

# Formalizing property rights why (not)?

## Security of land tenure in relation to economic development

**M.E. Hoefsloot - 1007157**

Faculty of Civil Engineering and Geosciences  
Department of Geodesy, Department of OTB  
Delft University of Technology  
Jaffalaan 9, 2628 BX Delft, the Netherlands  
Email: m.e.hoefsloot@student.tudelft.nl

This essay is the written assignment for the workshop: Security of land tenure in relation to economic development, as part of the course Land Management. In this essay, I will focus on the reason why we should entitle land. This will be with use of “The Mystery of Capital” by Hernando de Soto (2001) and three reviews of it from Woodruff (2001) and Fernandes (2002 and 2004).

### 1. Introduction

Problems concerning the optimal use of land resources and improved land management are important all over the world. With increasing population pressure, a greater need for environmental controls, and the mystery of missing capital - as de Soto (2001) wrote about it – the problems must be given greater attention. It is easy to find examples of the misuse of land resources, weak or non-existent planning, poor management and insufficient land regulation. The remedies are often difficult to develop and still more difficult to implement. In the words of the Preamble to the Habitat Agenda that resulted from the Habitat II Conference in 1996:

The most serious problems confronting cities and towns and their inhabitants include inadequate financial resources, lack of employment opportunities, spreading homelessness and expansion of squatter settlements, increased poverty and a widening gap between rich and poor, growing insecurity and rising crime rates, inadequate and deteriorating building stock, services and infrastructure, lack of health and educational facilities, improper land use, insecure land tenure, rising traffic congestion, increasing pollution, lack of green spaces, inadequate water supply and sanitation, uncoordinated urban development and an increasing vulnerability to disaster. (UNCHS 1996)

Access to land and security for credit underpin the solutions to most of these problems. Therefore,

there is a need to ensure that good land administration mechanisms are in place. This essay examines why (not) and how (not) this may be done. In particular, it

1. provides an introduction to the role that land plays in economic development;
2. focuses on the possibilities, pros and cons of formalizing properties;
3. gives hints, how to implement and execute a land titling process.

### 2. Land in economic development

Land, together with its associated buildings and construction, is, according to Dale and McLaughlin (1999), one of the most important financial assets in any country. Every investment is in some way or another dependent on land and property. Without land no shop or factory can be built, no road or railway constructed, there can be no schools or hospitals, and there can be no government or private sector buildings. Without the security of title to land or buildings, it is difficult to obtain investment funds and venture capital. Poor land administration is an obstacle to the growth of an economy, banks for example are hesitant to meet the needs for financing without security of title, because of the higher costs and more significant risks. Legal security of land tenure facilitates mortgage-based investment financing for small and middle-scale businesses and underpins the physical infrastructure of almost all commercial operations.

Good land administration contributes to economic development in a number of ways. It provides security to investors and permits real estate to be traded in the market place. It also allows governments to raise taxes based on the value of land and property, either at the time of land transfer or directly and annually on the estimated worth of the land or property. This is practically the same as a tax on wealth and has the

further advantage that unlike personal income, buildings and the land on which they stand cannot easily be hidden from the tax collector.

Above arguments of Dale and McLaughlin (1999) can also be found in the book of de Soto (2001), but not everyone agree with this, Woodruff (2001) and Fernandes (2002 and 2004) for example renounce it, I will come to that in Chapter 4.

### **3. Formalizing property rights**

Property systems may be formal or informal. Formal property systems are those where the interests are explicitly acknowledged and protected by the law. This is the case for the vast majority of property rights in developed countries. Informal property interests are those that are recognized by the local, informal community but which are not formally acknowledged by the state. They exist in most developing countries outside the legal system and are often the result of inadequate legislation, or excessive and inefficient bureaucracies.

Informal systems of tenure provide no state security but can, in practice, be sufficiently robust for the people in the areas concerned to invest in housing and development. In general, formal systems only give rise to security, if they are properly administered; where the formal system is poorly managed or where it does not have the support of the majority, security may break down.

Regardless of their origins, informal rights do not exist merely because someone claims them. Instead, people within the informal community agree among themselves as to where and how each can exercise these rights. The social basis of informal ownership is often clear defined. People are encouraged to operate in the informal sector when the costs of legal transactions increase.

### **4. “The Mystery of Capital” from de Soto (2001) and critics to his book**

In his book, de Soto intends to demonstrate that the major obstacle that keeps the rest of the world from benefiting from capitalism is its inability to produce capital. Capital is the force that raises the productivity of labour and creates the wealth of nations. It is the lifeblood of the capitalist system, the foundation of progress, which the poor countries of the world cannot seem to produce for themselves. No matter how eagerly their people engage in all the other activities that characterize a capitalist economy.

In a confronting introduction, de Soto takes us to an imaginary country where nobody can identify who own what, addresses cannot be easily verified, people cannot be made to pay their debts, resources cannot conveniently be turned into money, ownership cannot be divided into shares, descriptions of assets are not standardized and cannot be easily compared, and the rules that govern property vary from neighbourhood to neighbourhood or even from street to street. Nevertheless, people are most of the time content with their life and their belongings.

So, one can ask oneself why the informal property system should be turn into a formal property system. Formal property systems of the western society produce six effects that allow their citizens to generate capital. The aim of formalizing property was to secure ownership, but in de Soto's words, a full property registration system means “People who do not pay for goods or services they have consumed can be identified, charged interest penalties, fined, embargoed, and have their credit ratings downgraded”, this is not security of ownership at all.

One important argument, which is not mentioned before, but which is maybe the reason why land titling is not preferable is that much of the land on which the informal houses are built was obtained through invasion, taken from its previous owners without compensation. The current owners have these assets only because property rights have not been sufficiently enforced in the developing world to prevent them from being taken.

### **5. Benefits of formalizing property rights – concluding remarks**

Because of above argument, I can say that formalizing property rights programs should taking into account the local historical, cultural and political contexts as well as the existing forms of tenure arrangements, both legal and customary, and formal and informal. Individual property ownership will always be an attractive option that should be considered, but there are other legal-political alternatives.

It is important to note that individual beneficiaries of titling programs often do not have a full understanding of the protection, limitations and consequences of their title, educational programs for both city officials and residents should accompany the introduction of any formalization programs.

## References

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