: Editora El Commercio, 2000).

Hernando De Soto draws from the pernicious physiocratic doctrine of François Quesnay, the evil of Bernard de Mandeville, and the Jacobinism of Jean-Jacques Rousseau, to float an outlandish proposal for generating some $9.3 trillion in financial paper on the basis of the "assets" of the most marginalized poor.

chronic problems. For example, in *El Otro Sendero,* De Soto proposed the deregulation of the automobile sector, including advocating the free importation of used vehicles. Since the early 1990s, when De Soto was an adviser to the Alberto Fujimori government, Peru has imported approximately 250,000 small used buses, which had been discarded by other nations. For that quarter of a million junk vehicles, the country has paid at least $2.5 billion, funds would have been more than sufficient to construct an urban metro system. But, thanks to De Soto, all that capital today has vanished into smoke, and the streets of Lima and the other major cities are filled with broken-down vehicles.

For *The Mystery of Capital,* De Soto has relied on financing from the U.S. AID, the Center for International Private Enterprise, and the Brookings Institution. De Soto investigated, with the assistance of Her Majesty's Land Registry in London, the history of property registration in various countries. In Egypt, he had the help of the Egyptian Center of Economic Studies, run by Ahmed Galal. In Haiti, he worked with the economic team of the scary former President and current dictator Jean-Bertrand Aristide. In Mexico, he worked directly with the team of current President Fox, with Eduardo Sojo, Juan Hernández, and Fausto Alzati, among others. In the Philippines, he received help from deposed President Joseph Estrada. And in the United States, he is backed by neo-conservative sectors linked to the National Endowment for Democracy and the Heritage Foundation.

'Misery' Bonds To Save the Financial Bubble

In his new book, De Soto draws from the pernicious physiocratic doctrine of François Quesnay, the evil of Bernard de Mandeville, and the Jacobinism of Jean-Jacques Rousseau, to float an outlandish proposal for generating some $9.3 trillion in financial paper (stocks and bonds), on the basis of the "assets" of the most marginalized poor in the "informal" sector of the Third World and formerly Communist countries.

As De Soto admits, his proposal for generating "misery bonds" is a chip off the block of the "brilliant" Michael Milken, who invented "junk bonds" in the early 1980s—and ended up in jail for some of his "brilliant," but not necessarily legal, activities.

De Soto proposes something similar to what Milken did: Issue a large amount of financial paper—stocks, bonds, and credit—on the basis of the "housing" (actually, hovels), the ramshackle workshops, and other materials and equipment of the under- and unemployed. These people, thanks to 25 years of neo-liberalism, have become the "informal businessmen" who inhabit the "poverty belts" that surround nearly every Ibero-American city.

The only problem, according to De Soto, is that these "assets" are not legally recognized. Their owners do not have official deeds to their property, which therefore cannot be used as the basis for mortgages and credit.

Thus, argues De Soto, if capitalism is to triumph in the Third World and former socialist and Communist countries, the state must legalize these properties, and issue deeds to the homes and workshops of millions of "informals," thereby creating an efficient property registry system. Then, these deeds "could be used as guarantee for credits," and would be "the basis for creating values (for example, mortgage-backed bonds) that could be rediscounted and sold on secondary markets."

"Thus, through this process, capital is generated," proclaims De Soto enthusiastically, in the belief that he has "broken the barrier to producing capital" in backward countries.

Like the magician with his magic wand, De Soto has "created capital." But the reader should not be confused by this illusion of what capital is. For De Soto, capital—what moves an economy—is simply money, although he maintains that that money must be based on title deeds: "Money doesn't earn money; one needs a title deed before one can make money. Even when money is loaned, the only way to benefit from it is either by re-lending it or by investing it against some type of property deed which establishes rights over principal and interest."

Thus, the author concludes that "the system of formal property . . . is the place where capital is born."

'Social Contract' and the Drug Trade

De Soto's proposal requires an "adequate social contract," like that proposed by Rousseau and Thomas Hobbes, and which in essence is a social agreement about landed property. A social contract, he says, is the form whereby "people appropriate things and owners relate to one another." Further, "to create a national social contract over property, presupposes understanding the psychological and social processes—beliefs, wishes, intentions, customs, and rules—that exist in local social contracts, and then using the instruments which facilitate professional law to weave them into a single formal national social contract. This is what the Western countries achieved not so long ago."

One can see the legacy of Immanuel Kant very clearly here. For De Soto, it was Kant, the philosopher who promulgated Romanticism and the French Enlightenment, "who discovered that the true condition of the owner should be preceded by a social contract; all property law emerges from social recognition of the legitimacy of a claim."

Based on this, De Soto formulates a proclamation for what we might dub a "legalist" revolution, headed by lawyers, to carry out in the backward countries what supposedly made the development of capitalism possible in the Western industrial nations: a social contract "which efficiently regulates property for all, or at least for almost everyone."

This is a return to the anti-capitalist thesis, summarized in the liberal physiocratic dogmas of Quesnay, that land is the origin of the wealth of nations. However, De Soto is not only in debt to Quesnay for his notion of capital; he has also borrowed from Karl Marx's erroneous thesis on capitalist development. According to De Soto, Marx understood capital with greater clarity than did Adam Smith, because the author of *Capital* had the brilliance to discover the process of "primitive accumulation"; that is, the process of accumulation of money prior to and supposedly necessary for the appearance of capitalism. For Marx, this "primitive accumulation" is the amassing of money based on profits stemming from slavery, land rent, imperial trade, bank usury, and vulgar looting, and from freebooting.

Today, "primitive accumulation" could be represented by the profits of the drug trade. Further, the "informal sectors" of Third World economies are, to a large extent, mere tentacles of the huge drug-trafficking apparatus in these countries. It therefore comes as no surprise that many of the theorists of the informal economy and of deregulation, are also great promoters of drug legalization, including, for example, Milton Friedman, mega-speculator George Soros, and De Soto himself.

For Marx as for De Soto, "primitive accumulation" is a stage both prior to and necessary for capitalism. De Soto, in a chapter on the economic history of the United States, applies this concept of primitive accumulation (which in essence is a defense of slavery, robbery, and usury) to his dishonest view of the development of U.S. capitalism. As *EIR* has shown, the American System of political economy was, historically, diametrically opposed to British "capitalism."

A Fraudulent Treatment of U.S. Economic History

In a chapter entitled "U.S. History Lessons Not Learned," De Soto, in his zeal to give credibility to the physiocratic thesis that property is the origin of capital, presents a fraudulent view of U.S. economic history. He states that the invasion of foreign territories by American pioneers—"invaders," as De Soto calls them—was the basis for U.S. economic development. Thus, he turns the U.S. economic process into a history of imperial looting and spoils, which he dubs U.S. "primitive accumulation."

To illustrate his point, De Soto writes that in the 1670s, Lord Baltimore used "invaders" to colonize vast territories: The Penn family of Pennsylvania encouraged people to settle as much territory as they could; and adventurers such as "Ethan Allen and his invader cohorts practically seized the state of Vermont, before the 1776 revolution." In this process, says De Soto, "the most prominent feature of the nature of the invader was his violent and implacable hatred of the law."

For De Soto, primitive accumulation in the United States was not limited to the West, a relatively uninhabited region, but extended to neighboring countries, referring to the invasion of Mexico as one of the most important events in the formation of Yankee capitalism.

"From 1784 to 1850, the United States acquired nearly 900 million acres through conquest and purchase: Louisiana (1803) with 500 million acres; Florida (1819) with 43 million acres; Gadsen (1853) with 19 million acres; and the war with Mexico incorporated another 334 million acres."

He affirms that this process of looting, pillaging, and imperial invasion had the support of the state. In fact, he argues that this was official U.S. policy throughout the 18th and 19th Centuries. Thus, he writes, "from 1780 to 1848, the [U.S.] Congress gave 2 million acres of land to the soldiers who fought in the Revolution, 5 million to the veterans of the War of 1812, and 13 million to those who fought in the war against Mexico."

De Soto's main thesis in this chapter could be summarized by his assertion that the key to U.S. success lies in the fact that, at an opportune moment, the state "slowly" legalized this process of pillage and looting, based on an "adequate social contract." Institutional reform legalized ownership of illegally obtained soil, says De Soto.

The U.S. "proper social contract," according to De Soto, was the realization of the "Jeffersonian ideal" of putting property into the hands of private citizens, and made possible a system of property registration, which was the basis for the generation of "capital" based on mortgages, bonds, and other financial paper. In his words:

"Recognition and integration of the rights of extra-legal property, were key elements in making the United States the most important market economy and principal producer of capital, in the world. . . . In the 19th Century in the United States, a social agreement on ownership of farms, mines, and urban settlements was created, which produced a vast system of property ownership, upon which property was integrated into a formal legal system which allowed them to use it to create capital.

"U.S. property went from being the means of preserving an old economic order, to being a powerful tool for creating a new order. The result was broader markets and sufficient capital to promote explosive economic growth. This was the 'amazing' change that still today drives the economic growth of the United States."

What De Soto so pompously presents, is a version of U.S. economic history elaborated at Anglophile dinner parties, which has been exhaustively retailed by Ibero-American leftists and rightists alike, to attack the American Revolution. It hides the great truth, that the United States was the first successful anti-oligarchic republic in history, the first political form of the state which did *not* base its economy on some form of parasitic profit—whether slavery, land rent, or speculation.[2] The states and Constitution of the U.S. Republic, far from forging some form of Rousseauvian "social contract," were heirs to the Leibnizian tradition which sought the common good, or "General Welfare," promoting the self-perfection of its citizens in an environment of true freedom.

The American System of economics, in contrast to the British System of free trade and free enterprise, was not centered on the extensive exploitation (looting) of resources as such, but sought the development of science and technology as the key to economic development.

De Soto's version of history, in which he praises President Andrew Jackson as the darling of the "illegals," and explicitly attacks Henry Carey, Lincoln's economic adviser and a major exponent of the American System of economics, was fabricated to serve the interests of the oligarchy that has continuously sought to destroy the achievements of the American Revolution. By making policy recommendations based on such a hoax, De Soto reveals precisely who his bosses are.

The Great Fraud

The physiocratic and Marxist concept of capital that De Soto puts forth, is directly opposed to the Christian concept, that it is the developable cognitive capacity of the human mind that is responsible for the generation of real wealth. For industrial capitalism, historically identified with the American System of economics, this capacity to discover new, valid universal physical principles, and with it, the creation of new technologies and ever more perfect forms of production, is the true source of economic progress, and the origin of the increase in man's dominion over nature.

De Soto opposes all of this. He explicitly rejects educational and cultural advancements as the precondition for capitalist development: "A large portion of the agenda of necessary research to explain why capitalism fails outside the West, founders in a sea of unexamined and mostly unproven ideas, labelled as a matter of 'culture,' and whose principal effect is to allow too many inhabitants of the privileged enclaves of this world to enjoy a sense of superiority."

Thus, one needn't be all that brilliant to understand now why the appearance of De Soto's new book has been greeted with such fulsome praise from the representatives of the international financial community. His suggestions on how to generate capital in backward nations do not touch on the policies of the IMF. His sophisms hide the reality, that the lack of real capital in these economies results from the forms of commercial and financial looting to which they have been subject under the current international financial architecture. He further lies when he states: "The crisis of capitalism outside the advanced sector countries is not due to the failure of international globalization, but rather to the fact that the developing sector countries and those that are emerging from Communism have not been able to 'globalize' capital in their territories."

In sum, one could say that De Soto's proposal is but one more fevered attempt to keep the speculative financial bubble aloft a little longer, by injecting more "hot air." His bosses hope that it would accomplish the same thing today that junk bonds did in the 1980s, and financial derivatives and the dot-com stocks did in the 1990s. The "misery bonds" that De Soto promotes are only the latest desperate attempt to create a new speculative niche, literally based on the hunger and poverty of the Third World.

Without even blushing, the snake-oil salesman De Soto has begun to tour the plazas and parks of Lima, telling the poor that they are not really poor, but rich, and that their miseries "are worth double all the money circulating in the United States."

Now we know why Margaret Thatcher has said: "*The Mystery of Capital* has the potential to create an enormously beneficial new revolution. It should be mandatory reading for everyone responsible for 'the wealth of nations.' "

2. As American System economist Henry C. Carey proved, the pre-Civil War U.S. economy as a whole did not profit from the slavery that existed in the Southern states. The net economic benefit of that slavery was enjoyed, not by the internal economy of the U.S.A., but by the British monarchy, looting the U.S. physical economy. See Henry Carey, "The Slave Trade Foreign and Domestic," in W. Allen Salisbury, *The Civil War and the American System: America's Battle with Britain, 1860-1876* (Washington, D.C.: Executive Intelligence Review, 1992). See also Lyndon H. LaRouche, Jr., "The Tragedy of U.S. Education: Shrunken Heads in America Today," *EIR,* April 20, 2001.