Are Hernando de Soto's views appropriate to South Africa?

Graduate School of Public and Development Management

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Foreword

THIS PUBLICATION is the first of a series to be published as an outcome of intellectual enquiry at the Graduate School of Public & Development Management (P&DM) of the University of the Witwatersrand.

It arose from a colloquium, co-hosted with the Development Bank of Southern Africa, which focused on issues of title, land, housing, asset creation, and credit.

During the 1990s P&DM successfully provided housing education, including a Housing Certificate course, and hosted the International Housing Finance Programme based at the Wharton School of the University of Pennsylvania. The colloquium and this publication represent a revival of that earlier interest, which will be broadened to include land issues as well as housing.

P&DM academics and associates are engaged in academic and research activity in two focus areas, namely management and service delivery, and public policy and governance. The new occasional paper series will be used as a vehicle for publishing their work as well as the views expressed in the course of future engagements.

Prof Francis Antonie
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Kingwill, **Cousins**, **Hornby** and **Royston** are also involved in the Leap Project, a learning approach to promoting tenure security for the poor and vulnerable in South Africa.

Are Hernando de Soto's views appropriate to South Africa?

SINCE THE late 1990s the views of the Peruvian economist Hernando de Soto have had a growing impact on the international development community. They are also increasingly influencing South African policy-makers and planners; elements of his thinking are clearly discernible in the government's new housing plan, *Breaking New Ground,* as well as its Accelerated and Shared Growth Initiative (AsgiSA).

De Soto's views have not been properly examined and debated in the South African context

De Soto's proposition that the formalisation of land tenure can bridge the gap between the informal and the formal economy by bringing 'dead capital' to life speaks straight to the first and second economy[1] articulated by President Thabo Mbeki. Moreover, during a recent visit to South Africa, de Soto declared that the country appeared to be like other developing countries in that despite 'lots of migration towards cities like Johannesburg … most of the people are excluded from the legal system'. He added that property was the 'genesis of the rest of the market economy', and that 'without property titles the merging of the first and second economies would be impossible'.

However, despite their growing local influence, de Soto's views have not been properly examined and debated in the South African context. In order to fill this gap, the Development Bank of Southern Africa (DBSA) and the Graduate School of Public and Development Management of the University of the Witwatersrand (P&DM) organised a colloquium entitled *Examining Hernando de Soto's Views and Their Applicability to Alleviating Poverty in South Africa.* Held in Johannesburg in June 2006, and attended by academics, government officials, and representatives of the NGO and business sectors, it was aimed at providing a forum for a critical analysis of de Soto's views in a South African context, and their relevance to development and poverty alleviation in this country. The colloquium was not intended to present or develop a polarised view; rather, it was an attempt to elicit different perspectives on the relevance of de Soto's ideas to the South African situation.

Before dealing with the various contributions, it might be useful to briefly outline the trajectory of land rights in South Africa. As happened elsewhere under colonisation, European settlers progressively dispossessed indigenous people of the land they had traditionally occupied. The settlers then created a formal legal system for defining land rights in South Africa, based on Roman-Dutch Law, with strong elements of English common law.[2] This system was designed to legitimise and consolidate individual freehold ownership of land, notably by settlers, and ignored traditional land ownership by indigenous communities. Under segregation, and then apartheid, black people were confined to 'reserves', where they were allowed to exercise traditional forms of land ownership, and denied formal ownership rights in the rest of the country.

As the South African economy grew, the need for an increasing and stable work force required that black labour be housed closer to the cities – ie, on the periphery of white urban areas. The apartheid government therefore introduced a variety of tenure options for black people, which did not include ownership but did provide for long leases in 'townships' adjacent to white urban areas. At the same time influx control and other measures were used to control the rate of urbanisation.

From its inception, the government's new housing policy was based on providing ownership rights to the historically disadvantaged

By the 1980s, due to economic and other pressures and dynamics, 'grand apartheid' had begun to unravel, and black people began ignoring the system created to control their movement and location. This resulted in the widespread informal occupation of land, notably on the periphery of cities and towns, throughout the country.

In 1994 South Africa's first 'democratic' government inherited a spatial landscape punctuated by very large informal settlements housing millions of disadvantaged and dispossessed people. Twelve years later, this legacy of apartheid, and the system of segregation before it, is still very much in evidence. Among other things, black people were subject to a bewildering variety of tenure forms, ranging from illegal occupation through traditional land tenure to various systems of partial land rights and ownership.

Among the many major challenges facing the new government after 1994 was that of dismantling the previous government's settlement policies. These included enormous backlogs in land and housing, as well as redressing past injustices through the restoration of land rights to those who had previously been forcibly dispossessed.

From its inception, the government's new housing policy was based on providing ownership rights to the historically disadvantaged. This included providing poor and low-income people with formal title deeds to large numbers of low-cost housing, built with state subsidies, as well as converting old rental housing stock to ownership and passing it on to long-term tenants. Over the past decade, nearly 1,5 million households have taken freehold ownership of minimally serviced sites with rudimentary top structures, and 500 000 households have been given title deeds to the township houses they had rented from the state under the previous dispensation.

The government's latest housing policy document, *Breaking New Ground,* which re-examines and redirects the 1994 policy, acknowledges that, for a variety of reasons, owners of these houses do not regard them as valuable assets. It therefore sets out policies intended to ensure that the houses delivered in future are seen to have value.

In the keynote contribution, Scott McKinney outlines the genesis of de Soto's thesis, and questions the extent of the potential for converting 'dead capital' into 'live assets'. He argues that:

> So far there is not much evidence that granting the poor title to their assets will unleash the mysterious power of capital, increase the rate of economic growth and close the gap between the poor and rich countries of the world. However, one suspects – and the evidence supports the suspicion – that granting the poor property rights and dismantling the mercantilist state will improve the life of the poor. This seems like a good enough reason to do it.

While the other contributors did not entirely reject de Soto's ideas, they – and those who participated in the ensuing discussions – raised important questions about the extent to which its suggested measures would have the anticipated effect in South Africa, given the specific conditions in rural, low-income housing, and informal economic sectors.

The banks say they cannot lend to the poor because they earn too little to sustain repayments

For example, Tomlinson draws attention to the heated debates over the years between the established banking institutions and the government over access to finance for the poor. The government argues that the poor should be able to access mortgage finance, which would help them to move up the 'housing ladder' and empower themselves economically. More specifically, over the past ten years the government has provided nearly 1,5 million households with homes, via its housing subsidy programme. However, counter to de Soto's dictates, the fact that many of South Africa's poor now have title deeds to homes has not resulted in them accessing formal credit, or these homes turning into 'valuable assets'.

The banks say they cannot lend to the poor because they earn too little to sustain repayments. Moreover, most of the poor are informally employed, whereas formal employment is key to mortgage lending.

Tomlinson also notes that, since black home ownership has become legal, many black households which have bought homes with mortgage finance have lost them when their economic circumstances worsened, either due to personal factors or because of rises in interest rates.[3] These households tend to stretch themselves economically when they buy these houses, and do not have any financial cushion to fall back on when they experience an unanticipated drop in income, or when interest rates rise, as they did in the late 1980s. Therefore, rather than being economically empowered by home ownership, many thousands of households have suffered a major financial loss.

Royston notes that the development debate is awash with metaphors to capture the various processes meant to occur in the developmental housing sector, including de Soto's bridge between the first and second economies, Anthony Giddens's trampoline, and Kecia Rust's housing ladder. She asks: just how will the bridge be built? How will the trampoline bounce the poor out of poverty, and what will happen if social safety nets are removed? How can the gaps in the rungs on the ladder be filled, and ascendancy be ensured?

She argues that the 'bridge' approach is faulty because it does not sufficiently segment the poor in a way that takes account of the particular difficulties they experience in addition to a lack of title. Applying a formal system to informal areas can often increase the risk to the poor as it de-emphasises assets as a safety net and seeks to turn them into a tradable commodity. Tenure security rather than title, she argues, is often more valuable to the poor.

Rust observes that de Soto's views on assets being turned into capital appear to support the notion of a 'housing ladder' for households. This assumes that a house grows in value over time through the normal appreciation of the property market. When a household sells its house, the profit it makes from the sale can be used to fund a more expensive house, and thus moves them up the ladder.

There is so much hype around de Soto's views that some of the more complicated realities he describes in his books are obscured

In the case of South Africa's housing subsidy programme, the ladder is envisioned as follows: the title deed is handed over on receipt of the subsidised unit, which provides a household with a 'housing asset' that can be improved and sold over time. This will provide them with a deposit and help them to access mortgage finance for a better house. This process can be repeated several times, thus allowing them to climb the 'housing ladder'. In addition, poor households can use their subsidised houses as security for business loans, again leading to an increase in wealth.

Rust describes a recent study of townships in South Africa that investigated whether title deeds were, in fact, creating wealth. The short answer was 'no', and the study revealed that the de Soto thesis requires four factors in addition to title deeds: 1) a functioning secondary property market; 2) sufficient affordable housing stock; 3) people able to afford housing finance; and 4) mortgage lenders willing to move downmarket.

Nevertheless, de Soto's notion of a 'housing asset' is compelling because, while the subsidised house may not be performing as a 'financial asset' – in other words, its tradeable value is not increasing – it does provide households with an 'economic asset'. The same study found that the most common use of houses was for business purposes, eg as crèches, home offices, and the production and storage of goods. Policy should therefore be aimed at helping households to realise livelihoods by offering support to the home-based SME sector, promoting backyard rentals, and so on.

Cousins and Kingwill note that de Soto's views offer a beguiling message: that capitalism can be made to work for the rural poor through formalising their property rights in land, housing and small businesses. These views are provoking strong opposition from NGOs, social movements and other bodies, which argue that simplistic prescriptions are inappropriate for the poorest and most vulnerable, and could have negative impacts on their security and well-being.

Drawing on case studies, they find – similar to Tomlinson and Royston – that formal title may reduce tenure security, and that formalisation of property rights does not increase lending to the poor. Moreover, research reveals that informal property systems currently support a vibrant rental property market, which formalisation could undermine. De Soto's approach, therefore, does not in fact mesh with a rural land system based on common property resources that are never exclusive to one person, but have fluid boundaries and flexible rules as opposed to more rigid formal systems of land tenure.

Cousins and Kingwill maintain that the dominant legal and administrative frameworks for holding and regulating property in South Africa should be urgently reformed, so that the principles which govern 'extra-legal' property in rural areas and urban informal settlements, and which often emerge within land reform projects, can be legally recognised and supported.

Schirmer argues that there is so much hype around de Soto's views that some of the more complicated realities he describes in his books are obscured, and that his work may hold some valuable lessons for promoting gradual but sustained processes of poverty alleviation. More specifically, the formalisation of property rights cannot be a mechanistic, top-down titling process, but should rather have real meaning for the people who are supposed to benefit from them.

In order to integrate the poor into the market system, interventions are required that change the character of the relationship between the poor and the state

De Soto challenges the view that poor countries require primarily resources and investment to develop. He maintains instead that those countries that contain the majority of the poor and lag significantly behind the developed world could, in fact, be considered asset-rich and capital-poor. This argument shifts the emphasis away from the material deprivation of poor countries to their institutional deprivation. Therefore, Schirmer holds, de Soto's most important contribution is to demand that development should be about building on existing initiatives, energies and assets. Property rights therefore become laws, conventions and practices that allow people to engage in formal economic activity and be integrated with the market economy. The establishment of property rights, however, as experienced in the West, was a long, difficult and gradual process involving fundamental social transformation. History is therefore far more complicated than de Soto's advocacy role suggests.

In order to integrate the poor into the market system, interventions are required that change the character of the relationship between the poor and the state. This requires processes of democratisation initiated by the state, the poor, or, preferably both at the same time. Development should therefore be about promoting the processes of change that will facilitate greater co-operation between the poor and the state, or as de Soto has recently stated, 'meshing (institutions) with people's beliefs'.

Schirmer argues that promoting de Soto's vision in South Africa will therefore require:

- opposing the current trends towards increasing state control;
- encouraging those programmes and those sections of the state that are seeking to co-operate with the market system; and

- promoting democratisation processes while eschewing populism and zero-sum confrontations.

Participants argued that the state needs to be wary of simplifying the challenge of lifting the poor out of the second economy

Hassen explores the role of the state and how this links to de Soto's thesis in a situation of growing poverty and economic inequality. He argues that a narrow focus on land titling results in an ignoring of alternative development strategies, while relying on 'imperfect credit markets' in which development is to occur. Central to addressing developmental issues, he argues, is a redistributive framework in which the state plays a much more interventionist role.

In sum, the colloquium attempted to unravel the 'mystery' of what happens as the poor proceed along a continuum of practices, which begins with informality and proceed to formality. Participants argued that the state needs to be wary of simplifying the challenge of lifting the poor out of the second economy and moving them into the first economy through the use of silver bullets such as land titling. Rather, development should promote democratisation processes while encouraging and strengthening the activities the poor are already engaged in.

The colloquium was convened by Glynn Davies of the DBSA, and Monty Narsoo and Mary R. Tomlinson of the P&DM.

Endnotes

1 President Mbeki's view that South Africa is divided into 'two economies', the one modern and well-developed, the other undeveloped and incapable of self-generating growth as a result of its 'structural disconnection' from the first economy. AsgiSA is one of the government's responses to the challenge of linking the first and second economy.

2 One of the results of the application of these legal systems was the development of a strong cadastral system describing and establishing each land parcel in the country.

3 During the late 1980s and early 1990s, when the black South Africans were first allowed to buy property, the mortgage rate soared from 12 per cent to 18 per cent in a matter of months, forcing may of these first-time home owners into default.

Making sense of de Soto

Scott McKinney

HERNANDO DE Soto's books, *The Other Path (1989)* and *The Mystery of Capital* (2000), are attempts to make sense of and learn from the massive rural-to-urban migrations of the post-war period. For example, the percentage of Peru's population living in urban areas grew from 35 per cent in 1940 to 65 per cent in 1981 (de Soto 1989:7) and 74 per cent in 2003 (World Bank 2005). *The Other Path* focuses on the city of Lima, Peru, which grew from 973 000 in 1950 to 4,4 million in 1980 – de Soto's group did its research there during the 1980s – and 8,2 million by 2005. Growth of this magnitude places more demands on the city – for housing, jobs and transportation – than can be satisfied. Desperate and ingenious people satisfy their needs in ways that are designated as 'informal.'

De Soto's books are attempts to make sense of and learn from the massive rural-to-urban migrations of the post-war period

In *The Other Path*, de Soto reports the findings of his Instituto Libertad y Democracia on the extent and nature of the informal sector, the costs and benefits of remaining informal rather than becoming formal, and the nature of the state that makes informality necessary. His group estimated that in 1985 some 69 of every 100 houses built in Lima were in the informal sector, and that 48 per cent of the economically active population worked in the informal sector, producing 39 per cent of GDP (ibid:12).

How is one to interpret this onslaught? One initial reaction is to suppose that the migrants living in these shacks – which clearly violate the city plan and city codes – are inhabited by lazy, immoral and sometimes criminal people, marginal to the economic life of the city. A later reaction is to see this as a necessary and appropriate response to the shortages resulting from the migration. When, in 1998, I visited La Lucha de los Pobres ('the Struggle of the Poor', or informal city) in Quito, capital of Equador, I discussed the homeless problem in the United States with inhabitants. Dumbfounded by the seeming passivity of the American homeless, they asked me why they did not invade vacant land and build their own homes. Why indeed? My reaction was to say that 'that sort of thing' just was not done in the United States, and that the police would enforce property rights. But, of course, an important part of de Soto's argument in *The Mystery of Capital* is that historically the new immigrants populating America did just 'that sort of thing', and that it has served the country's development well.

If economic times are supportive, informal housing settlements can become solid neighborhoods with services within 20 years, and itinerant street vendors can find a regular place to do business and finally settle in a market stall. The informal transport sector can negotiate the importation of buses that specifically satisfy their requirements (Lima), and the informal clothing sector can negotiate with capital-intensive cloth and thread producers to obtain the inputs required for locally produced Lee and Baboo jeans (Ecuador).

In *The Other Path*, de Soto begins to develop the argument that appears in fuller form in *The Mystery of Capital*. He reports the famous figures about how long it takes in Peru to acquire legal title to a home, namely 83 months (pp 136–39), the time and money it takes to open a formal store, namely 43 days and $590.56 (p 142), and the time it takes to build a market, namely 14,5 years (p 142). The high costs of becoming formal and the minor benefits of being formal account for the extent of informality. This situation is created by the mercantilist state, which concentrates on the redistribution of wealth rather than on creating the conditions for the creation of wealth. What is needed, he argues, is a good legal system that clearly identifies property rights. Good law 'guarantees and facilitates the efficiency of the economic and social activities that it regulates', creates incentives, and facilitates specialisation and interdependence (p 182). He concludes that '[a]ll the evidence suggests that the legal system may be the main explanation for the difference in development that exists between the industrialised countries and those, like our own, which are not industrialized' (p 185).

De Soto asks: 'Why does capitalism thrive only in the West, as if enclosed in a bell jar?'

De Soto takes up the discussion in *The Mystery of Capital*, asking: 'Why does capitalism thrive only in the West, as if enclosed in a bell jar?' It fails elsewhere, he concludes, because the poor are not given the means to produce capital. The poor save and accumulate assets, but because the assets are not formally owned there are limitations on their owners' ability to trade those assets, use them as collateral, and sell shares in them (pp 5–6). For this book his research team moves beyond Lima, identifying and measuring the assets held by the poor in Haiti, the Philippines, and Egypt. They report a total value of $9,3 trillion held but not legally owned by the poor of the second and third world countries (p 35).

De Soto draws on Adam Smith to develop the argument that capital enables the specialisation and resulting growth of productivity that is the foundation of economic growth and higher standards of living. 'What I take from him, however, is that capital is not the accumulated stock of assets but the *potential* it holds to deploy new production' (p 42). Having secure property rights to one's assets 1) makes it possible to use the assets as collateral for loans; 2) makes the assets fungible, so that they can be combined with other property or divided into shares; 3) protects transactions concerning the property; and 4) provides location and information useful for transactions (ch 3).

In a brief review of the development of property rights in the United States, de Soto points out the ways in which 1) voluntary associations of farmers or miners would keep track of property ownership; and 2) the formal legal system would accept and adopt these *de facto* systems and make them *de jure*. The integration of the formal and informal sectors makes it possible for property to be recognised and used outside a small group so that the assets become fungible and can become productive (ch 6). He concludes that '… only twenty-five of the world's two hundred countries produce capital in sufficient quantity to benefit fully from the division of labor in expanded global markets' (p 209). It is capital which supports specialisation, increased productivity and production, and wealth. The failure of capitalism and globalisation is due to the inattention to property (ch 7).

De Soto's arguments and figures have been controversial. The methods that were used to produce the estimates have been criticised. Thus Christopher Woodruff (2001) estimates that the value of untitled real estate in developing countries is more on the order of $3,6 trillion than the reported $9,34 trillion. He points out, however, that even if each dwelling is valued at $5 000 instead of de Soto's $20 500 there would be more than enough collateral to cover the $1 000 median replacement cost of capital of Mexican firms with five or fewer workers. On the broader question of land titling, Woodruff concludes: 'There is almost certainly something to what de Soto says in *The Mystery of Capital.* The question is, how much? Land titling is made to sound like a free lunch. But without a broad set of complementary reforms, property titling and registration systems are likely to have a more limited effect than de Soto's (very refreshing) enthusiasm would lead one to believe' (ibid:1222–3).

So far there is not much evidence that giving the poor title to their assets will unleash the mysterious power of capital

The question is, how much? Urban titling programmes have been implemented in numerous places. De Soto's Instituto Libertad y Democracia carried out a pilot programme that was then extended by the Peruvian government, ultimately titling 1,2 million households. Studies of this programme and titling programmes in Guayaquil in Ecuador and Buenos Aires in Argentina find that as a result of having secure property rights:

people place a higher value on their property (perhaps because it can be sold or rented more easily);

households invest more heavily in their property;

people work away from the home for more hours a week (because of the reduced need to protect the property);

fertility falls (in Peru, where putting women's names on the titles was encouraged); and

increases in access to credit are small and insignificant.

So far there is not much evidence that giving the poor title to their assets will unleash the mysterious power of capital, increase the rate of economic growth, and close the gap between the poor and rich countries of the world. However, one suspects – and the evidence supports the suspicion– that giving the poor property rights and dismantling the mercantilist state will improve their lives. This seems like a good enough reason to do it.

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Are title deeds a silver bullet for accessing credit?

Mary R. Tomlinson

WHEN, IN 2005, the Peruvian economist Hernando de Soto visited South Africa, he observed that it appeared to be like other developing countries in that despite 'lots of migration towards cities like Johannesburg … most of the people are excluded from the legal system'. His views have attracted the attention of both the South African government and private sector. For example, the government's current housing strategy, *Breaking New Ground: A Comprehensive Plan for the Development of Sustainable Human Settlements* (2004), states that one its main objectives is to 'unlock dead assets' – a phrase used by de Soto to describe his strategy for formalising the property rights of the poor.

In a nutshell, de Soto argues that if poor people are given title deeds to property they traditionally occupy, they can use this to empower themselves economically – for example, by using them as collateral for loans from financial institutions, which they could use to start a small business. The objective of this paper is to examine the applicability of de Soto's views to South Africa – particularly the notion that poor people could use property as collateral for business and other loans.

De Soto argues that if poor people are given title deeds to property they traditionally occupy, they can use this to empower themselves economically

Background

De Soto, in line with development agencies such as the World Bank, emphasises that the main stumbling block to development is the inability of the poor to produce capital, because capital is the force that 'raises the productivity of labour and creates the wealth of nations' (2000:5).

In his most recent book, *The Mystery of Capital,* de Soto argues that the poor have many more assets and behave in a far more entrepreneurial fashion than is generally recognised. The resources they possess, however, are held in a defective form. For example, their rights to the land or houses they occupy are not adequately recorded, making them difficult to trace and validate. As a result, these assets cannot be used, cannot be traded outside of narrow local circles in which people know and trust each other, cannot be used as collateral for a loan, and so on – in short, they are 'dead capital'. In fact, de Soto argues that the conversion process required to transform the invisible into the visible has only occurred in the West, which explains why western nations can create capital and the third world and former communist nations cannot.

In 2004 a South African study entitled *Workings of Township Residential Property Markets* found that nearly R68,3 billion in township property was unrealisable in value because of a dysfunctional secondary market, in part due to titling problems. The report argued that the state should ensure that this situation was rectified.[1]

This paper does not dispute the fact that a house is by far the most important asset owned by the vast majority of households, especially if they are able to benefit from capital appreciation. Moreover, housing can clearly help to alleviate poverty if their owners rent out some space for either residential or commercial purposes. This applies to both subsidised as well as unsubsidised houses. It is also not disputing that, when appropriate financial and legal systems are in place, property may be used as collateral for business and other loans.

Hinging the problem of economic empowerment in South Africa on the lack of title deeds is simplistic at best

It does argue, however, that hinging the problem of economic empowerment in South Africa on the lack of title deeds is simplistic at best. First, this approach does not take into account the historical dispossession of black South Africans and how this has shaped their relationship to property in post-apartheid South Africa. Second, it does not acknowledge the lessons learnt from extending housing credit to low-income black South Africans in the late 1980s and 1990s, which had dire consequences for many households, mainly because they were unable to meet the bond repayments, resulting in attempts by banks to repossess those properties. This period pointed to the need for 'appropriate' credit, generally micro loans rather than mortgage loans, for low-income borrowers, as this does not expose them to losing their house when they fall into default (Tomlinson 2002).

Lastly, the de Soto thesis does not recognise the fact that nearly 80 per cent (or 8,7 million) of 11 million South African households earn less than R3 500 a month (StatsSA 2001). Members of these households are unlikely to be formally employed[2] or earn other forms of regular income, and are therefore unable to walk into a bank, or even a micro lender, and access credit in the way that formally employed people are able to do.

The history of property ownership by black South Africans

South Africa's urban areas have been shaped by the legacy of apartheid, notably racially based spatial planning and a political economy that developed the minority at the expense of the majority, separating both races and classes. Moreover, the apartheid strategy depended on treating different segments of the black population in different ways. This has resulted in inequitable residential patterns in urban areas, with recent migrants and young people in the most vulnerable positions. Unable to find permanent jobs, migrants and youths have been forced to live in unregulated and unrecognised accommodation, including shacks in back yards and informal settlements. Resources only begin to flow into these areas when they are recognised by the state. Poverty is therefore more than just an inability to access income; it also extends to a *lack of capital assets*, including land (Parnell 2004:14–15).

Hence, in South Africa's case, the argument that the poor can be economically empowered by 'unlocking' their assets is not entirely apposite, as black South Africans were, until very recently, legally prevented from owning property in most of South Africa.

South African housing policy

Following South Africa's transition to democracy, its housing policy was largely aimed at alleviating the housing backlog of about 1,5 million units, and catering for new family formation. Recommendations that were, to a large degree, incorporated into the new housing policy included:

Poverty is more than just an inability to access income; it also extends to a lack of capital assets

- moving the focus of the subsidy policy away from better-off first-time home buyers towards the 'poorest of the poor';
- providing secure tenure to low-income households (initially via ownership and later via rental); and
- facilitating the provision of mortgage finance via the retail banks.

The key element of the policy has been the delivery of a once-off capital subsidy to poor households – specifically, households earning less than R3 500 a month. While the subsidy has been able to deliver a serviced site and a rudimentary top structure, which has increased in size over time due to the introduction of minimum national standards, it is widely acknowledged that this sum is not enough to provide a 'four-roomed house', the vision held out by ANC politicians at the time of the 1994 elections.

By linking subsidies to mortgage loans, the expectation was that households would be able to afford a conventional house. However, due to affordability constraints, ie not having enough income to service a loan, less than 10 per cent of households have accessed mortgage finance along with their subsidies (Public Service Commission 2003).

Housing delivery data

Breaking New Ground describes the state-assisted investment of some R29,5 billion that has produced more than 1,6 million (freehold) housing options,[3] and has given some 500 000 households the opportunity to secure title of old public (rental) housing stock.

It notes that despite the high rate of delivery, the changing nature of demand and rapid urbanisation have meant that the size of the backlog has increased. The number of households living in shacks in informal settlements and backyards grew from 1,45 million in 1996 to 1,84 million in 2001 – an increase of 26 per cent. Moreover, it states that between 1996 and 2001 the population grew by 2,1 per cent on average a year; however, the country experienced:

- a 30 per cent increase in the absolute number of households, due to a drop in average household size from 4,5 in 1996 to 3,8 in 2001; and
- a rise in unemployment from 16 per cent in 1995 to 30 per cent in 2002 as a feature of the increased size of the labour pool and slow job creation, placing additional pressure on household income.

In sum, household numbers, and therefore the housing backlog, have increased, as has unemployment, thus decreasing household income of the poor. In other words, the households that make up the housing backlog are getting poorer over time, and will therefore continue to expect a free house from the government. And, if demand continues to outstrip supply, households already owning a subsidy house, or lucky enough to access one in future, will hang on to it very tightly.

Households that make up the housing backlog are getting poorer over time, and will therefore continue to expect a free house from the government

Lessons learnt from ten years of low-income housing finance

As noted earlier, South Africa's new housing policy was based on a commitment that the financial sector would provide sufficient end user finance to make the vision of a 'four-roomed house' a reality. Banks and non-bank lenders have offered various instruments (mortgage loans, pension/provident-backed loans, micro loans and savings linked to credit) in response to the demand for housing. Numerous lessons have been learnt from each type of credit over the past ten years.

By the mid-1990s the government's focus on mortgage bonds as the appropriate lending instrument for low-income households was already going against the lessons retail bank lenders had learnt in previous years. While extremely successful in the conventional housing market, traditional banking practices were turning out to be unsuccessful in the emerging low-income market, for a range of reasons.

Lessons learnt from mortgage lending in the late 1980s to early 1990s

The first blacks to borrow from the retail banks in the late 1980s were soon faced with a huge interest rate spike (from 13 per cent in 1987 to 20 per cent in 1989) that most could not handle. In addition, due to the decision by banks to replace down payments with collateral replacement insurance, most of these first-time borrowers had insufficient equity in their homes.

Moreover, a lack of understanding of loan conditions, due to a lack of experience of mortgage lending and limited education of borrowers, resulted in most first-time borrowers not fully understanding their financial commitments. These issues, combined with the shedding of nearly 500 000 formal jobs in the years following the 1994 elections, resulted in about 33 000 households going into default.

Many of these purchasers were angry about the poor construction of their houses, and were also disinclined to pay. Moreover, the threat of politically inspired bond boycotts, which had become a weapon of the 'struggle' against apartheid, were making it difficult for banks to repossess houses whose owners were in default. It soon became apparent that extending mortgage bonds to low-income households was problematic (Tomlinson 1998b, 1999a, 2002).

As a result of these difficulties, the banks developed a perception that poorer households posed a greater risk than higher income families, and largely abandoned the township housing market.[4] In fact, the Financial Sector Charter[5] (www.banking.org.za) negotiations have largely hinged on how to lessen what the banks perceive as the abnormal risks associated with the township market.

The Financial Sector Charter negotiations have largely hinged on how to lessen what the banks perceive as the abnormal risks associated with the township market

Lessons learnt from micro lending

As it became apparent that mortgage finance was inappropriate for the vast majority of South Africa's poorer households, low-income housing finance began to evolve in a different direction: both banks and emerging non-bank lenders, known at the time as 'alternative' lenders,[6] began providing a new and different financing product known as micro loans (Rust 2002a, 2002b).

Microfinance institutions (MFIs) provide various types of credit, including small cash loans targeting short-term borrowers, and larger loans of between R1 500 and R5 000 for up to three years. Most of these loans are made to formally employed, salaried individuals, ie people with regular rather than irregular incomes.

The loans are not secured with brick and mortar, as conventional mortgage loans are, and rely on repayments via debit orders arranged with employers. The risk of this less secure form of lending is covered by the price of the loan. In other cases, pension/provident fund benefits are used to secure the loans. These loans are primarily made for consumption, education and enterprise creation purposes, but MFIs have found that a large percentage of the funds are invested in housing.

Observation of lending patterns and primary research carried out in 1996 and 2003 (Tomlinson 1999b; Zack and Charlton 2003) have revealed that beneficiaries of the state housing subsidy actually prefer to take out several small loans which they can repay over time rather than a large mortgage loan, which requires regular, stable income for a minimum of 20 years and could expose them to losing their house if their economic situation worsens.

Moreover, micro loans have not only turned out to be better suited to the needs of lower-income borrowers, but also as better options for lenders, as they do not have to try to evict households in the case of non-payment. Rather, borrowers will lose a portion of their pension/provident funds, or, in the case of unsecured loans, the cost of default is built into the loan.

In a study conducted in 2005 for FinMark Trust on the pro-poor microfinance sector in South Africa, Baumann notes that when it comes to supporting employment creation, the government's policy has mainly been aimed at supporting small and medium enterprise (SME). This means that micro credit is only being made available to individuals with the right mix of assets (skills, education, time, energy, connections, savings, and so on), and does not reach down to the very poor.[7]

Since its inception in 1992, a R17 billion microfinance market has emerged, of which 30 per cent has gone towards developmental purposes (ie enterprise, housing and education). The Micro Finance Regulatory Council (MFRC) concludes that about 3 million people now have access to formal finance, the majority of whom did not have access to finance before. Moreover, the MFRC's initiatives in respect of disclosure, fair practice and so on have helped to create a safer lending environment for low-income borrowers (ECI Africa 2005:iii).[8]

Micro loans have not only turned out to be better suited to the needs of lower-income borrowers, but also as better options for lenders

Since the development of credit has largely been dictated by collection methods available to lenders, and the most common practice, the debit order, requires borrowers to be salaried, where has that left the vast majority of low-income households, which have no salaried incomes? A report prepared by ECI Africa and IRIS for the MFRC in March 2005 states that only developmentally focused MFIs – not formal financial institutions or private sector (ie commercial) MFIs – are extending loans to non-salaried people.

The need for a pro-poor microfinance sector

Baumann correctly draws policy-makers' attention to the fact that there are large numbers of poor South Africans who are unlikely to get formal sector jobs or even to succeed in small businesses, either as owners or employees.

Therefore, he argues that the lending methods appropriate to the very poor are those that identify, develop and employ community-level resources termed 'social intermediation methodologies' (SIMs), more commonly referred to as group lending. The purpose-specific social bonds formed among the participants reduce risk and become a substitute for traditional forms of collateral. Hence, by linking savings and credit and keeping the system simple and locally controlled (ie located in a community-based institution with low overheads), this form of lending will serve poor households far better than the costly and inaccessible services offered by commercial banks. Moreover, by linking savings to credit, this method mitigates risk in a way that will have a far less onerous impact on a defaulting household than if it used its title deed as collateral for credit.

But, how available is this more appropriate type of credit? There are only a handful of entities that currently deliver this form of finance; one of them is the Kuyasa Fund, a housing microfinance institution operating in Cape Town, which views itself as a 'development' finance institution. It provides credit to the traditionally 'high-risk' segment of the low-income market, ie unemployed, informally employed and pensioned borrowers, most of them women. Potential borrowers qualify for loans on the basis of savings, and an applicant has to produce a six-month savings record. The maximum loan granted is up to three times the savings, to be repaid within 30 months. Hence this system utilises the assets of the poor, but not in the form of a title deed (Van Rooyen and Mills 2003; Kuyasa Fund 2005).

Defining the low-income market

As noted earlier, when determining the credit needs of low-income households, the issue of affordability – ie the income required to successfully service various types of credit – must be clearly understood. More specifically, size of income, type of employment (formal and informal), and *regularity of income* will determine the type of credit best suited to various households. Similarly, particular types of lenders are better suited to delivering certain types of credit than others.

When determining the credit needs of low-income households, the issue of affordability must be clearly understood

Numerous attempts have been made to define the low-income market. A recent analysis by Illana Melzer of Eighty20 for FinMark Trust (2005) examined both the FinScope Survey (2004) and other relevant survey data. She also examined the results of the most recent version (2004) of the All Media and Products Survey (AMPS) and the 2001 Census.

AMPS indicates that there are 6,4 million households with a gross monthly income of R0–R2 999; of these 4,7 million earn less than R1 600 a month. It is this income group that makes up most of the residents of informal settlements in South Africa as well as the government's housing subsidy projects. According to the national census, about 7,3 million of South Africa's 11 million households earn less than R1 600 a month, and about 1,4 million households earn R1 601 – R3 200 a month. Therefore, some 8,7 million households earn less than R3 200 a month.

FinScope (2004) notes that a significant proportion of adults who earn less than R3 500 a month are unable to meet their families' basic needs. For example, 45 per cent of households earning less than R1 500 a month and 29 per cent of households earning R1 501–R3 000 a month had gone without food during the previous 12 months (Eighty20 2005:9). This implies that incomes in these lower brackets are irregular at best, making it impossible for those households to service mortgage bonds or possibly even micro loans.

Moreover, high poverty levels imply that the 'very poor' are already inclined to incur debt due to their inability to finance their short-term consumption and basic needs (termed adaptive consumption), let alone long-term asset accumulation. Households that spend more than 60 per cent of their income on housing, food, beverages and clothing are considered vulnerable. Living standard measure (LSM) 1–9 households (monthly incomes of R0–R11 555) are regarded as vulnerable as they contribute between 61 per cent and 62 per cent of their expenditure to these items (ECI 2003:3).

Lastly, the FinMark Trust's Financial Diaries (2005) (www.financialdiaries.com) contain some interesting information on the livelihood profiles of households.[9]

They state that households can have formal and informal and regular and irregular streams of income.[10] Regular wage earners tend to live in urban areas, and grant recipients in rural areas. Regular wage earners are at the top of the monthly income range, while grant recipients are at the bottom. The Financial Diaries also reveal that business owners (with an average monthly income of R1 964) tend to *provide* financial services rather than use them. In fact, one of the forms of financial management employed by business owners is to provide credit.

De Soto's conception of how property assets become active capital

The 'very poor' are already inclined to incur debt due to their inability to finance their short-term consumption and basic needs

In *The Mystery of Capital* de Soto notes that the great classical economist Adam Smith believed that capital was the engine which powered the market economy. De Soto takes this point one step further by focusing on the mystery of 'how accumulated assets become active capital, which can then put additional production in motion'. He argues that 'capital is not the accumulated stock of assets but the *potential* it holds to deploy new production'. This potential is abstract, and must be processed and given tangible form before it can be released, something that the West does through the intricacies of its formal property systems.

De Soto emphasises the importance of title deeds to economically empowering the poor. He therefore argues that developing countries should extend formal title to the poor, and develop quick and efficient titling systems. In Peru, his researchers found that it took 28 steps for a migrant to obtain legal title to land. In the Philippines, if a person wanted to build a house on either public or private urban land, this required 168 steps, involving 53 public and private agencies and taking 13 to 25 years.

De Soto argues that extra-legality has become the norm in many developing countries, with the poor taking control of great quantities of land and production, leaving governments with no choice but to integrate these resources into an orderly and coherent legal framework.

Title deeds in South Africa

As previously noted, a sound title and registration system is vital to housing finance, as it provides a basis on which lenders can confidently extend mortgages. South Africa's new housing policy was based on the principle that beneficiaries would acquire ownership, and therefore title. To date, about 1,6 million households have received a subsidy aimed at providing freehold title to a serviced site.

The extent to which title deeds had in fact been issued to former township residents, and the extent to which this had stimulated the development of normal property markets in these areas, were investigated in the study entitled *The Workings of Township Residential Property Markets* (2004). Households were interviewed in three phases at 18 sites in four metropolitan areas (Johannesburg, Ekurhuleni, eThekweni and Cape Town). Four submarkets were included in the sample (defined as medium and upper private stock, old township stock, RDP subsidy stock and informal stock), each with their own unique history and regulatory framework.

The study further defined the residential property market as being made up of two key components, the primary and secondary market. The primary market refers to new housing stock and requires a township establishment (cadastral) process – from identifying land to transferring title. The secondary market refers to the sale and transfer of previously built and owned housing stock, and requires willing sellers and willing buyers as well as finance.

The study found that a lack of title deeds was having a negative impact on the secondary market. It analysed the process of purchasing and transacting land in South Africa, as well as Deeds Registry data from 1999 onwards; one of the key issues examined was the title deed situation, that is, who has them and who does not (ie, the size of the urban backlog).

Sound title and registration system is vital to housing finance, as it provides a basis on which lenders can confidently extend mortgages

Its findings in respect of the various housing submarkets were as follows:

- The informal market: due to the illegality of informal settlements there were no title deeds in this market, and hence no formal transfers. Notably, *Breaking New Ground* envisages the upgrading and legalisation of these settlements.
- The RDP subsidy market: the issuing of title deeds was far behind schedule (as of December 2003 some 1 547 869 houses had been delivered, but due to delays in opening township registers only 1 308 585 had been formally transferred.
- The old township property market: in 1991 the government began a programme to transfer state rental stock to private owners; however, less than 50 per cent of old township houses had been been upgraded in terms of tenure; and
- The private township market: these are unsubsidised houses, purchased with mortgage bonds, and therefore their owners all had title deeds.

Interestingly, the study revealed that owners of houses in all these submarkets expressed extremely high levels of security: private (96 per cent), old township (89 per cent), subsidy (91 per cent) and informal (92 per cent). Therefore, whether or not they had a title deed, and whatever type of tenure they had, on average 93 per cent of respondents felt secure in their homes.

How do South Africa's poor view their housing asset, and would they use it as collateral for a loan?

The assumption that people – including home owners – are driven by self-interest, and therefore make rational choices, forms the basis of market theory. *The Workings of Township Residential Property Markets* found that socio-cultural factors also played a role in determining household behaviour around buying and selling property. This raises the question whether households would be willing to use their houses as collateral for a business loan, something which the study did not directly examine.

The responses of households about buying and selling their property (over 90 per cent were against selling) should therefore begin to give some indication of what other uses they would, or would not, consider with respect to their house.

The study (Shisaka 2003a) revealed that low-income households tended to view their housing asset as 'social and cultural' rather than as 'financial'.

Explanations for this included:

- Houses are viewed as a family rather than individual asset, thus limiting the ability of any one member of the household to sell them.
- There are social and cultural pressures not to sell – selling the family house and moving to a better neighbourhood can lead to family strife, because other household members may stand to lose from the sale.
- The house is a 'cultural' rather than a 'financial' asset – a house may have multiple values, with its 'cultural' value holding more importance to the family than its 'financial' value.
- The house maintains a presence – a township house allows an individual who has moved to former white suburbs to maintain a presence in and socio-cultural ties with the old areas.
- The retention of a house is a sign of respect for the memory of the parents and/or grandparents who struggled to gain ownership.
- Owning several houses limits the risk resulting from being dependent on the precarious economic situation in a particular area.

Low-income households tended to view their housing asset as 'social and cultural' rather than as 'financial'

This goes a long way towards explaining the behaviour of black households with respect to buying and selling property. These responses also shed some light on whether households would be prepared to use their property as collateral for a loan. The fact that houses are viewed as 'family' assets seems to militate against their being used by a single household member as collateral for a loan.

Conclusion

Any attempt to answer the question of whether de Soto's views are relevant to alleviating poverty in South Africa must take into account the history of material dispossession and deprivation in this country; the institutional environment in which assets are now being provided to address this deprivation; the lessons learnt from efforts thus far to provide credit to poor households; and household perceptions that houses are 'social' and 'cultural' rather than 'financial' assets.

The delivery of more than 1,6 million housing subsidies can be viewed as an attempt to address the severe material deprivation caused by apartheid. Moreover, the provision of freehold title to land and houses to the poor has meant that the country's cadastral system has had to be harnessed to establish these new townships.

However, because of the extent of the low-cost housing programme, huge backlogs have built up in the titling process. Should the government proceed with its plans to legalise and upgrade remaining illegal informal settlements, this will exert even greater pressure on the deeds registry system. Therefore, while South Africa is in a better position that other developing countries that either have no or very limited land titling systems, it does need to address this problem.

Addressing a recent Overseas Private Investment Corporation (OPIC) conference held in Cape Town, the senior director of property rights and land policy for the Millennium Challenge Corporation stated that 'it is a myth that titling brings credit'. In other words, title deeds are a necessary component of land markets, but are insufficient in themselves to attract credit.

This is because accessing credit is far more complex than it seems at face value, with some types of credit being more appropriate to various types of low-income borrowers than others. Experience in South Africa has shown that low-income households easily become overborrowed, and that, if their loans are in the form of mortgage bonds, their homes are at risk. Given the difficulties of repossessing township houses, banks are still working off the effects of the mortgage loan defaults of the late 1980s and early 1990s, and are unlikely to return to using brick and mortar to secure small entrepreneurial loans.

Accessing credit is far more complex than it seems at face value, with some types of credit being more appropriate to various types of low-income borrowers than others

But not being able to use a title deed as collateral for business loans does not mean that low-income households should not access other, more appropriate, forms of credit, including micro loans, savings linked to credit, SMME credit, and overdrafts. And while in the past lending institutions concentrated on the sources of income (formal and salaried), today they are beginning to look to income stability and credit history (where available).

Oddly, in *The Mystery of Capital*, de Soto never distinguishes between classes of credit. He either refers generically to 'credit', or describes using title as 'collateral' for a mortgage. The index contains one entry on microfinance, and nine on mortgage finance. Rather unhelpfully, de Soto points out that in the United States, for example, up to 70 per cent of credit extended to new businesses comes from using formal titles as collateral for mortgage loans.

So, when de Soto talks about economically empowering the poor by giving them title deeds to their property which they can then use as collateral for a loan, is he talking about formally employed, salaried people who qualify for mortgage bonds, are able to make the repayments, and are therefore equipped to use their homes as collateral for business loans? This is certainly not the core of the problem in South Africa.

Rather, one has to assume that he is referring to people who are struggling to subsist and are striving to become self-employed. These individuals need money to purchase small amounts of stock, cover simple overheads, and ride out periods when income is not being generated. This type of small enterprise is renowned for going under more than once, which means that using a home as collateral for business loans would be irrational behaviour on the part of the borrower.

Even experts in property rights will argue that when land is used as collateral, foreclosure must be a last resort, and with sound due process. If this is not the case, unscrupulous manipulators will use title deeds to take over people's land.[11]

De Soto's views have become conventional wisdom throughout the world. Governments of developing countries in particular seem taken with his 'silver bullet' approach to economically empowering their poor – ie, give them title deeds, and credit will follow. An examination of the situation in South Africa at least has revealed this is not the case. Land titling should be a priority for all governments, but that is a separate issue from using title deeds as collateral for business loans for the poor.

Endnotes

1 The study was conducted by Shisaka Development Management Services and was jointly sponsored by the FinMark Trust, the Ford Foundation, the Micro Finance Regulatory Council (with support from USAID), the South African National Treasury, and the National Housing Finance Corporation. Its purpose was to reach a better understanding of the dynamics of township property markets in South Africa and the elements that contribute towards their functionality/dysfunctionality, and to make policy recommendations aimed at improving their functioning. See FinMark Trust [online], http://www.finmarktrust.org.za/themes/trpm/trpm.asp.

2 FinScope 2003 revealed the following sources of income for LSM 1–5 (money from family 30 per cent, work for salary from company 13 per cent no money 16 per cent, work for salary from individual 14 per cent, self-employed 6 per cent, government/pension 7 per cent, child grant 8 per cent, and piece work 8 per cent). Only 27 per cent of the households in the LSM category are in salaried (formal) employment.

3 Over the years, the state subsidy has increased from R12 500 to about R31 000, which has generally resulted in a 30 square metre structure.

4 Organised bond boycotts are very rare today, and the financial sector is now more concerned about what it views as the 'dysfunctionality' of the secondary market – ie, the absence of the normal buying and selling of property due to a lack of stock and other factors (Shisaka 2003).

5 Launched in 2003, The Financial Sector Charter is aimed at transforming the financial sector, including increasing investment and extending lending into the low-income housing market.

6 'Alternative' lenders began to emerge in the late 1980s. They include micro lenders, niche market (housing-focused) lenders and NGO lenders, all of which are considered to be non-deposit taking institutions, which means they are regulated by the Usury Act rather than the Banks Act (Rust 2002a, 2002b).

7 The National White Paper on Small Business (1995) suggests that the largest component in the South African SMME economy is the 'survivalist' sector which it estimates at 2,5 million businesses, compared to 800 000 SMEs (Bay Research & Consultancy Services 2005).

8 Despite improvements in credit checks, the MFRC reports that defaults are significant; statistics reveal that between November 2000 and February 2004 arrears (clients who

are 60 days or more in arrears) have hovered between 30 and 40 per cent across eight registered housing lenders.

9 Profiles included regular wage earners, grant recipients, remittances from relatives, business owners, casual workers, and formal pension recipients.

10 The Financial Diaries project noted that for the various livelihood strategies the monthly income includes all sources of income, not just the main source. Hence, the highest monthly income group, regular wage earners, includes all forms of income in the overall amount.

11 According to a manager of the Kuyasa Fund, unscrupulous operators in the Cape Town area are extending small loans with title deeds as collateral in the expectation that the borrowers will default.

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Snakes and ladders:

A housing perspective on de Soto and the first and second economy debate in South Africa

Lauren Royston

De Soto's assumptions about title are faulty unless an approach is adopted that segments the market, or differentiates 'the poor'

HERNANDO DE Soto's thesis that giving the poor formal title to the land or property they occupy can bridge the gap between informal and formal economies and help to advance market-based economic development in developing countries speaks directly to the first and second economy debate in South Africa. This paper examines the extent to which his ideas are reflected in the Accelerated and Shared Growth Initiative of South Africa (AsgiSA), as well as the current discourse on housing policy. By identifying the secondary objectives of the housing policy, particular economic ones, a link is made with de Soto's claim that capitalism can work for the poor.

I argue that de Soto's assumptions about title are faulty unless an approach is adopted that segments the market, or differentiates 'the poor'. Such an approach reveals that the poorest are still not catered for, although his proposals may be more appropriate for some households in the 'gap' housing market (households that earn too much to get state subsidies but not enough to secure mortgage finance – ie, R3 500 –R7 500 a month). This approach builds on the notion that 'the poor' are not homogenous, but also recognises that access to title has a place in some segments of the market which has historically been denied it.[1] In my experience, this approach opens up debate instead of shutting it down. I identify why these assumptions are faulty, and then add a particular housing perspective to the critique, taking the market segmentation approach further.

De Soto, the dual economy, and AsgiSA

In his book *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, de Soto argues that the failure of capitalism to progress in developing countries is related to a lack of well-defined systems of property law and records. He contends that, when people own assets informally, they cannot use them to procure capital. He argues that the formalisation of such property rights will unlock what he calls 'dead capital' and contribute to economic development, particularly in third world and former communist states (Royston 2006). De Soto offers a simple yet beguiling message: that capitalism can be made to work for the poor if their ownership of land, houses, and small businesses is recognised and formalised (Cousins et al 2006). He calls for the creation of a single integrated property system that incorporates all the previously disparate extralegal property arrangements typically found in developing countries – in short, a new 'people's law', or all-encompassing social contract. De Soto and his colleagues call this 'the capitalisation process', and provide a formula for discovering and decoding extralegal arrangements, putting in place the legal and political mechanisms for introducing this new dispensation, and devising operational and commercial strategies for bringing capital to life. In short, he offers a way of making capitalism work for the poor in developing countries (Royston 2006). To illustrate his central thesis, de Soto uses the image of building a bridge from the extralegal sector, marked by 'dead capital', to the legal sector, marked by 'living capital'.

De Soto's notion of two economic sectors resonates strongly with that of the dual economy prevalent in South African policy discourse. This debate has been sparked by President Thabo Mbeki's widely publicised statements that South Africa is divided into two economies, the one modern and well-developed, the other underdeveloped and incapable of generating growth as a result of its 'structural disconnection' from the first economy (Mbeki 2003, cited in Cousins et al 2006). AsgiSA is one of the government's responses to the dual economy, as one of its objectives is to create new linkages between the first and second economy. Intended to serve as a major engine for achieving the UN's Millennium Development Goals of halving unemployment and poverty by 2014, AsgiSA is also aimed at achieving a range of other macroeconomic goals, including improving the efficiency of the state, creating better conditions for business, closing the skills gap, and improving governance. The AsgiSA base document argues that South Africa's full growth potential will remain unrealised as long as a significant part of the population is excluded from the mainstream economy. It also alludes to the criticisms of social welfare with reference to the social grant programme, which I will return to later when I refer to the 'safety net' and 'third way' approaches. It asserts that, although the social grant programme is contributing significantly to poverty reduction and income redistribution, about a third of South African households remain unable to benefit directly from the country's economic success. So there are parallels to be drawn between de Soto's legal and extralegal divide and South Africa's dual economy. More specifically, AsgiSA is organised into six interventions to counter major constraints to economic growth, one of which is labelled 'second economy interventions'. The others are macroeconomic issues, infrastructure programmes, sector investment strategies (or industrial strategies), skills and education initiatives, and public administration issues.

De Soto's notion of two economic sectors resonates strongly with that of the dual economy prevalent in South African policy discourse

AsgiSA's second economy interventions are based on the premise that, without initiatives directly aimed at reducing South Africa's historical inequalities, economic growth will be unsustainable. These are aimed at bridging the gap between the first and second economies, and ultimately eliminating it altogether. AsgiSA also uses the metaphor of a bridge to describe the interventions needed to address the disjuncture between the first and second economies. One of the key mechanisms envisaged is to use the strength of the first economy as a lever to improve the second. Two key examples of this are increased levels of public expenditure as well as certain sector strategies to address development goals in the second economy. Another set of second economy interventions is centred on the challenge of realising the value of 'dead assets', and it is here that the link with de Soto is most obvious. AsgiSA provides examples of dead assets as being land, houses, livestock, skills, indigenous knowledge, and other assets with intrinsic value that are not currently recognised or realised. Both land and housing assets are relevant to this argument. Moving more rapidly towards formalising land tenure is one of the second economy interventions cited in ASGIS-SA; another is ensuring that the financial services charter on housing finance is effectively implemented, once again reinforcing the general alignment with de Soto-type thinking. Other interventions are the livestock improvement programme, improvements in planning and zoning capacities, and support for the development of co-operatives.

it is clear that AsgiSA resonates with the de Soto thesis

Therefore, it is clear – even from this brief overview – that AsgiSA resonates with the de Soto thesis. De Soto proposes formal title as the main mechanism needed to 'bring capital to life'. In line with this, AsgiSA proposes the formalisation of traditional land tenure as a means of realising the value of 'dead assets' in the second economy.

Figure 1: AsgiSA and de Soto: the housing perspective

Formal property in de Soto:

- formal recognition of property will 'bring dead capital to life'
- 'capitalise the poor' by legalising their extra-legal property
- document property rights and turn them into assets that can be more widely traded or used as collateral for loans

Formalisation of tenure in AsgiSA:

- intervention aimed at bridging the gap between the first and second economies, thus reducing inequality and helping to achieve sustainable growth

De Soto and the housing policy discourse

The South African Minister of Housing, Lindiwe Sisulu, has referred to de Soto in approving terms, recommending that government strategies 'take into account the new thinking that has evolved internationally to end poverty' (Sisulu 2005:70, quoted in Cousins et al 2005). The government's current housing policy document, *Breaking New Ground* (BNG), takes this idea further. Approved in September 2004, BNG is the government's 'comprehensive plan for the development of sustainable human settlements' over the next five years, and is the most significant housing policy statement since the White Paper on Housing of 1994.

BNG states that despite delivery at scale the size of the housing backlog has increased, largely due to urbanisation and the changing nature of demand. It acknowledges that the 1,6 million subsidised units built thus far have not become valuable assets in the hands of the poor, and also that municipalities often view low-income housing projects as liabilities because of the non-payment of municipal services and taxes. BNG expands the housing mandate to accommodate lower-middle income groups (defined as those households earning between R1 500 and R7 000 a month) via access to a credit and savings-linked subsidy, to be finalised under the Financial Services Charter.

BNG has two sets of objectives: primary ones, directly related to housing, and secondary ones aimed at achieving a series of 'spin-off' benefits, most of them economic. Some of the latter – particularly 'realising the value of assets', and 'reducing duality in the housing sector' – clearly resonate with de Soto's thinking. Figure 2 reflects the BNG's objectives in these terms, and highlights the envisaged spin-offs relevant to this analysis, namely 'property as an asset for wealth creation and empowerment', 'leveraging growth in the economy', and 'reducing duality in sector by supporting the functioning of the entire residential property market'.

BNG's objectives of realising the value of 'dead assets' and reducing duality in the housing sector demonstrate that de Soto's ideas have definite currency in the current housing policy discourse.

BNG argues that the residential property market has been skewed, to the detriment of those living in marginalised areas

Figure 2: Tracing the duality thesis in BNG

Core objectives	Spin-off objectives
Vision Promoting the achievement of a non-racial, integrated society through the development of sustainable human settlements and quality housing **Housing** Utilising housing as an instrument for the development of sustainable human settlements, in support of spatial restructuring	**Social** • accelerated delivery as a key strategy for poverty alleviation • reducing crime and improving social cohesion and quality of life • helping to create a non-racial society **Economic** • using the provision of housing to create jobs • using property for wealth creation and empowerment • leveraging economic growth • reducing duality in the housing sector; supporting the functioning of the entire residential property market

BNG and reducing duality in the property sector

BNG argues that the residential property market has been skewed, to the detriment of those living in marginalised areas. As a result, it proposes promoting and supporting the residential property market as a whole. Figure 3 reflects the proposed elements of this initiative, highlighting the issue of access to title.

Figure 3: BNG's strategies for reducing duality in the property sector

- Extending state housing subsidies to lower-middle income groups (thereby expanding the lower end of the property market)
- Adopting a more flexible approach to demand, and shifting away from product uniformity
- Enhancing the role of the private sector in housing provision by creating new opportunities for private sector participation in construction, collapsing the subsidy bands, providing housing finance, putting in place project management and other support and promoting employer-assisted housing.
- Creating linkages between the primary and secondary residential property market by supporting individual housing demands, removing barriers to housing trade, focusing on the local level, and enhancing access to title

BNG therefore posits that enhancing access to title will help to realise the value of 'dead capital', and support the housing policy's objective of alleviating poverty

BNG therefore proposes enhancing access to title as a means of reducing the duality in the property market.

BNG and housing assets

BNG problematises the investment value of the housing subsidy in stating that subsidised houses are not perceived as valuable assets. Its goal of supporting the entire residential property market represents a significant shift in focus. The creation of linkages between the primary and secondary residential property market is one of several strategies for realising the asset value of housing. It argues that a dysfunctional secondary residential property market undermines the realisable value of property

Figure 4: BNG's strategies for realising the value of housing assets

- Supporting individual demands by making subsidies available for secondary market transactions
- Reducing the prohibition on the sale of government-subsidised property from eight to five years
- Enhancing access to title by stimulating the transfer of free-standing public housing stock and by expediting the registration of transfer of subsidised houses

and the concomitant poverty alleviation aspects of subsidised housing. Figure 4 reflects those elements of BNG that address asset creation, and again tracks the role of formal property rights.

BNG therefore posits that enhancing access to title will help to realise the value of 'dead capital', and support the housing policy's objective of alleviating poverty.

This brief overview of BNG shows that enhancing access to title features prominently as a means of reducing economic duality, and realising the value of dead assets. BNG promotes title in a way comparable to de Soto's promotion of formal property, as summarised in figure 5.

Figure 5: BNG and de Soto: housing and spin-off considerations

Formal property in de Soto	Formal title in BNG
• Formal recognition of property will 'bring dead capital to life'; • document rights, turn them into capital so they can be traded outside narrow local circles, used as collateral for a loan to a share against an investment; and • capitalise the poor by legalising their extralegal property.	Enhancing access to title to: • Support a functioning residential property market; create linkages between primary and secondary markets so that the value of property can be realised and also the concomitant poverty alleviation aspects of state-subsidised housing; and • reduce duality to the benefit of those in marginalised areas.

So far, this paper has linked the dual economy thesis, AsgiSA, and BNG to de Soto's ideas about formal property and its economic spin-offs for the poor. It now moves to a critique of de Soto's claims, which suggests that the state's expectations of the benefits of the formalisation of tenure (AsgiSA) and formal title (BNG) may need to be rethought.

Linking title to access to credit and the maintenance of formal property ownership by the poor turn out to be faulty assumptions

Three metaphors unpacked

In one way or another, de Soto, AsgiSA and BNG all claim that a bridge can be built from the extralegal sector, the second economy, or the informal system to the legal sector, the first economy, or the formal system. Their proposals comprise a broadly similar inclusionary agenda: making capitalism work for the poor (de Soto), mainstreaming the poor in the first economy (AsgiSA), or BNG's bundle of wealth creation and empowerment, poverty alleviation, and benefiting those living in marginalised areas. The development debate is awash with metaphors aimed at capturing this process, including a bridge (de Soto), a trampoline (Giddens), and a housing ladder (Shisaka Development Management Services, 2004) – the last-named a home-grown variation on the theme. While they inspire optimism about including the poor in the formal system, legal sector, or first economy, they also beg some questions. Exactly how should the bridge be built? How will the trampoline bounce the poor out of poverty? And how can advances up the housing ladder be ensured?

The bridge

De Soto uses the metaphor of the bridge to convey the notion that formalising property rights can be used to move the poor from the extra-legal sphere, marked by dead capital, into the legal sphere, marked by living capital. I have argued elsewhere against de Soto's bridge-building hypothesis (Royston 2006). I will briefly recall the main arguments here.

Upon examination, linking title to access to credit and the maintenance of formal property ownership by the poor turn out to be faulty assumptions. And even if they stood on firmer ground, legal integration is a complex task that will take considerable time to achieve, as de Soto himself acknowledges.

There is great deal more myth than mystery in the access-to-credit claim. Lenders don't lend to the poor; if they did, it would be risky for the poor; and in cases where credit is extended to the poor, formal title does not appear to be a precondition. Access to credit alone is not enough to elevate the poor out of poverty, and is not sustainable on its own because there are factors other than the lack of title that prevent the poor from entering the market in the first place. Unfortunately, poverty is more complex than the lack of formal title. I have argued that de Soto's analysis lacks the political-economic consideration of whose interests are served by maintaining the status quo, which makes the prospect of successfully introducing the legal reforms required for a more appropriate, accessible and sustainable property system highly unlikely. There is little recognition of the realities of power relations and political imperatives; and if these aspects are not successfully dealt with, the chances of formalising the property rights for the poor – a seemingly simple and standardised solution – are exceedingly slim. In addition, sustainining access to title and capital is at least as important as gaining it in the first place – and what often happens in practice is that as soon as formal systems are applied to informal and especially communal areas, they break down (Leap 2004).

The housing subsidy and the provision of free basic services are South African examples of the asset protection or safety net approach

These two points – about the risks associated with using property as collateral, and the reality of reversion – call into question the bridge-building hypothesis. The poor are not a homogenous group in possession of assets that can uniformly be described as 'dead capital'. Land functions in various ways, which the notions of use and exchange value denote, and the concept of dead capital is of limited value in more informal contexts.

The trampoline

The metaphor of the trampoline comes from 'third way' thinking about the failures of the welfare state to combat poverty and reduce income inequality, as espoused by Anthony Giddens in his book with the same name (*The Third Way*, 2002) and embraced by the former British prime minister Tony Blair. In short, the hypothesis is that by removing the safety net (the welfare state) and bringing in the trampoline (the third way), the poor can 'bounce' themselves out of poverty. The link with de Soto, AsgiSA, and the housing policy discourse in South Africa lies in the treatment of assets.

A welfare approach emphasises asset protection ('the net'), and risk prevention and mitigation in order to protect the poor and vulnerable against factors threatening the erosion of their assets. The 'third way' approach emphasises asset accumulation and the longer-term consolidation of assets in order to create opportunities for the poor to build their assets (Moser 2006).

The notion of protection is located within the sustainable livelihoods approach initially developed by the United Kingdom's Department for International Development (DFID), and includes the 'safety net' welfare approach, as well as a broader social protection mandate encompassing risk prevention and mitigation (Moser 2006). Moser extends the notion of 'protection' from the traditional welfare approach (the 'safety net') to encompass risk prevention and risk mitigation as well. In practice, Moser argues, policies tend to be far better at providing a safety net and far less successful at preventing and mitigating risk (ibid). Asset protection from a housing perspective would therefore include (i) providing safety nets, (ii) preventing risk, and (iii) mitigating risk. The notion of building assets is located in a more varied set of approaches aimed at complementing social protection policies with policies that focus on creating opportunities for the poor (ibid). Thus asset-building implies both the accumulation of assets as well as their longer-term consolidation, so that the poor and vulnerable do not fall back into poverty (ibid). Asset-building from a housing perspective would therefore include (i) building assets, and (ii) the longer-term consolidation of assets. BNG's emphasis on assets shifts housing policy from the welfare orientation associated with the provision of public subsidies closer to 'third way' asset-building and consolidation objectives, as property is an asset for 'wealth creation and empowerment'.

The trampoline metaphor itself illustrates the major weakness of the approach it is meant to espouse

Figure 6: The welfare net: a housing perspective

- Protection (net): subsidy, free basic services
- Risk prevention: tenure security for the vulnerable (not necessarily provision of individual title); succession law impacting on property inheritance, and the status of minors in the context of AIDS orphans
- Risk mitigation: livelihood diversification, such as backyard rental accomodation; insurance mechanisms, including protection against downward raiding (see above)

Figure 7: The trampoline: a housing perspective

- Accumulation of assets: access to secure tenure, including title; access to credit
- Longer-term consolidation of assets: linkages between the primary and secondary markets

The housing subsidy and the provision of free basic services are South African examples of the asset protection or safety net approach. The provision of tenure security for the vulnerable and addressing succession law and the status of minors can be classified as risk prevention strategies from a housing perspective. Note that my suggestion is for tenure security, not formal title, as the former is not tantamount to formal title but inclusive of other tenure arrangements. In some cases formal title can in fact contribute to tenure insecurity. Support for livelihood diversification, such as backyard rental accommodation and the provision of insurance mechanisms, such as protection against downward raiding (where middle-class households purchase subsidised housing intended for poorer households, often at below subsidy value) can be classified as risk mitigation strategies from a housing perspective. Asset accumulation strategies would include access to secure tenure, including title, as well as credit, while creating linkages between the primary and secondary markets could be classified as a strategy contributing towards the longer-term accumulation of assets. The following two figures illustrate my application of the various approaches to assets to housing, using both welfare and third way frameworks.

In many ways, the trampoline metaphor itself illustrates the major weakness of the approach it is meant to espouse, notably: what happens if you fall off ? This suggests a retention of the safety net. The foundation of my de Soto critique, namely its failure to segment the market and the poor, is equally applicable here. Some of 'the poor' may bounce out of poverty with the right kind of housing policy that enables them to accumulate and later consolidate their assets, but some – the poorer and more vulnerable – will continue to rely on housing subsidies as a safety net for asset protection, risk prevention, and risk mitigation. This assertion is substantiated in the section below, notably in respect of the City of Johannesburg.

Title is no guarantor of credit, as the ongoing challenge to move the banks downmarket in the financial sector charter initiative demonstrate

The ladder

The metaphor of the housing ladder originates from the housing discourse in South Africa (see Shisaka Development Management Services 2004). It is intended to conceptualise market segmentation, and particularly to emphasise gaps in the supply of housing. These gaps involve households that earn too much to be eligible for subsidies but too little to be regarded as eligible for commercial loans – ie, households earning between R3 500 and R7 000 a month. The metaphor is used to demonstrate that there are missing rungs in the housing ladder; provide a basis for formulating strategies to fill in those missing rungs (such as BNG's expansion of the housing mandate to subsidy-ineligible households)[1] and convey the notion of mobility up the housing scale. In this sense, the notion of 'pathways to scalability' (Moser 2006) is useful. What enables ascent up the housing ladder? And how long should it take? Title and credit are commonly cited elements of the pathways to scalability. However, as I argue in my critique of de Soto, the relationship between title and access to credit is complex. Title is no guarantor of credit, as the ongoing challenge to move the banks downmarket in the financial sector charter initiative demonstrates. Neither does title necessarily secure tenure, as unregistered transfers of subsidy housing demonstrate. It appears that some households are deciding (albeit under severely constrained economic circumstances) to sell their subsidy houses and revert to informal residence.

The housing ladder helps to highlight the differentiation or segmentation of the housing market because it draws attention to gaps in housing and a particular component of the poor – in our subsidy framework, arguably the borderline poor –

and because it emphasises the particularity of different rungs on the ladder in relation to housing demand and need. However, this metaphor also begs a set of important questions. These may prove helpful to public policy as long as the optimism inherent in this metaphor does not divert attention attention away from the more intractable problems lingering beneath it, and its more pessimistic association with slithering down a snake – the well-known board game's counterpoint to upward mobility. How to get a foot on the first rung? What factors influence ascent? Is mobility unidirectional (what happens to those that fall down or off?) How long should and does it take to ascend?

In table 1, Rust et al illustrate the City of Johannesburg's population distribution by monthly household income as well as housing delivery, with a great deal more in between. Strikingly, it shows that 68 per cent of households in Johannesburg earn less than R3 500 a month (and almost half earn less than R1 500 a month). It also shows that this category benefited from only 14 per cent of housing delivery in the city.

Our housing strategies need to be far more accurately targeted and focused. The category of 'the poor' requires much greater differentiation than de Soto offers

This table shocks the reader into segmenting the market, and differentiating the poor. It prompts the following questions:

- Where should policy attention and delivery effort be focused?
- How much of it should be aimed at subsidy-eligible households earning up to R3 500 a month, and how much at households above it where the market is also not delivering?

Table 1: Housing delivery in the City of Johannesburg

Monthly household income category	% Population		Housing type affordability (indicative)	Number delivered in 2004	% of total delivery
>R10 001	15%	15%	Mortgage >80m^2 Sectional title	5 207	49%
R7 001–R10 000	5%				
R5 001–R7 000	6%	18%	Mortgage <80m^2 Social housing	3 927	37%
R3 501–R5 000	7%				
R2 501–R3 500	9%				
R1 501–R2 500	10%	68%	Subsidised housing (RDP)	1 450	14%
R0–R1 500	49%				
Total	**100%**			**10 584**	**100%**

- How much net and how much trampoline?
- What are the pathways to scalability, and how should they be achieved?
- How sharp do our housing policy instruments need to be in the current context?

When we propose access to credit as a major strategy for bridging gaps in our economy, and thus alleviating poverty, how much of the population can possibly benefit? As important as it is overall, how significant a thrust of public policy should filling in gaps in the housing ladder actually be? This table questions the applicability of the trampoline (shorthand for support to asset accumulation and consolidation) to most of Johannesburg's population.

In the absence of segmentation, the poorest of the poor are still not being catered for

The bridge, the trampoline and the ladder all reflect a welcome optimism – that the bridge can be built, that the poor can be bounced out of poverty, and that everyone can access a secure home. My concern is this: glamorous claims that come with new ways of thinking about old problems run the risk of diverting attention away from prioritising the poorer and more vulnerable away from the simple and often unexciting work that needs to be done. Making existing instruments work better. Targeting them appropriately. And, most difficult of all, addressing the foundations on which the ladder, the trampoline and the bridge must stand.

This paper's journey through de Soto, AsgiSA and BNG has brought us to a simple conclusion: that our housing strategies need to be far more accurately targeted and focused. The category of 'the poor' requires much greater differentiation than de Soto offers. In the absence of segmentation, the poorest of the poor are still not being catered for. We need to sharpen our blunt instruments, which means delivering the housing subsidy at scale. We need mechanisms for protection, prevention, and mitigation. And we also need to pay more attention to improving integration between aspects of our single economy (so-called 'first' and 'second') and aspects of our whole residential property market (so-called 'formal' and 'informal'). Ultimately, the metaphors fail in this respect.

Endnotes

1 The latter is an important argument to make in the context of RDP housing schemes that have fallen short of actually registering title deeds.

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Supporting the housing asset triangle:

South Africa's real housing challenge

Kecia Rust

Beneficiaries can also use the collateral value of their progressively more valuable houses to access business finance

IN HIS seminal work *The Mystery of Capital*, the Peruvian economist Hernando de Soto seeks to shed light on the nature of poverty in developing countries, and ways in which this can be relieved. Notably, he writes:

> Poor people save … but they hold these resources in defective forms: houses built on land whose ownership rights are not adequately recorded and unincorporated businesses with undefined liability … Because the rights to these possessions are not adequately documented, these assets cannot readily be turned into capital, cannot be traded outside of narrow, local circles where people know and trust each other, cannot be used as collateral for a loan, and cannot be used as a share against an investment (2000:6).

This proposition is based on the notion of a housing ladder for households. This assumes that the nominal value of a house increases over time, as a result of the normal appreciation of the property market. As owners continue to pay off their loans, their equity (the value of the house less the loan amount outstanding) in the asset increases. This means that when they sell their house, they will make a profit from the sale which they can then use to buy a more expensive house that better suits their needs. This process can continue for the entire life of home owners, so that by the time they retire, seeking finally a smaller or simpler home, they can use the equity realised from the sale of their last home to fund their retirement.

In the case of South Africa's subsidised housing programme, the ladder is envisioned as follows: the title deed given to beneficiaries when they receive their units gives them ownership of a housing asset that can be improved and later sold. The profit from the sale will help them access mortgage finance on their next – and better – house. In this way, they can continue to climb the housing ladder, accessing progressively better houses in the process, and maximising their asset value. Beneficiaries can also use the collateral value of their progressively more valuable houses to access business finance.

One of the key factors undermining South Africa's affordable housing programme has been a failure to acknowledge the linkage between low-income housing and upper-income housing via the housing ladder, examine ways in which the progression up the ladder may break down, and devise ways of addressing this. A major cause of breakdown is the following: given all the financial pressures they find themselves under, subsidy beneficiaries have little incentive to improve their houses if they are worth little more than the shelter they provide. And if subsidy beneficiaries don't invest in their houses, low-income housing areas will deteriorate while their residents prioritise investments in schooling, food, medical care, consumer goods, and so on. If this happens, the government's investment of R25 000, R30 000 or R32 000[1] in these houses becomes stagnant – and housing becomes a consumptive rather than a productive good.

In 2003 and 2004 the FinMark Trust, together with the Ford Foundation, the National Treasury, the National Housing Finance Corporation, the then Micro Finance Regulatory Council (now the National Credit Regulator), and USAID undertook a study of the workings of township residential property markets (TRPM).[2] This was aimed at investigating the performance of township residential property, and specifically to interrogate the de Soto thesis that title deeds necessarily create wealth. The short answer provided by the study (which is extensively documented in a series of reports available on the FinMark Trust website) was that they do not. Notwithstanding title deeds, it found that houses in former black townships had not become financial assets to the extent envisaged by housing policy, that the market was significantly depressed compared with non-township areas, and that houses were worth significantly less than they would have been elsewhere.

The de Soto thesis depends on (at least) four factors additional to title deeds which are not uniformly evident in the South African housing market, and are largely absent in the low-income housing market

Crucially, the de Soto thesis depends on (at least) four factors additional to title deeds which are not uniformly evident in the South African housing market, and are largely absent in the low-income housing market:

- **A functioning secondary property market**. The TRPM study found a dysfunctional property market in the former townships, with limited churn and depressed property values. Home owners were unable to realise the asset value of their housing because there was no effective market in which to trade.
- **Sufficient affordable housing stock**. The shortage in the 'affordable' housing market of housing units costing less than R200 000 has been well documented. The Housing Supply and Functioning Markets research commissioned by the Banking Association estimates a shortage of more than 600 000 affordable housing units. Only 17 339 units costing less than R200 000 were delivered in 2005.
- **Affordable mortgage finance**. About 86 per cent of South African households cannot afford the mortgage repayments that a R200 000 loan would require.
- **Mortgage lenders willing to go downmarket**. Notwithstanding the commitment by lenders in the Financial Sector Charter (FSC) to provide housing finance to low-income earners, the FinMark Trust has established that 53 per cent of households in the FSC target market are ineligible for mortgage finance, and a further 20 per cent are too poor. Currently, only 5 per cent of households in the

FSC target market have a mortgage, and only 20 per cent more would be eligible if they were to apply.

This helps to demonstrate that the de Soto thesis has a limited application if the market isn't working – simply because the financial value of housing is only relevant if it is realisable. And yet the notion of a housing asset is a compelling one. Clearly, it requires a broader interpretation.

The notion of the housing asset

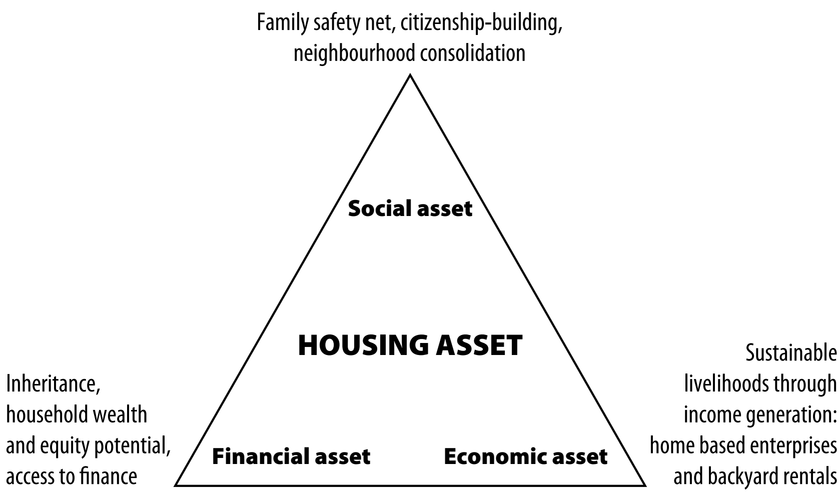
The government's current housing strategy introduces the notion of housing as an asset

The government's current housing strategy, *Breaking New Ground*, introduces the notion of housing as an asset and includes it as part of the new housing vision: '*Ensuring property can be accessed by all as an asset for wealth creation and empowerment*'. BNG notes that:

> In Towards a 10 Year Review, poverty is understood to involve three critical dimensions: income, human capital (services and opportunity) and assets. A composite analysis of indicators in these three categories assists in compiling a broad picture of the experience of poverty in terms of deprivation of basic needs and the vulnerability, powerlessness and experience of exclusion which accompanies lived poverty.[3] Housing primarily contributes towards the alleviation of asset poverty. This contribution is to be strengthened in the new human settlements plan through supporting the development of sustainable human settlements and the development of housing assets.

The nature of this housing asset is not monodimensional, however. Housing assets have three components: social assets, financial assets, and economic or productive assets (figure 1).

Figure 1: The three components of a housing asset



The government has focused on the *social* component since the introduction of the housing subsidy programme in 1994. The social asset value of a dwelling lies in the fact that it provides the household with a family safety net, a sense of citizenship, and a sense of belonging in the area in which they live. In providing subsidised housing, the city involved provides households with a valuable social asset that will help them to sustain themselves and improve their income and security.

The *financial* component becomes important when a household wants to improve its housing conditions and climb the housing ladder – ie, sell their current home and buy a better one more suited to their needs. This aspect is emphasised in BNG. The more the household can sell their original home for (and this depends on the current property market, the quality of their home and neighbourhood, and the availability of capable buyers), the more they can afford to spend on the next one. Conversely, households that want to downsize can buy a less expensive house and treat the balance as income. The value of houses can also be leveraged to access finance for other purposes, such as establishing a business or paying university fees. In these ways, viewing their homes as financial assets offers households an opportunity to improve their financial situation and life chances. However, as noted earlier, the performance of the house as a financial asset depends upon a functioning secondary (resale) property market, and solid linkages between the primary and secondary property markets. It also depends on municipal management (services, utilities and so on) that make an area 'investment grade' and help property prices to appreciate. In the absence of a functioning market, de Soto suggests that property becomes 'dead capital'. It has been estimated that 'dead capital' in South Africa's former black townships totals at least R68,3 billion.

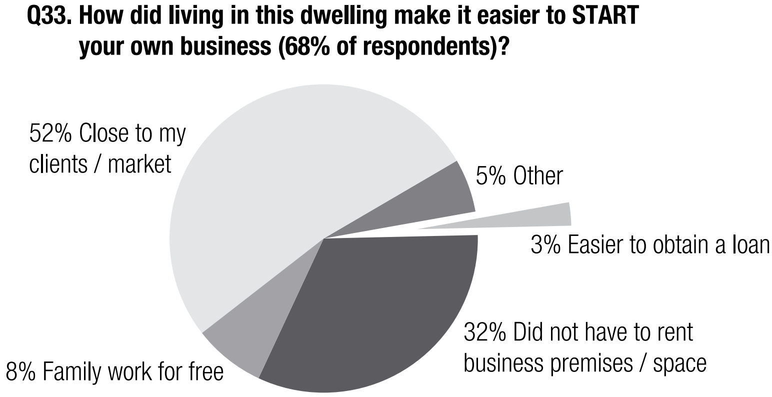
In many instances the quality of the structure supporting the income-earning opportunity is poor

But are these housing assets really dead? This is where the third corner of the triangle comes into play. The *economic* component of a housing asset comprises its income-earning potential and the extent to which it can contribute towards sustainable livelihoods. In the context of high unemployment, income that can be earned from housing, either through home-based enterprises or offering accommodation for rent, becomes extremely important. However, in many instances the quality of the structure supporting the income-earning opportunity is poor. This suggests an opportunity for investment in improving the structures concerned (and therefore an opportunity for incremental, non-mortgage housing finance).

Recent research into the dynamics of housing as an economic asset

The TRPM study also examined the role of housing in entrepreneurs' business strategies as another way of interrogating the de Soto thesis. The study surveyed 400 entrepreneurs in former townships in Cape Town, Johannesburg, Ekurhuleni and Ethekweni, and asked them to talk about how their homes contributed towards their businesses (figure 2).

Figure 2: Role of housing asset in starting small businesses



The banks say they cannot lend to the poor because they earn too little to sustain repayments

The research found that the most common use of housing was as a venue for the business. The majority of respondents who used their dwelling for business purposes ran their shop, crèche or office from their home, or used their home as the base for the production or storage of goods. The use of housing as collateral for venture capital was virtually nil. While about 68 per cent of respondents said that their dwelling made it easier to start their businesses, only three per cent (eight respondents) said they made it easier to obtain a loan.

Whether or not they used their home as security, few entrepreneurs accessed loan finance to start their businesses. Only 15 per cent (58 respondents) said they had taken a loan of some sort – and of this, only 36 per cent (21 respondents) said the loan had been from a bank. Only three of the 400 respondents had a current mortgage loan, and none had used the mortgage to start their business. The majority (87 per cent) had used own funds – savings, pension payouts, retrenchment packages and so on – to fund their businesses.

The TRPM research suggested that the role of the housing asset in wealth creation was not as straightforward as the de Soto thesis implied. Housing for the entrepreneurs surveyed represented a significant asset not because of its worth as collateral for business loans, but because of its physical use for business purposes.

To explore these issues further, in 2005 the FinMark Trust, together with Nedbank, the Social Housing Foundation, and the national Department of Housing, conducted a study of the activities of small-scale landlords and home-based enterprises in inner city areas and former townships in Gauteng. The findings were then extrapolated for the whole country.[4]

The study found that housing provides a crucial platform for residents to become entrepreneurs, either as small-scale landlords or home-based enterprises, earning an income and building their assets while also supplying and managing much-needed affordable rental accommodation for other low-income households. Some of the findings are summarised in table 1.

Table 1: The role of small-scale landlords and home-based enterprises

Small-scale landlords	Home-based enterprises
• Small-scale landlords are delivering at scale. An estimated 1,85 million (or 15%) of South African households rent accommodation from small-scale landlords. Sixty per cent of this accommodation (for 1,1 million households) is provided on the property of the landlord, in either formal or informal backyard dwellings. This means that small-scale landlords are providing at least as much accommodation as the housing units provided by the national housing subsidy scheme since 1994.	• Home-based enterprises are significant contributors to local economies. An estimated 355 000 HBEs are active in former townships and inner cities across South Africa, comprising about 13% of the total population of these areas, and generating about R476 million a month. By definition they operate in residential areas, enhancing access to services and products by low-income households throughout South Africa, and contributing to the development of sustainable human settlements. While most of these businesses can be classified as micro or small, for many of the entrepreneurs who own them they represent their sole income.
• Small-scale landlords offer well-located, affordable rental housing for low-income households. The average income of their tenants is only R1 800 a month. This is much lower than the income levels targeted by the government's subsidised social housing programme (generally R2 500–R7 500 a month), which as of December 2005 had only delivered 34 208 rental housing units.	• The home is an important asset for entrepreneurs. Most of the entrepreneurs identified in the survey (70%) operate from the homes. This is higher in township areas (83–89%) than in inner city areas (39–63%). The house has an important impact on reducing the costs of entrepreneurial activity, and is therefore a useful business incubator in the initial phases. Few entrepreneurs (6–7%) use their homes as collateral for a business loan.
• Small-scale landlords are small-scale enterprises, and are earning an income. The sector is currently generating a rental income of about R421 million a month, or just more than R5 billion a year. The majority of landlords are otherwise unemployed. Many landlords in the former townships are elderly women with little or no other income.	• Many HBEs are entrepreneurial. More than one third (33%) of HBEs in inner vities and just less than half (42%) in former townships show entrepreneurial characteristics, having been the first to undertake the business in their area. Only one third (32–33%) of HBEs surveyed in both inner cities and former townships said they would take permanent employment if it was offered to them.
• There is potential for growth. Demand for stock is high, and more than 62 per cent of landlords in both inner cities and townships said that it was easy to find tenants. Township landlords report that vacancy is effectively zero. However, this potential for growth is not being realised. The overall rental sector decreased from 31 per cent of the total housing sector in 1999 to 27 per cent in 2005.	• There is potential for growth: The majority of HBEs in the former townships (90%) and inner cities (95%) want to expand. Many (about 55%) feel their businesses are growing. Given the low prevalence levels (only 13–22% of the population in the neighbourhoods surveyed were found to operate as entrepreneurs – lower than in most other countries), but also the significant income generated, HBEs represent a still largely untapped opportunity for unemployed South Africans.

Housing entrepreneurs operate at the nexus of housing and local economic development strategies. Whether as small-scale landlords, incubators for growing SMMEs, or survivalist ventures for the unemployed, they are making an important contribution to our economy. Housing entrepreneurs are clearly developing sustainable livelihoods by using their houses as an economically productive asset. The research found that this grass roots effort at poverty alleviation should be recognised and supported by national, provincial and local governments.[6]

A broader application of the housing asset

Housing entrepreneurs operate at the nexus of housing and local economic development strategies

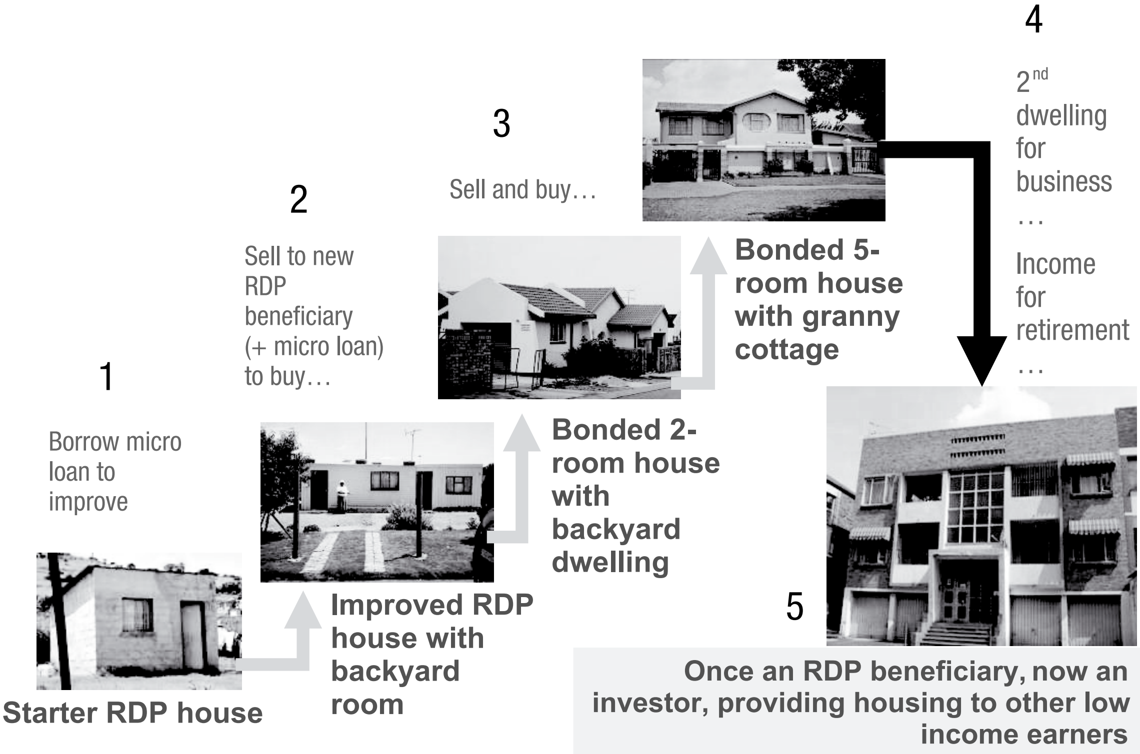
If housing policy wishes to promote the notion of the housing asset, and if the housing asset that is being delivered neither realises the financial wealth expectations of policy-makers nor subsidy beneficiaries, some other approach must be found. The answer lies in understanding housing as an economic asset – something that can help households to earn sustainable livelihoods by offering opportunities for income generation. As households seek to enhance the performance of their home so that its income-earning potential is maximised (building additional rooms, improving fittings, etc), they are also improving its overall value. When the secondary property market does begin to churn, the financial asset value of their property will also be enhanced.

De Soto argues that, if the poor are given formal title to land or houses they occupy or own informally, their housing will become mortgageable, encouraging home owners to collateralise their homes in order to access business finance. In the South African context, this is an oversimplification, for a number of reasons. First, it requires a level of affordability that is limited to at most 14 per cent of the population. Second, it expects that most home owners will want to risk losing their homes by offering them as collateral: an unreasonable expectation, given the relative volatility of the economy and labour market in South Africa. And third, it requires a 'thick' property sector with ample buyers and sellers to enhance choice and opportunity. Numerous studies of the housing sector in South Africa have shown that this currently does not exist.

Rather, a more appropriate approach would be to support incremental forms of finance – housing micro loans – that could be made affordable to particular clients and will better suit their home improvement processes. Crucially, micro lending should seek to support the development of income-earning activities within the home, both to improve the borrower's loan repayment capacity as well as to enhance their potential to realise a sustainable livelihood.

If the entire housing asset is realised and supported in policy terms – in other words, if the housing unit's performance as a social, economic, and financial asset are equally promoted – housing can indeed alleviate poverty. This requires recognition and support of the home-based SME sector, settlement planning to accommodate small-scale business activity in residential neighbourhoods, and the promotion of backyard rental. South Africa's real housing challenge is this: allowing low-income households to use their homes flexibly to provide shelter as well as generate income and, ultimately, wealth. While this is more than de Soto proposed, it is the very least we should expect from our housing policy.

Figure 3: The ideal South African housing ladder



Endnotes

1 Total state investment in housing is in fact much higher. Besides the R32 000 basic subsidy, 15 per cent is added to cover land costs, and further investment is made in terms of the Municipal Infrastructure Grant (MIP). Also, new settlements are often subsidised in terms of their ongoing operating costs, the professional fees involved, electricity connection, the social package which includes water and electricity, and so on.

2 Shisaka Development Management Services, The Workings of Township Residential Property Markets, reports from three phases, available on http://www.finmarktrust.org.za/themes_and_projects/theme_detail/theme_detail.asp?uno=7.

3 Asset poverty arises out of inadequate access to assets by individuals, households and communities, including inadequate shelter (which finds expression in badly located, low quality and overcrowded dwellings), the inadequate provision of appropriate infrastructure, and the inadequate provision of basic services such as health, safety, emergency services, and educational and day care facilities.

4 The study was carried out in Gauteng in 2005 and 2006 by Shisaka Development Management Services. The research team conducted interviews and focus group sessions with small-scale landlords and their tenants in two inner city areas (Hillbrow and Berea in Johannesburg, and Sunnyside and Pretoria Central in Tshwane) and two

townships (Katlehong and Orlando East) in Gauteng. For more information, visit www.finmark.org.za.

5 Just less than one third (3,5 million) of all South African households live in rental accommodation. Of this, 57 per cent rent their accommodation from small-scale landlords – of these, about 60 per cent (1,1 million households) rent formal accommodation, and about 40 per cent (740 000 households) rent informal accommodation.

6 The research has identified a range of policy interventions that could stimulate the growth of home-based enterprises in South Africa, contributing to the development of sustainable human settlements and thriving local economies. Areas for further research have been identified, and discussions are under way with various organisations to carry the work forward. See http://www.finmark.org.za, or contact kecia@iafrica.com for more information.

Mysteries and myths:

De Soto, property and poverty in South Africa

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High levels of poverty and inequality persist in democratic South Africa. This is despite a decade of government policies and budgetary realignments designed to address the legacies of apartheid and promote steady economic growth. Some policies have been relatively successful: access by the poor to clean water, electricity and sanitation has improved dramatically, and more people now receive social grants. But South Africa has the second highest level of inequality in the world after Brazil, and the gap between the rich and the poor appears to be widening. It is increasingly clear that growth alone will not reduce poverty and inequality, and that improved social services and grants do not address the fundamental problem: entrenched structural features of the economy.

South Africa has the second highest level of inequality in the world after Brazil, and the gap between the rich and the poor appears to be widening

The South African Presidency has described the country as having 'two economies'. The first is an advanced, sophisticated economy, based on skilled labour, which is becoming more globally competitive. The second is an informal, marginalised and unskilled economy, populated by the unemployed. The government is now focusing on transferring resources to 'the marginalised', through expanded public works programmes, micro credit for entrepreneurs, skills development, and agrarian reform.

For some analysts a key problem is the absence of formal property rights to the assets owned by the poor. A recent African National Congress discussion document suggests that the failure to provide title deeds to land and houses 'sterilises the enormous value of these existing assets, which could so easily be turned into collateral to secure access to capital' (ANC 2005). Government's new housing policy document, *Breaking New Ground* (Department of Housing 2004), complains that the 1,6 million new houses funded by the state since 1994 have not become 'valuable assets' for the poor, and suggests that improved access to title deeds will help the poor to participate in residential property markets.

These examples demonstrate the increasing influence of the Peruvian economist Hernando de Soto and his book *The Mystery of Capital* (2000). De Soto offers a simple yet beguiling message: capitalism can be made to work for the poor by formalising their property rights in houses, land and small businesses. This approach resonates strongly in the South African context, where private property is dominant, and works well for those who inhabit the 'first economy'. At the same time, international support for de Soto's ideas appears to be increasing. A High Level Commission on the Legal Empowerment of the Poor was launched this month, hosted by the United Nations Development Programme (UNDP), and co-chaired by de Soto.

However this initiative is generating strong opposition from NGOs, social movements and bodies such as the International Land Coalition, which contest the single-minded focus on individual title, formalisation and credit as solutions to poverty (www.desotowatch.net). In this paper we analyse evidence from South Africa which suggests that many of de Soto's policy prescriptions may be inappropriate for the poorest and most vulnerable in our society, and could have negative rather than positive impacts on their security and well-being. We then offer some alternative approaches to securing tenure and property rights.

The *Mystery of Capital* is a call for a global reform to overcome poverty and underdevelopment

Bringing 'dead capital' back to life

The *Mystery of Capital* is a call for a global reform to overcome poverty and underdevelopment. Its focus is the formal recognition of 'extra-legal' property. De Soto argues that the poor of the world living in shantytowns and backward rural areas hold assets worth trillions of dollars in the form of houses, buildings, land, and small businesses. The problem is that their rights are not adequately documented, and hence 'these assets cannot readily be turned into capital, cannot be traded outside of narrow local circles … , cannot be used as collateral for a loan, and cannot be used as a share against an investment'. Existing legal and administrative systems to register property or set up a business are bureaucratic and time-consuming, and create insuperable barriers to the formal recognition of property rights. As a result, the assets of the poor are 'dead capital'.

In the West, by contrast, 'the mysteries of capital' have been solved; every building and every piece of land and equipment is documented and is part of a 'vast hidden process that connects all these assets to the rest of the economy'. This allows these assets to become *capital*, with the potential to create additional value. Assets are used as collateral for credit and to create securities and secondary markets. They also provide an 'accountable address' for collecting debts and taxes (thus forming a firm basis for public services utilities). De Soto argues that what is required across the developing world is a programme to 'capitalise the poor' by legalising their extra-legal property.

Extra-legal property systems, says de Soto, are not chaotic. Rather, they are based on local agreements and detailed understandings of who owns what; a localised 'social contract'. But these rules are not codified or standardised, and cannot be applied outside their area of origin. Local systems must therefore be 're-engineered' into one national, formal property social contract. This involves the reform of existing legal and administrative systems to accommodate 'extra-legal' property, and the creation of a single, integrated regulatory framework.

What de Soto's critics say

De Soto's ideas have mesmerised high-ranking policy-makers and politicians. But a significant body of scholars and land reform practitioners is concerned that his analyses and policy prescriptions are highly misleading.

Critics question his oversimplification and mystification of capitalism, the informal economy, and associated property and power relations. His primary argument, that economic growth is fuelled by property rights which enable the release of credit, is not seen as a plausible response to global poverty. For some critics, rather than 'empowering the poor', the formalisation of property is instead 'machinery for transferring property from small owners and concentrating it into larger and larger hands' (Mitchell 2004). Durand-Lasserve (2005) describes how titling programmes in informal urban contexts become 'market-driven displacements'; and in rural areas such programmes allow traditional elites to get richer by selling land for development. He suggests that these processes of land attrition have very negative effects on the poor, forcing them ever more towards urban squatter settlements. Other critics provide evidence that converting property into capital encourages speculation in poor housing, as well as a renting class. This undermines the use of property for investment by smallholders in productive activities, such as crops or livestock (Mitchell 2004). Thus many of de Soto's critics stress the importance of property's non-market functions, such as securing livelihoods and reinforcing social identity, social continuity, and social security. Numerous studies in Africa have found no positive correlation between title and investment, and if anything, investment in insecure tenure is often a means to securing the land (Chimhowu and Woodhouse 2005). In these situations, critics argue, other types of tenure than exclusive private property remain more secure and certain.

Other critics provide evidence that converting property into capital encourages speculation in poor housing, as well as a renting class

Although de Soto rightly advocates the 'adjustment' of legal frameworks to accommodate 'extra-legal' property, in reality his policies boil down to converting informal property into private property through systematic titling. While he acknowledges the failure of previous titling programmes in the developing world, he does not convince us that these failures will be avoided in future formalisation programmes. De Soto's work almost completely ignores scores of studies on African customary property regimes showing their diverse responses to current pressures on land. These responses may include individualisation, privatisation and marketability, but not necessarily along the linear path suggested by de Soto. Neither is it clear how de Soto's policy prescriptions could be applied to rural common property resources (which are often governed not by informal rules but by highly formalised practices), since his focus is on individual land parcels. By portraying the poor or 'extra-legal' constituency as homogenous and undifferentiated, he also misses the implications of market reforms for those who already spontaneously engage with local markets,[1] albeit without formal title or credit, and those who own virtually no assets at all.

However, the biggest problem for critics is that de Soto's main claims do not rest on 'security' of tenure but on the capitalisation of property to allow its exchange value to be realised in the form of credit. A number of empirical studies show that even where property and credit markets do emerge, the credit effect in most cases fails to materialise. Even where a positive correlation between titling and credit was found (eg Thailand), land was not being used as collateral (Woodruff 2001). The limiting factor is that poor people's property is seldom collateralised, and informal credit is the poor's first choice. Mortgage finance has been found to be far too risky for banks (eg when prices are too low and insurance and enforcement mechanisms too weak to justify the risk) as well as for the property holders who, even if they do seek title, will not risk it in taking out loans (Mitchell 2004).

A key legacy of apartheid was weak and insecure property rights for black South Africans in both urban and rural areas

De Soto rightly suggests that land administration institutions should evolve to accommodate informal property rights, but his assumptions about how formal institutions can accommodate property systems other than individual private property are oversimplistic. Hunt (2004) has drawn attention to the unforeseen institutional consequences of state intervention in customary land tenure regimes in Africa when the institutional complexities of land tenure reform have not been fully grasped.[2] Von Benda Beckmann (2003) reminds us that converting rights through formalisation 'changes' the nature of the rights and can exclude weaker rights (eg women's rights) under customary laws. It is not at all clear how formal private property systems can be designed to avoid this problem.

Most critics agree that titling probably is useful to elite and middle-income groups who can afford financial leverage, risk, and real estate markets. For the poor, whose concerns are more about day-to-day survival, direct access to livelihood, and keeping costs down (Gravois 2005), de Soto's prescriptions, far from being empowering, may provoke their further descent into poverty.

De Soto and the South African context

Although de Soto correctly identifies weaknesses in the way current legal and 'extra-legal' systems limit poor people's access to resources in South Africa, experience and evidence indicate that many of his proposals would not work here.

Property rights in post-apartheid South Africa

A key legacy of apartheid was weak and insecure property rights for black South Africans in both urban and rural areas. Many new policies have been put in place since 1994 to address the problem, including the abolition of all racially based legislation, amendments to existing laws, and ambitious land reform and housing laws and programmes. About two million households live in informal settlements or in backyard shacks, and in rural areas at least 2,5 million households hold land as part of 'communal tenure' regimes.

Two contrasting approaches to securing property rights underlie these new policies and laws. The first is to open up the world of private property for those denied access to it under the discriminatory regimes of the past. Thus beneficiaries of state-funded housing are entitled to full private ownership and registered title deeds, and land reform beneficiaries can own land individually or collectively. The second approach is to secure people's rights of occupation and use *without* conferring ownership, including occupation of land owned by others (for example, commercial farms, or state land). This qualifies and constrains the 'absolute' rights of private ownership.

However, according to current state policy, the most secure form of tenure is private property recognised via the system of national registration, whether it is individually owned or group-owned. The formal property system in South Africa requires compulsory national registration of all land parcels in order to recognise full ownership rights. Policies, laws and institutional frameworks relating to land use, land management, development planning, and service delivery generally assume that surveyed land parcels will be privately used, owned and registered.

From its inception, the government's new housing policy was based on providing ownership rights to the historically disadvantaged

The act of registration is the culmination of a number of specialised technical and administrative processes (among the most rigorous in the world) that feed into the registration system. These include formal planning, surveying and conveyancing to prepare property for registration and maintain its technical and legal integrity. This enables the formal property system to be linked to, and embedded in, multiple institutions including the regulation of land use, the delivery of and payment for state services, and recourse to a range of private services. The formal cadastre has thus become a multipurpose instrument serving many purposes. The coherence of the formal land management system as a whole is sustained by the concept and practice of land parcellisation, ie the notion that for each delineated property there is a corresponding and current owner, either individual, corporate or state (Kingwill 2005). This interconnected system of property recognition via a national land registry linked to surveyed land parcels does not mesh well with property that is governed by customary or adapted local institutions.

Such property is not based on surveyed boundaries, single estate ownership and registration. Instead, it involves social membership and multiple layers of rights where several users may have access to different resources on the land simultaneously according to different social and generational cycles (Cousins 2005). These features create social and territorial boundaries that are somewhat dynamic, and tend to be inclusive rather than exclusive. This older pattern of landholding, though adaptive, is seldom abandoned when registration drives are introduced, even with group titling. Private transfers do not entirely replace customary practices, and the overlapping tenure systems lead to considerable institutional uncertainty with regard to authority. This has been evident in studies of land reform communities (Cousins and Hornby 2000). Even in situations where titling does 'stick', out-of-date titles (more the norm than the exception) create legal and administrative confusion as well as social tension (Kingwill 2005).

It is clear that South Africa's new land policies, while making important inroads into the way in which property rights were formerly constructed, continue to face serious challenges. The two case studies below illustrate the limitations faced by new legal frameworks in providing meaningful tenure security for the poor. One of the unsolved problems is that the formal legal construct of ownership in South Africa, which has been shown to disadvantage the poor, still remains.

Joe Slovo Park, Cape Town

In 1990 a group of households occupied part of Marconi Beam, a well-located, vacant piece of land in Cape Town owned by a parastatal company. The area was then declared a temporary 'transit' area. After years of negotiation, the Joe Slovo Park housing project was implemented in 1997–1998, next to the informal settlement. The project built 936 houses, using a housing subsidy worth R15 000 per beneficiary (Smit 2000).

It is clear that South Africa's new land policies, while making important inroads into the way in which property rights were formerly constructed, continue to face serious challenges

In line with national policy, the form of tenure granted was individual ownership. However, for many people this meant a decrease in security of tenure. Whereas previously family members had tenure rights linked to kinship and responsibilities, ownership was now registered in the name of only one member of each household. This reduced security for women and members of the extended family, as the 'owner' could claim new legal rights to use and dispose of the property. Also, the allocation process was biased: some long-standing residents were never allocated houses, while community leaders allegedly received more than one house. The new property owners also became liable to pay rates and service charges, then around R200 a month. Many were unable to afford this, although the situation has subsequently improved with the introduction of rebates. Five years after the project was completed, about 30 per cent of the new houses had been sold (Jacobsen 2003). But almost all sales of properties were informal, and the formal land registration system had broken down. People who legally owned houses were sometimes unable to occupy them, as street committees had decided who should be the occupier, and in some cases houses had been rented out by people who did not own them.

Some socioeconomic impacts have also been negative. Informal economic activities have been displaced (and sometimes relocated to nearby informal settlements). Social networks were disrupted as the allocation of plots ignored kinship ties and social networks. The small size of the houses also meant that landlords were unable to accommodate extended family members or tenants, upon whom the landlords had relied for rental income (Yose 1999).

This case reveals that individual ownership can sometimes reduce *de facto* security of tenure, and undermine socioeconomic status. It provides clear evidence of how such settings often 'revert' to informality. From a policy perspective, it shows that intervention must differentiate 'the poor' in terms of affordability/income and vulnerability; allocation processes must be fair and transparent; and livelihood strategies must be accommodated.

Ekuthuleni, KwaZulu-Natal[3]

Ekuthuleni is a rural community of 224 households in KwaZulu-Natal. Residents currently live on state-registered land that they wish to formally acquire through land reform and hold in collective ownership, in order to secure their property rights and also receive the benefits of public and private services. The community includes farmers engaged in small-scale fruit and crop production on a hectare or less, to forestry farmers on 5–10 hectares. Most families, however, survive on welfare grants, and supplement these with subsistence agriculture and natural resources harvested from common land. Elderly women head many of these families. Community members say they want to hold land in common because 'we must have some group control here to prevent strangers from coming in and causing conflicts', and because 'we cannot afford the costs of maintaining individual title'.

This case reveals that individual ownership can sometimes reduce *de facto* security of tenure, and undermine socioeconomic status

These characteristics highlight the limitations of the formal system of property rights. This requires three criteria to be met before rights can be registered: an individual rights holder must be identified; the exclusive rights of this rights holder must be precisely described; and the boundaries of land parcels must be accurately depicted through beaconing and geo-referencing. In Ekuthuleni, property ownership is never exclusive to one person. It is always shared by a number of family members: those living now, some who are deceased and some yet to be born.

This is a concept that South African property law cannot easily accommodate. The closest current law can come to doing so is through establishing a family trust. But this option is inappropriate to Ekuthuleni's inhabitants: it does not capture the nature, content, and governance of family and community-based land rights. There are many nuanced layers of rights in Ekuthuleni (of access, use, transactions and decision-making) and it would be extremely difficult to precisely describe these in title deeds.

In relation to boundaries, people continuously adapt their land boundaries to fit social needs, such as to temporarily accommodate a relative in distress or to resolve conflicts over rights. Boundaries are flexible and adaptable in the interests of social harmony, in a context where land provides access to vitally important livelihood resources. The Ekuthuleni case reveals that there is often a fundamental incompatibility between property rights in community-based systems and the requirements of formal property. In both urban settlements and rural communities there is the additional problem that their 'extra-legal' property rights do not fit the assumptions of mainstream systems of planning, service delivery and land management. This makes it difficult for them to benefit from planned development.

Evidence from other studies

A growing number of studies suggest that the key features and processes found in Joe Slovo Park and Ekuthuleni are typical of wider realities in urban and rural South

Africa (Mongwe 2004; Cross 1994). A recent study of township property (FinMark Trust 2004) found a weak secondary market for houses. Most home owners were not interested in a formal sale because their incomes were too low to move up the housing ladder, and most viewed their homes as a family asset rather than as 'capital'. Over 90 per cent of respondents felt reasonably secure, even without title deeds. None of those who operated enterprises from their homes had a mortgage in the name of the business. Tomlinson (2005) suggests that a strong focus on title deeds is inappropriate, given the real constraints of affordability and the limited availability of housing stock.

Studies in rural areas show that shared and relative rights are characteristic of most communal areas (Alcock & Hornby 2004; Cousins 2005). Most people enjoy *de facto* security of tenure, but their rights can be vulnerable to abuse by both traditional authorities and elected bodies. Access to services and infrastructure is constrained by lack of formal recognition of property rights. The strongest demand on the ground is for security of rights of families and individuals, but within a system that secures access to shared resources (Claassens 2003).

Access to services and infrastructure is constrained by lack of formal recognition of property rights

To summarise, our analysis suggests that key elements of de Soto's arguments have limited use in South Africa:

- *Titling does not necessarily promote increased tenure security or certainty,* and in many cases does the opposite.
- *Formalisation of property rights does not promote lending to the poor:* banks do not lend to the poor because of the high risk of non-repayment, the low value of their assets, and relatively high transaction costs. Households earning less than around R3 500 per month are unlikely to get access to formal credit using land or housing as collateral, whether or not they hold title deeds to their homes and land.
- *Rather than turning their property into 'capital', formalisation could increase the rate of homelessness*: if banks were persuaded to lend to the poor using their assets as collateral, foreclosure of loans would result in repossession. Poor households understand this.
- *The urban and rural poor already have some access to credit*, through informal mechanisms such as loans from family members. They try to avoid creating a long-term debt burden, and are averse to forms of borrowing that might lead to loss of important assets. Entrepreneurs do, however, want improved access to medium-sized loans for which informal credit is unsatisfactory.
- *Formalisation through registered title deeds creates unaffordable costs for many poor people*: registered properties become subject to building regulations, boundaries must be surveyed, services must be paid for, and rates must be paid to local government.
- *Informal property systems currently support a vibrant rental market*. It is estimated that 78 per cent of tenants in informal rental units earn less than

R1 500 a month (Shisaka 2003). While lack of regulation of this sector might have some negative consequences for economic mobility and the protection of rights (see Chimhowu and Woodhouse 2005), formalisation, by pushing up costs, could undermine this market.

- *Formalisation via title deeds for individual property can very quickly become inaccurate*. Many 'extra-legal' land tenures defy division into individual estates governed by principles of exclusive access and control. Registers based on these assumptions quickly become outdated; similarly, land-use plans that do not reflect practice on the ground become meaningless.
- *'The poor' are not homogeneous, and those in the extra-legal sector should be differentiated according to income and vulnerability status*. Formalisation via title deeds may be affordable and appropriate for some, especially those who are upwardly mobile, but can have negative impacts on the security and well-being of the unemployed and other marginalised groupings.

Formalisation of property rights is relevant only for those already on the way out of poverty

Rather than being a 'silver bullet' for poverty reduction, formalisation of property rights within dominant legal and administrative frameworks is relevant only for those already on the way out of poverty. Innovations by government and the private sector in relation to low-cost methods of property titling and microcredit schemes are welcome and should be encouraged, but these have clear limits.

Alternative approaches

For many rural and urban households, the lack of legal recognition of their property rights can result in insecurity of tenure, and can also hamper development. Laws and policies to increase tenure security and promote investment and development are thus required. If formalisation via integration into the existing system of private property is not the answer for large numbers of people, then what is? There are many interesting and important innovations in tenure reform under way across the developing world. These can provide pointers for the future.

Box 1 contains some examples from South Africa. Underlying these multifaceted attempts to pilot innovative approaches in South Africa has been a singularly successful legal intervention: the *Interim Protection of Informal Land Rights Act* (IPILRA, Act No 31 of 1996). This law was intended as a short-term measure to arrest dispossession of rights of customary-type occupation on state-owned land in the former homelands. It has also protected existing rights in a manner that recognises and legalises informal land occupation. While the IPILRA does not provide for a new land tenure and administration system, the concept of 'adverse possession' has helped to shape a new understanding of land rights not covered by the common law concept of ownership. Rights holders cannot be deprived of their land rights without their consent other than by formal expropriation, an action that requires the quantification of their rights and in effect means these rights achieve a value previously unrecognised in law. These laws have provided a base for developing a

Box 1: Some South African innovations in tenure reform

The New Rest site is an informal settlement in Cape Town whose residents, after lengthy negotiations, are working with the local authority to upgrade their services.The City of Cape Town and representatives of the New Rest community decided to explore a new approach to tenure upgrading. A phased approach to ownership was advocated.This involves property rights which are very close to formal ownership, but where the City retains the nominal formal ownership. Rights holders receive substantive tenure rights, although not quite full ownership.This land administration system is more flexible and cheaper than formal ownership. Rather than registration in the central Deeds Registry, the City holds and maintains records,which are also locally managed and controlled by street committees and neighbours.The community thus monitors new admissions and departures. It is user friendly, flexible, affordable and incorporates local tenure practices. Contracts between the Council and the rights holders reflect both the local reality and local practices, and fulfil the needs of the formal system (Walker, 2005).The legal arrangements for this tenure system are currently being prepared.

In Ekuthuleni, the case study discussed above, a land rights NGO, AFRA, has been helping the community to develop legal, affordable and accessible records as an alternative to the inflexible registration system offered by current state policy.Working at multiple levels (social, technical and legal), and with diverse stakeholders (government, private sector and NGOs), some important milestones have been achieved. Land holdings were demarcated on colour orthophotos showing existing local tenure arrangements. A recording system was built around local practice and knowledge. Spatial data was digitised using modern geo-spatial technology to produce mapped layouts of land rights and land use.However, without an appropriate legal framework to provide state support to local land administration systems, it is difficult to achieve the community's desired goal of legally recognised land rights. Thus AFRA and the community are seeking to pilot their approach under the government's Communal Land Rights Act (Act No 11 of 2004); agreement has yet to be reached.

concept of ownership through possession that diverges from the dominant common law concept of ownership in South Africa.

Lessons and conclusions

Much more attention should be paid to supporting existing social practices that have widespread legitimacy, rather than to developing expensive solutions to replace them. Some features of 'extra-legal' property regimes found in South Africa's informal settlements and communal areas provide the keys to the solution. These include: their social embeddedness; the importance of land and housing as assets that help to secure livelihoods; the layered and relative nature of rights; and, in some rural contexts, the flexible character of boundaries. Approaches based on Western property regimes fail to acknowledge and respond to these features, and can lead to distortions that negatively affect the poor – even when this occurs within streamlined, more efficient and lower cost administrative systems. The risks of damage are thus as important as the risks of failure.

More attention should be focused on the complex relationship between property rights, development and state investment and administration. In many developing countries, the state lacks the capacity to provide the poor with formal housing and associated infrastructure and services, and indications are that the problem is increasing exponentially. Attempts to address the problem through 'one-off' solutions involving high levels of state investment, such as systematic formalisation of property rights, need to give way to a more nuanced, incremental and integrated development approach. This would help extend infrastructure, services and economic opportunity—linked to legal recognition of diverse tenure forms—but without having to impose a country-wide property register.

The enormous inequities in property ownership inherited from the apartheid era remain a fundamental constraint to the poor. Poverty reduction policies must therefore centre on large-scale redistribution programmes. The snail's pace of current land redistribution efforts is not politically sustainable; new policies are urgently needed and may now be in the pipeline. Land reform laws such as the *Extension of Security of Tenure Act and the Land Reform (Labour Tenants) Act* that seek to secure the rights of occupiers without necessarily transferring full ownership to them, remain important but are proving inadequate in their present form. Research indicates that nearly one million farm dwellers have been evicted in the decade since 1994 despite these Acts (Wegerif *et al*, 2005). Property rights of people on farms thus need to be strengthened and the government needs to allocate resources for their protection. Similar arguments can be made for people continuing to be evicted from urban and peri-urban land.

For these suggestions to take root, reform of the dominant legal and administrative frameworks for holding and regulating property is urgently required, so that the principles that govern 'extra-legal' property in rural and urban informal settlements, and which often emerge within land reform projects, can receive legal recognition and practical support. This is the major focus of tenure reform initiatives currently being undertaken across Africa, Latin America and Asia. South Africans can learn from these.

Endnotes

1 Chimhowu and Woodhouse (2005) call these local markets 'vernacular' or 'disguised' markets, and stress the importance of understanding their operation for market and land tenure reforms.

2 These include the failure to anticipate impacts on public budgets, especially those of urban local authorities; the failure of commercial bank loans to agriculture; conflict of interests between banks, potential borrowers and protected dependants; gender equity conflicts; and the scale of direct implementation costs.

3 Documented in Hornby 2004.

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Deriving development from de Soto:

A vision for South Africa

Stefan Schirmer

Reducing de Soto's work to such mechanistic, one-size-fits -all prescriptions will do little to advance the cause of development in South Africa, or anywhere else for that matter

DURING A recent visit to South Africa, Hernando de Soto, the Peruvian property rights guru, stated that 'it was very important to note that property was the genesis of the rest of the market economy', and that 'without property titles the merging of the first and second economies would be impossible' (SAPA 2005). This type of pronouncement, based on a whirlwind visit, can have the effect of making the solution to development problems seem simple: just hand out property titles to those who do not have them. However, reducing de Soto's work to such mechanistic, one-size-fits-all prescriptions will do little to advance the cause of development in South Africa, or anywhere else for that matter. In this paper I will argue that the hype that now surrounds de Soto has served to obscure some of the more complicated realities he describes in his books. If these are interpreted from within a particular development paradigm, they contain valuable lessons for promoting gradual but sustained processes of poverty alleviation.

Interpreting de Soto

Even those critics of de Soto who do not find his emphasis on markets totally unacceptable have argued that the formalisation of property rights simply does not work as a developmental solution. As one such critic put it: 'On the ground, it turns out that de Soto's ideas are doing very little to solve the actual problems of poor people' (Gravois 2005). Writers such as Alan Gilbert, Geoffrey Payne and Camilla Toulmin have pointed out that property titles do not set the poor on to a happy path of capitalist accumulation, and can often make them vulnerable to expropriation (Gilbert 2001; Payne 2002; Toulmin 2005).

John Gravois (2005) observes that de Soto responds to such criticisms by claiming that the actors in these scenarios have not properly understood the teachings of the master. If true, this would be an arrogant and simplistic response. It is much more useful to place de Soto's prescriptions within an approach that sees processes of democratisation as crucial, and believes that, in order for change to be sustainable, 'it must come from within those that are changing' (Ellerman 2005:ii). Such an approach is defined by four essential elements:

1. It proposes that the central means of achieving development is the extension of Aristotelian democracy – which implies extending power to the people or, in Hirschmanian terms, giving more people a greater 'voice' (Sklar 1996:27).
2. It sees developmental interventions as harmful if they create dependence and perverse incentives, but necessary if they 'help the poor to help themselves' (Ellerman 2005).
3. It sees markets as the primary mechanism of generating material improvements, but does not favour unregulated markets, which in Sklar's terms are regarded as 'utopian dreams'. As Sklar (1996:39) puts it: 'Democracy implies the public management and nurture of markets so that they will flourish with affordable fairness in the distribution of opportunities, services and wealth'.
4. Following a dichotomy defined by Karl Popper, it chooses 'piecemeal democratic reform' over 'utopian social engineering' (Easterly 2006:14).

From this perspective, the formalisation of property rights that de Soto calls for cannot be a mechanistic, top-down titling process. Instead, property rights must have real meaning for the people who are supposed to benefit from them; they cannot exist as mere paper rights. They are therefore only operational if they actually enhance the ability of people to participate in the wider economic system. Secondly, the process of creating such rights cannot simply be imposed in a top-down fashion by existing bureaucracies. Such a process will inevitably produce the kind of bureaucratic exclusion de Soto identifies so often in his book *The Other Path*. Formal titling systems that have no meaning to people on the ground are the same as the complex company registration processes that de Soto described in Peru. These will often be less useful than the informal, localised rights that poor communities inevitably create for themselves. We therefore reach two core conclusions:

The formalisation of property rights that de Soto calls for cannot be a mechanistic, top-down titling process

- Property rights will only be effective if they draw people into the core economic system, and allow them to participate in that system.
- Creating real, meaningful rights is a very complex social process.

These conclusions make de Soto's 'solution' a lot less simple than is sometimes believed. This does not, however, constitute a reason to abandon it.

What are property rights?

A central point made in de Soto's work is that the poor, broadly defined as the 80 per cent of the world's population that lives significantly below the standards of developed western countries, have lots of property but no rights. Thus, de Soto argues, the poor are not as desperately impoverished as people often imagine. According to research conducted by his Institute for Liberation and Democracy, the value of trapped assets in Mexico and Egypt are $300 billion and $198 billion respectively. The problem is that the people who control this 'property' do not have the ability to turn these assets into capital, which prevents them from embarking on the accumulation process that has been at the heart of all successful economic development.

De Soto has therefore been instrumental in challenging the view that poor countries required primarily resources and investment to develop. He maintains instead that those countries that contain the majority of the poor and have lagged significantly behind the developed world could in fact be considered as asset-rich and capital-poor. Markets and entrepreneurship are equally extensive in these poor countries, but once again they do not generate as many benefits and as much wealth as they should. As C K Prahalad (2005:79), a supporter of de Soto's work whose contribution is discussed below, has put it, 'poor countries mostly have vibrant private sectors and market economies, but the private sector is informal, fragmented and local'.

De Soto's work has therefore shifted the emphasis away from the material deprivation of poor countries towards their institutional deprivation

De Soto's work has therefore shifted the emphasis away from the material deprivation of poor countries towards their institutional deprivation. His fundamental and important contribution is to demand that development should be about building on the initiatives, energies and assets that exist already. The purpose of development should be to unlock the inherent potential that the poor already possess. Property rights are the key to unlocking this door. But property rights are really a short-hand way of describing the social and legal institutions that will allow people to become willing participants in an integrated market economy. Property rights must therefore be those laws, conventions and practices that allow people to engage in the following activities:

- the relatively easy buying and selling of property;
- investing in their own enterprises, and getting others to invest in them as well;
- using assets as a basis for obtaining loans from a variety of institutions;
- taking legal action against those violating property rights;
- receiving protection from the state when property is threatened; and
- entering into contracts that are binding and enforceable.

If the will to enter into any of these activities exists, but there are concrete barriers in their way, then property rights have not been effectively established. In short, a property right that is not secure cannot be considered as such. A title recognised by the state or a legal paper that does not allow the holder to engage in the kind of market activities listed above is the same as the informal titles that provide some local rights but also force the holder to take responsibility for defending the right against competing claims. Property rights should therefore be thought of broadly as mechanisms through which people are integrated into the market economy. Such rights are inevitably contained in complicated institutional networks.

Property rights in this broad sense cannot be simply seen as title deeds, or as 'paperised' forms of ownership. The critics who point to the limits of such titles are correct, but do not invalidate the property rights approach. If property rights are complicated networks of laws and norms, the process of creating them has to be more difficult than simply handing out pieces of paper to poor people. The process of creating effective property rights now becomes the thorny question on which the practical usefulness of de Soto's vision hinges. The following sections will provide reasons why accepting the difficulties does not invalidate the approach.

Creating property rights through social processes

There are times when de Soto seems to suggest that solving poverty is simply about getting those in authority to see the light. Development agents have failed to recognise that property rights are the solution, he argues. If they can be made to see this truth, by reading and consulting with de Soto and his Institute of Liberty and Democracy, then they can proceed straight to turning poor people into property owners. In one story the process is described as following de Soto around the slums of the Phillipines and listening to dogs barking. Where a dog barks to defend someone's house, property exists, and can be listed as such in a national registry (Cabacungan 2004).

The creation of property rights in the West was a long, difficult and gradual process involving fundamental social transformations

This is the core of the problem with the way in which de Soto's work is being appropriated. The process of creating property cannot be that simple, as one can gather from an in-depth reading of his two books. His analysis of how property was created in the West includes the following synopsis:

> The process within the formal property system that breaks down assets into capital is extremely difficult to visualise. It is hidden in thousands of pieces of legislation, statutes, regulations and institutions that govern the system. The genius of the West was to have created a system that allowed people to grasp with the mind values that human eyes could never see and to manipulate things that hands could never touch (de Soto 2001:34).

This is put forward to show why property rights are the hidden secret to developmental success, and it suggests that people in the West gained an advantage because individual geniuses somehow grasped this secret before anybody else. But property rights in the West were not consciously created by clever individuals. They emerged out of complex processes that involved 'thousands of pieces of legislation' and required ideological shifts, both within the state and within crucial segments of society. The creation of property rights in the West was a long, difficult and gradual process involving fundamental social transformations. Promoting development through property rights can therefore not be as simple as de Soto in his advocacy role sometimes seems to suggest.

De Soto's books contain descriptions of these difficulties, including unsuccessful and successful examples, both of which demonstrate just how hard it is to create a meaningful property rights system. In *The Other Path* he shows that in Peru's informal sector it is not necessarily the absence of property and contract laws *per se* that prevents poor people from using their assets to break out of poverty. It is, instead, the inability of the poor to work within the ambit of the national law that creates the problem. The reasons for this situation are diverse and complex. A central issue in countries such as Peru is the cost imposed by and the inefficiency of the legal system. This makes it too expensive and difficult for the poor to operate legally, and they therefore withdraw into the informal sector. But the major long-term problem that this creates is the entrenched conflictual relationship that is set up between ordinary entrepreneurs and the legal system. People in the informal system are now regarded as criminals who must be punished by the law, whereas the law comes to be seen as an alien, oppressive force that needs to be resisted. As a result people in the informal sector are unlikely to accommodate the law, and the law is unlikely to accommodate the interests and concerns of those in the informal sector.

De Soto has acknowledged that property rights require a co-operative relationship between state and society

De Soto (1989:160) describes the history of informal trade in Peru as 'a long march' in which the traders have tried to become an integral part of the legal system and thereby create the secure property rights that they need to become successful accumulators working in established markets. However, he also sees the process as a 'fluctuation between persecution and cooperation' that began in colonial times and has persisted 'century after century'. He thus shows that the state made numerous attempts to draw the traders voluntarily into the system, but that these usually failed, and were then followed by coercive attempts to formalise and control the traders. He blames this situation wholly on the state. The authorities, he argues, clearly did not understand what was happening. Their efforts to control the vendors were politicised, and the state was constantly defending the status quo, which the vendors seemed to threaten. The vendors, by contrast, acted rationally, fighting for their property rights and becoming politicised only in reaction to the unfair controls government sought to impose.

This seems like a rather one-sided account. The essential problem was the failure of the two parties to reach common ground. This failure can clearly be partly blamed on the government's short-sightedness and the narrow interests various regimes represented. An additional problem that de Soto does not take seriously enough, was the lack of competence within the bureaucracy. Even when officials tried to build an integrated property rights system, they failed to get it right. But most importantly, despite informal leaders periodically being co-opted into government, the levels of trust between government and the informal traders have generally been low. This often leads to spiralling conflict as traders respond to government initiatives with protest marches (in one instance led by a Maoist and a Trotskyite), and the state responds with police repression. Under such conditions an effective legal system facilitating market-based accumulation is unlikely to emerge. The fundamental obstacle to creating effective property rights in Peru, then, appears to be general social conditions that are not conducive to creating the necessary levels of integration between state and civil society.

De Soto has certainly acknowledged that property rights require a co-operative relationship between state and society. Take the following quote from *The Mystery of Capital* as an example. Formal property, de Soto (2001:231) admits, is more than a system for titling, recording and mapping assets:

> It is an instrument of thought, representing assets in such a way that people's minds can work on them to generate surplus value. That is why formal property must be universally accessible: to bring everyone into *one social contract* where they can *cooperate* to raise society's productivity (my emphasis).

De Soto's review of the history of property law in the United States shows that it was precisely a contingent process of accommodation between the law on one side and emerging entrepreneurs and potential property owners on the other that ensured the success of the capitalist system. He (2001:158) depicts a long and complicated historical process through which formal law in the United States embraced and incorporated many of the extralegal arrangements that settlers on the frontier had created. By accommodating these emerging entrepreneurs in this way, American law-makers brought ordinary people into the ambit of the law of the land while simultaneously legitimising that law in the eyes of the ordinary people.

Development generally should therefore be about promoting the processes of change that will facilitate greater levels of co-operation between the state and the poor

Initially, law-makers in the state and in the courts saw America's squatters as a threat to property and the public order. It was only through the particular way in which democracy developed that those in power began to see the value of squatters, and the latter were then able to influence and become part of the legal system. The turning point came when pressure began to mount against an 1821 Supreme Court ruling – the so-called Biddle case – that had favoured only those with legal title to the land they occupied. In de Soto's words:

> Politicians who had been cultivating the support of their extralegal constituents lambasted Biddle as 'most ruinous' and causing 'great alarm' for Kentuckians. The Supreme Court might be oblivious to the new political and legal reality taking shape on the rapidly expanding frontier, but Western politicians only had to look out their windows to see how quickly the country was changing. Tens of thousands of hardy migrants had trudged westward from the original colonies over the Appalachians to settle on fertile, virgin lands. In 1620, there had been approximately 5,000 settlers in all of British North America. By 1860, the US population was more than 30 million and counting. Fifty percent of that citizenry lived west of the Appalachians (2001:162).

But many Latin American politicians have looked out their windows, seen thousands of rapidly urbanising poor people, and failed to integrate them into the legal system. In these countries lawmakers cannot see 'squatters' or 'informals' as legitimate citizens, nor can the informals bring themselves to submit to government control. It is not that these politicians have somehow been prone to making policy mistakes. Instead, they have not been subjected to the kinds of democratising processes that were unleashed in the United States. It was crucial in America that the squatters were able to exert pressure – but it was equally important that this pressure was exerted within the structures of the broadly democratic American system. In many Latin American countries, by contrast, the informal poor are either too marginalised to exert any pressure, or launch full-frontal attacks on the system, led, for example, by Maoists and Trotskyites. It is therefore vital for property rights that processes of balanced democratisation emerge, in which the poor pressurise the state to develop an agenda that promotes their participation. This has to occur without the state becoming subject to quick-fix, populist solutions. Getting this right is a very difficult balancing act that depends on the convergence of numerous processes.

From this reading, de Soto's perspective contains a catch-22 type dilemma, which explains why building market economies in poor areas have not progressed more rapidly. Markets do not work properly for the poor if poor people are not integrated into the system, and the most effective way to integrate people into the system is to make markets work for them. To break this vicious cycle, interventions are required that pull the poor into the market system, but in order to initiate these processes the character of the relationship between the state and the poor has to change. This must involve processes of democratisation initiated by the state, the poor, or – preferably – both at the same time. The poor have to cease playing the role of stubborn outsiders or opponents, and become social partners who demand reform. It is only then that the value of being inside rather than outside the system will gradually emerge.

Creating property rights is not a quick or easy solution to alleviating poverty

Development generally should therefore be about promoting the processes of change that will facilitate greater levels of co-operation between the state and the poor. To get this process off the ground we need a dual approach. We first need a vision of development that is about integrating, in a particular way, the existing initiatives of the poor into the state-run legal system. This must be a process in which the state moves closer to the poor masses, and vice versa. It must not be a top-down planning process in which the state imposes a particular vision on the poor. Nor must it be a populist process in which the poor impose quick-fix solutions to their predicament on the state. Instead, the state sets the broad agenda and then seeks to accommodate the poor in such a way that it becomes possible to build on the economic efforts the poor are already engaged in.

In a recent talk de Soto (2006) endorsed this interpretation of his work. He admitted that achieving development is 'more difficult than we thought', and asserted that 'the real problem is how do you actually mesh [institutions] with people's beliefs. What adjustment do you have to make so that a good rule becomes applicable and culturally recognisable in your own country?' He also emphasised the importance of building on the organisational efforts initiated by people on the ground.

Creating property rights is therefore not a quick or easy solution to alleviating poverty. And to develop practical ways of creating them we require a historical understanding of why bureaucracies become inaccessible. Rather than simply assuming that states will see the light if we tell them the answer, we need to understand how they got to where they are and what specifically needs to be changed to improve the situation. It also requires initiating localised mobilisation and experimentation.

Addressing the South African state

The state is the agency that has to take the lead in implementing this approach. It is the only agency that can provide the effective integration and centralised law enforcement on which workable property rights hinge. Unfortunately, the South African state – as in many other developing countries – lacks the capacity to quickly create the efficient institutional network required. This problem has to be acknowledged in order for the development vision proposed in this paper to have any practical relevance. Faced with this reality, solutions that build up markets and encourage popular participation can seem too slow and too difficult, while extreme poverty demands urgent solutions. Such feelings are understandable, but not very helpful to the poor.

In South Africa there is a growing feeling within the ruling party and among its supporters that markets have failed, and that centralised government intervention is required to transform the 'backward second economy'. This has led senior officials to argue for the introduction of a 'developmental state' as a solution to poverty. Southall (2006) has pointed out that there is very little clarity or agreement about what this means. There are, however, suggestions that it means moving to the kind of 'state-planning-that-tolerates-markets' that analysts such as Chalmers Johnson (1982), Robert Wade (1990), and Alice Amsden (1989) identified in East Asia. The problem in South Africa is that we have neither the state capacity that Evans (1992) saw as crucial, nor the close co-operation between state and civil society that Doner and Hawes (1995) have emphasised. By moving to developmental state options we would therefore be replicating the mistakes that de Soto identifies in Peru. Through extended state control, we will simply push the poor out of the market system, and prevent that system from expanding sufficiently to accommodate them. What seems like a more achievable goal in the short term will in effect have negative long-run consequences. If development advocates focused on only one thing, it should be to persuade governments to avoid utopian quick fixes, which implies an end to extending their control beyond their capacity.

Through extended state control, we will push the poor out of the market system, and prevent that system from expanding sufficiently to accommodate them

To promote de Soto's vision in South Africa, we must therefore:

- oppose the current trends towards increased state control;
- encourage those programmes and those sections of the state that are seeking to co-operate with the market system; and
- promote democratisation processes while eschewing populism and zero-sum confrontations.

Government must choose its interventions carefully and, rather than solving a major national issue all at once, various bureaucracies must start by taking small bites out of bigger problems. We must avoid, as Hirschman (1981:234) says, 'overconfidence in the solvability of all problems,' and instead help people to confront their own difficulties. We should build on local knowledge and initiatives, and reduce, where we can, the obstacles that block people's participation in the economic system.

Doing this well does require capacity, but working together with others will help government agents to learn by doing and will allow them to draw on the abilities of those outside the state.

One arm of the state that shares this vision is the Public Service Commission. In its 2006 report the commission argued that partnerships between civil society and the public and private sectors 'need to be pursued in earnest since they promote a leveraging of skills and other resources, and thus help augment the capacity of the Public Service'. The commission, sensibly, does not see this as a panacea, as it recognises that successful partnerships require strong leadership. But pursuing gradual democratising processes that draw in the private sector and the poor must be seen as the best way to build up developmental structures that will last.

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Agencies of change

Development, then, should not be left entirely up to the state, although its role is crucial. Other agents of change who can contribute positively to expanding property rights are large corporations and non-governmental organisations. These agencies can promote the processes required to build an integrated property rights system by drawing poor people into markets on the one hand, and encouraging co-operation between bureaucracies and disadvantaged people on the other.

Two recent development approaches also have the important side-effect of drawing the poor further into the market system. They can therefore promote the kinds of democratising processes that lead to the social contracts between the state and the people necessary for the effective establishment of property rights.

The first approach is C K Prahalad's call to involve large corporations in serving the segment of the market he calls 'the bottom of the pyramid' Prahalad (2005:77), sees big businesses as more than mere participants in markets. He also regards them as powerful institutions that can change the conditions within which markets operate. Thus his work examines both the business strategies that should be followed if corporations want to profit from selling goods and services to the poor, and the social strategies that should be followed to ensure the growth of markets in poor areas. The two processes in fact overlap. Prahalad shows that, by becoming involved in poor areas and striving to construct effective, workable business ecosystems, corporations draw poor people into markets and provide them with what he calls 'transaction governance capacity'. This entails a learning process whereby poor people become trained in the ways of entering into and enforcing contracts while simultaneously developing a commitment to honouring the legal system. By benefiting from the workings of the market, poor people begin to understand that respecting contracts creates a win-win situation for them and the firms they are engaging with. Participation in a business ecosystem also enhances the relative power of poor consumers and producers, which contributes to people's desire to be part of the system. Participation in markets helps the poor to see the rationale for the contracting system: 'how and why it reduces transaction costs and therefore reduces the costs of capital and increases the access to capital' (Prahalad 2005:68). He sums up this process as follows:

> By creating a collective commitment to accountability to contracting conditions [business ecosystems] continually reinforce in the local community the benefits of being within the system. Ultimately, the goal in development is to bring as many people as possible to enjoy the benefits of an inclusive market. Transaction governance is a prerequisite. The market-based ecosystem might provide us an approach to building the basic infrastructure for inclusion of [poor] consumers. It also allows large firms to build new and profitable growth markets (69).

This view fits rather closely with seeing the establishment of property rights as a social process in which the poor are drawn into, and are then able to influence, the system. In addition, the advantage of harnessing big business to this process is that they have fairly immediate self-interested reasons to become part of the solution – they are trying to make profits for themselves. This should not, however, be seen as an automatic, market-determined process. Big corporations are not oriented towards serving the poor, and their managers therefore regard such activities as unsuitable and too risky. Interventions are therefore required to get businesses to see the advantages of entering and building up the markets in which the poor participate.

Interventions are therefore required to get businesses to see the advantages of entering and building up the markets in which the poor participate

Prahalad (2005:71) does not, in fact, advocate leaving the building of markets in poor areas entirely to private enterprises. He argues that the process of creating an inclusive legal system is primarily determined by 'how bureaucracies deal with citizens'. In order for governments to draw people into the system they must act in the interest of their clients, be transparent, and reduce corruption. They then have to convince their citizens that it is cheaper to be inside than outside the system. In order to achieve this, government must make a clear commitment to reducing corruption and transparency, and, most importantly, it must pursue these goals in a highly consistent manner.

The second way in which property rights can be helpfully promoted is the Making Markets Work for the Poor approach adopted by many non-governmental organisations (NGOs). This stems from a realisation that traditional types of NGO interventions have been counterproductive. These involved protecting the poor from markets rather than promoting processes through which the poor gain access to and become part of the market system. The British Department for International Development (2005:4) recently criticised this protective approach in the following terms:

> The distortions that were introduced impaired efficiency of resource use and hence undermined growth, reduced the incentive for the private sector (the engine of growth), did not meet the needs of many of the poor and, in the end, were not sustainable.

By contrast, the new approach seeks to draw the poor into markets, build on existing initiatives undertaken by the poor, and ensure that markets run smoothly. DFID (ibid) explains that this approach 'focuses on changing the structure and characteristics of markets to increase the participation of the poor on terms that benefit them. [It] addresses the behaviour of the private sector and so reinforces the market system rather than undermining it.' By undertaking such efforts to draw the poor into the market, and by promoting initiatives that ensure that markets work in such a way that participation by the poor is facilitated, NGOs are contributing to the kinds of processes through which effective property rights will become established.

A story from Vietnam illustrates the point. From September 2003 to December 2004, the NGO International Development Enterprises (IDE) implemented a project targeting about 54 000 households in the coastal provinces of Thanh Hoa and Quang Nam. The project examined two research questions: 1) whether rural families will invest in latrines when a range of low-cost models are available from local private sector suppliers; and 2) to what extent targeted promotional campaigns can influence consumers' decisions to invest in and change sanitation practices. The first question is about building on existing market-based activities that involve the poor; the second is about drawing the poor more extensively into market-based solutions to their problems. Unlike the conventional approach normally applied in Vietnam, this one offered customers no capital cost subsidies. Instead, it focused on stimulating weak rural sanitation markets and helping these markets to become viable.

The new approach seeks to draw the poor into markets, build on existing initiatives undertaken by the poor, and ensure that markets run smoothly

One outcome of this project was the more effective provision of sanitation facilities compared to the more traditional subsidy-driven or direct provision approaches. But the other outcome was that people in Vietnamese villages were drawn much more extensively into the market system, revealing that toilets can have more than one purpose. For example, women formed voluntary groups to encourage members to maintain their payments, and helped one another to mobilise funds from informal sources when necessary. Private sector resources then flowed into this market, and local economic activity was further stimulated (Tanburn 2005).

The stimulation of these market activities had the effects outlined by Prahalad. It demonsteated the benefits of the market system to poor people, and therefore made them more ready to demand full participation in the system. This then makes it easier for states, if willing, to accommodate demands for legal rights and to help confer the legal rights necessary to make poor people fully fledged property owners.

Is this a progressive or a conservative approach?

Gravois (2005) seems to be critical of the way in which de Soto appeals both to 'the left' and 'the right'. He maintains, slightly sarcastically, that 'for the left, de Soto has formulated the most seemingly practical ideas for reducing global poverty. For the right, de Soto offers the most compelling way to market capitalism to the poor.'

But this is one of the most appealing aspects of de Soto's approach, as it allows us to avoid the old state-versus-markets debate. Thus far, neither states nor markets have, on their own, done much for the poor. De Soto's approach brings the two together as it requires the state to structure the environment in such a way that the poor are enabled in a market context. It means helping the poor to help themselves, and this requires vision and purpose from the state.

What hope for the poor?

We have to recognise that this approach, like all poverty reducing schemes, contains significant limits. It is not easy to implement; is gradual, and requires extensive local knowledge and experimentation based on what the poor are already doing. Rather than devising grandiose schemes, it asks development agencies to strengthen those activities that the poor are already engaged in. Most seriously, this approach is not well suited for NGOs and government departments that need to demonstrate tangible, quantifiable results; it does not really produce measurable 'outputs'. Despite these difficulties, it provides hope for the poor.

The system needs to create many more jobs, and this should be the primary way in which poverty is reduced in South Africa

Firstly, it should be seen as part of a general strategy of allowing as many poor people as possible to become part of the market system. This requires that efforts be concentrated on expanding the system, and making it more robust. Most importantly, the system needs to create many more jobs, and this should be the primary way in which poverty is reduced in South Africa. We should never adopt an approach that focuses only on small-scale entrepreneurship; one of the aims of de Soto's approach is to allow some small, informal businesses to become big businesses and thereby to create jobs for others.

Secondly, although the momentum for drawing the poor into the market system may be relatively weak, it can quickly happen that small, disparate initiatives add up and create the momentum required to launch transformative growth. Both economic growth and scattered processes of co-operation and democratisation already exist. These elements will allow us to transform poverty in South Africa if they are not overwhelmed by the negative elements of authoritarianism, the desire for control, the lack of trust, and the growing tension between the government and the poor.

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The second economy and 'dead assets':

Why we must think beyond de Soto

Ebrahim-Khalil Hassen

In South Africa at least, the connection between formalisation and participation in the economy is far from assured

THE SOUTH African government – and specifically the Presidency – argues that the country has a 'first' and second' economy, and that ways should be found of bridging the divide between the two. In line with this, the Accelerated and Shared Growth Initiative for South Africa (AsgiSA) states that:

> A final set of Second Economy interventions is centred on the challenge of realising the value of *dead assets* – land, houses, livestock, skills, indigenous knowledge, and other assets that have intrinsic value not currently realised (The Presidency, 2005 – author's emphasis).

The government's proposals for addressing the problems surrounding the 'second economy' include attempts to provide the poor with improved access to credit, notably via the Financial Sector Charter. It is also focusing on formalising land tenure in the informal sector, as well as assisting informal traders.

The concept of 'dead assets' and the strategies being adopted to put them to productive use can be traced to the work of the Peruvian economist Hernando de Soto. Support for de Soto's work in South Africa is not a shallow or fleeting phenomenon; there is evidence that his ideas have profoundly influenced the thinking of government officials. For example, the Deputy Minister of Finance, Jabu Moleketi, recently declared that the informal sector had a major role to play in attaining the goals of halving poverty and unemployment by 2014 (Moleketi 2007).

De Soto's thesis has an intuitive appeal. Surely, his supporters argue, having a title deed for an informal house is better than not having a title deed at all. This argument has some merit, but also an important limitation: it assumes that once people who own property informally are given title deeds, they will use them for productive purposes. However, in South Africa at least, the connection between formalisation and participation in the economy is far from assured. On the contrary, a ground-breaking study on the township residential property market has found that low-income township households are not using their property to generate income, either through rentals or for business purposes. The study thus argues that:

> Consequently, houses in black townships are 'dead assets' – contributing towards households' housing needs but not contributing towards economic empowerment (FinMark Trust 2004).

There is thus an important disjuncture between the formalisation of property ownership on the one hand and the ability to use such assets to earn an income or secure business loans on the other. This disjuncture is examined in this paper. It argues that, given the structural nature of poverty and inequality in South Africa, alleviating poverty and stimulating the 'second economy' requires far more than formalising the existing assets of the poor; in fact, what is required is a comprehensive asset-building strategy for poor households. To this end, it starts with a brief review of South Africa's development challenge. Next, it discusses the de Soto thesis, focusing on the concept of 'dead assets' and the role of the state in 'bringing them to life'. Following this, it examines alternative explanations of the role of assets in development. Finally, it makes some policy recommendations that link assets to poverty reduction more strongly than the mechanisms proposed by de Soto.

Democratisation has not yet provided the poor with ways of exiting out of poverty

The developmental challenge

The Presidency has released a set of development indicators which acknowledge that the structural nature of poverty, inequality and unemployment in South Africa are still binding constraints on realising the goals of halving poverty and unemployment by 2014 (The Presidency 2007).

First, the report shows that high levels of inequality are entrenched, and are in fact increasing. The data shows a complex picture of continuity and change. On the one hand, income inequality has remained virtually unchanged between 1993 and 2006, suggesting that democratisation has not succeeded in reducing inequality.

In fact, South Africa's Gini Coefficient – a measure of inequality in a given society – increased slightly from 0,67 in 1993 to 0,68 in 2006, with 0 representing perfect equality and 1 perfect inequality. In 2006 the richest 10 per cent of South Africans received a staggering 55,9 per cent of all income, while the bottom 10 per cent only received a paltry 0,6 per cent. On the other hand, there are changes in income shares based on race: inequality between racial groups has declined, but inequality within racial groups has increased. In 1993, 61 per cent of inequality was between race groups, but by 2006 this had declined to 40 per cent. This suggests that inequality in South Africa is now more class-based than race-based. This is unsurprising, given the black middle class is growing at an estimated 20–35 per cent a year. At the same time, incomes of wealthy households have grown far more than those of poorer households. The overriding picture is that democratisation has not yet provided the poor with ways of exiting out of poverty. More worryingly, if assets – not just income – are included, levels of inequality are probably much higher, and might reveal high levels of indebtedness among the black middle class. Consequently, South African society might in fact be more unequal than is suggested by looking at income statistics alone.

Second, the estimates of poverty suggest a decline in the poverty head count from 50,1 per cent in 1993 to 43,2 per cent in 2006. While the actual numbers are disputed, the trend is encouraging. However, caution is needed, as the poverty line used to measure these trends is R250 per person per month, which is hardly enough to buy basic foodstuffs and other necessities. The National Treasury puts the poverty line at R322 for 2000, which would change the picture dramatically. This is especially true as the incomes of black households – who are the majority of poor households – are clustered around the poverty line. This is important, as a mere R35 increase in the poverty line adds 2,6 million people to those in poverty. The most significant policy question arising from this is that even if people were above the poverty line, any household or economy-wide shock would result in a significant increase in poverty rates.

The development indicators for poverty, inequality and poverty suggest that the structural pattern of poverty remains entrenched

Third, the official statistics on unemployment suggest a decline in unemployment from 2001 to 2006; however, in the same period 1,6 million jobs were created. Whilst there are major disputes about the definition of a job, the median income for employed Africans in 2005 was more than R1 500 a month (COSATU 2007). This median income would place households with one person working slightly above the poverty line used by the Presidency, but would put a household of four below the R430 poverty line estimated by the National Treasury for 2006. The implication is that, assuming that there is no overcounting of informal sector subsistence activity as jobs, many wage-earning households live below the poverty line.

However, since 1999 Statistics South Africa has included more informal sector workers and subsistence farmers as being employed (Makgetla and Van Meelis 2002). This has a significant impact on counting the number of jobs. In an important analysis of the number of unemployed, Casale, Muller and Posel (2004) argue that about 175 000 jobs a year have been created between 1995 and 2003, rather than the reported 270 000. The difference is partly accounted for by excluding 'survivalist' activities. This is an important observation, as de Soto argues that it is the informal sector – especially self-employment – that, once formalised, will offer an exit route out of poverty.

However, taken together, the development indicators for poverty, inequality and poverty suggest that the structural pattern of poverty remains entrenched. This is evidenced by rising levels of inequality, poverty reduction that will probably be eroded by any national shock, and low median wages. The question that arises is whether de Soto's proposals would enable a break from structural poverty, or whether bolder initiatives are required. We turn to this issue in the following sections.

'Dead assets' and the role of the state

'Dead assets' is a key phrase in de Soto's work. By this he means that the poor own assets which they cannot utilise because their ownership of those assets has not been formalised. In his writings, 'dead assets' include housing, transport, informal business and land, and they have this status because households are unable to use them to access credit. At their core, de Soto's arguments are similar to those about credit market imperfections. In other words, 'dead assets' are dead because they cannot generate a flow of income or credit, and they cannot do so because they have not been included in the recording process central to a capitalist system.

De Soto's central proposal is therefore that, if informal markets were formalised, the poor would be able to use their assets to generate additional income, or access business loans. This, in turn, would help them to exit out of poverty, as they would be able to diversify their income and create new income flows through the utilisation of credit.

These proposals have received widespread attention, and have influenced the strategies of various countries to overcome poverty. However, as Sachs (2005) argues, they are tantamount to a 'silver bullet'; a single, one-size-fits-all solution that ignores a number of important modalities, and fails to recognise contextual variations.

Yet providing titles for housing in South Africa has not incorporated the poor into the formal economy, or allowed them to extract capital flows from housing

Redistributive combines and power

Another central concept in the de Soto system is that of 'redistributive combines' – interest groups that pressure policy-makers into making laws or regulations that favour them economically without regard to the broader effects of these measures on society (de Soto 2002:190). De Soto and his collaborators describe these sorts of measures as 'bad laws', and identify 'redistributive combines' as their cause. In *The Other Path*, de Soto writes that:

> There are of course differences between right-wing mercantilism and left-wing mercantilism; the former will govern to serve foreign investors or national business interests, while the latter will do so to redistribute well-being to the neediest groups. Both, however, will do so with bad laws which explicitly benefit some and harm others. Although their aims may seem to differ, the result is that in Peru one wins and loses by political decisions. Of course, there is a big difference between a fox and a wolf but, for the rabbit, it is the similarity that counts (2002:239).

The concept of 'redistributive combines' recognises the important idea that the absence of a transparent and inclusive property system makes it easier for politicians to distribute favours and privileges to various interest groups. Capitalism does, of course, produce winners and losers, and this is partly explained through the existence of these kinds of networks. However, as the above passage shows, de Soto argues that left- and right-wing governments both attempt to satisfy interest groups, resulting in similar outcomes. Embedded in this argument is a recognition that changes in power are central to achieving more inclusive economic arrangements. However, both the strategy being advanced to reconfigure those power relations and the underlying argument are open to substantive criticisms.

The strategy of formalisation assumes a causal effect on the livelihood strategies of households. Yet providing titles for housing in South Africa has not incorporated the poor into the formal economy, or allowed them to extract capital flows from housing. The weakness of de Soto's argument is that it assumes that existing power relations – embedded in credit markets, for instance – would see value in extending credit for informal or low-income housing, which requires the provision of title deeds. In South Africa, the Financial Sector Charter is an explicit recognition that credit provision to poor households is very weak, and that credit in itself can be exploitative. This has resulted in the government overhauling the credit system via the National Credit Act 34 of 2005.

Moreover, credit (with interest) is a double-edged sword for household livelihood strategies. Current rates of household indebtedness suggest that the South African consumer is already overborrowed. In 2006 the Monetary Policy Committee stated that:

The notion of assets as an important aspect of development strategy resonates across ideological divides

> … the ratio of household debt to disposable income had risen to just below 66 per cent in the final quarter of 2005. The cost of servicing this debt, while still low, nevertheless increased from 6,75 per cent of disposable income in the third quarter of 2005 to 7 per cent in the fourth quarter. (http://www.sarb.gov.za).

Importantly, the figure of 7 per cent refers to debt servicing only – without any redemption of the principal loan amounts. Households with working members therefore face the danger of landing in debt traps. While debt might be raised for buying a house, or paying for children's education,

> The figures on incidence of debt may be substantially under-reported because many people do not want to admit to their level of borrowing. Although only 11% of South African adults claim to have a personal loan, there are factors that raise the red flag of concern. First is the tendency of a high proportion of people to claim that they will get into debt for an item they desire rather than saving up to buy it. Even more worrying is that 7% of the population claims they have incurred or would get into more debt to pay off existing debt, leading many into a debt spiral. This, coupled with the fact that only 23% of the population claim really to understand what interest rates are, emphasises the continued need for financial education to allow better financial decision making, and ultimately financial health. (FinMark Trust 2006).

Consequently, there is both a linearity in de Soto's proposals, as well as a weak causal effect between formalising and breaking down structural poverty. The proposals are linear in that the downside of credit – notably its ability to trap households in a debt spiral – is not acknowledged. Consequently, the effects of formalising access to credit and addressing poverty are much more contingent than advanced by de Soto.

Assets are not linear

The notion of assets as an important aspect of development strategy resonates across ideological divides. Michael Sheridan, one of the leading thinkers about asset-building, argues that:

> Income only maintains consumption, but assets change the way people think and interact with the world. With assets, people begin to think in the long term and pursue long-term goals. In other words, while incomes feed people's stomachs, assets change their heads … welfare policy has gone off track in becoming almost exclusively preoccupied with the income protection of the poor. Policy should seek to empower as well as to protect. Especially policy should take into account the critical role of asset accumulation in economic and social well-being … 'implicitly we seem to believe not only that the poor have no wealth, but that they *can* have no wealth' (1992:6–9).

In some sectors – notably agriculture – formalisation can play an important role in maintaining or improving livelihoods

This process has been termed the 'asset effect'. Broadly speaking, it is aimed at improving income security and resilience to shocks; advancing strategies for social mobility; and improving social capital and spatial connectivity.

The weak linkages between the formalisation of property ownership and the 'asset effect' were discussed earlier in this paper. At this point, the focus is on understanding why these effects have not occurred despite a significant roll-out of low-income housing as well as other processes of formalisation.

A study of Meadowlands in Soweto has found that older residents in particular have not used the titles they have received to access credit, or put their hoes to produce use in other ways (Parnell et al 2003). Thus, even if we assume that broader society is conducive to leveraging assets, some new title holders are not inclined to start small business or take any risks.

In addition, the formalisation of various kinds of businesses often entails increased costs. For example, many taxi operators remain in the informal sector in order to evade paying taxes. Recent attempts to widen the tax net have included tax amnesty for small businesses, provided they register. Taxi owners have been quick to take advantage of this, suggesting that they would be prepared to formalise provided all punitive measures were withdrawn – a strategy which de Soto supports. However, many taxi operators will remain inside the informal economy, and outside the tax net. Significantly, then, formalisation might work for some businesses but not for others.

However, in some sectors – notably agriculture – formalisation can play an important role in maintaining or improving livelihoods. The process of extending tenure to farm workers has been an important one for the South African government. Furthermore, minimum wages have been introduced in the sector. These are progressive measures aimed at reforming the apartheid systems of labour exploitation and land use. However, these processes have resulted in a million farm worker households being evicted from farms (Nkuzi Development Association 2005). Wegerif summarises the impact of these evictions as follows:

> Many of those evicted from farms had been producing for themselves, with 44 per cent having livestock and 59 per cent growing their own maize. Now less than 10 per cent of the evicted households have livestock and they are left with small stock, such as chickens, whereas they previously owned cattle. Only 26 per cent now produce maize for themselves and in smaller quantities than they did when on farms (2006:10).

Moreover, attempts to expand services in rural areas have run in tandem with what Seekings and Nattrass refer to as de-agrarianisation. They note that:

Building the assets of the poor remains central to resolving structural poverty and inequality; however, important issues surrounding service delivery and assets need to be addressed

> Farm workers continued to be evicted from commercial farms in large numbers, there was no programme of land reform resettling families into smallholdings, so these largely unskilled families were pushed into the most disadvantaged positions in a labour market characterised by massive unemployment (2004:15).

The implications of de Soto's thinking for the agricultural sector are discussed more fully elsewhere in this publication (see PLAAS paper**). The central point here is that formalisation creates winners and losers – which de Soto does not fully acknowledge. The agricultural example demonstrates the importance of the role of the state in ensuring that asset transfers achieve their intended objectives. Without deliberate state intervention, market mechanisms are likely to result in current owners adopting strategies to compensate for a loss of income.

Building the assets of the poor remains central to resolving structural poverty and inequality; however, important issues surrounding service delivery and assets need to be addressed. Service delivery should not be confused with creating an asset base for the poor, or creating an environment for doing so. The most influential measure of asset poverty, utilised by the Development Policy Research Unit (DPRU) at the University of Cape Town, does not really measure assets but services. For example, it includes sanitation and electricity as assets (Bhorat et al 2006), but this is incorrect, as they cannot be regarded as sources of income, or a cushion in times of crisis. The study adds to our understanding of non-income welfare transfers, but does not adequately measure asset poverty. May (2006) adopts a different approach to measuring asset poverty, including education, land and savings.

Most services are in fact not aimed at creating assets, but rather at extending access. For instance, yard taps, which are widely installed, might satisfy households' water needs, but cannot be used for irrigation. Nonetheless, delivery would have been achieved, and the case added to delivery statistics. This is not to downplay the importance of the delivery of water: water is associated with higher levels of health, improved nutritional status, and the elimination of disease. The same is true of electricity, which has significant social multipliers. However, improving access to services without implementing livelihood strategies as well do not feed into a system of delivery that reduces poverty. A central missing link in policy has been the inability to link access to service, thus reducing the input costs of businesses.

Moreover, the price of urban land near jobs and services has risen significantly, resulting in the well-documented inability of housing to catalyse local economies and support labour-intensive growth (see Hassen 2001). Therefore, providing assets without altering the market itself will not create the 'asset effect' envisaged in government policy.

Why build assets?

What, then, is the argument for focusing on assets? First, economic growth will not resolve structural poverty. Haroon Bhorat (2006) offers an interesting review of labour market performance compared with GDP growth (see table 1).

Further increases in economic growth could catalyse significant growth in employment

Table 1: Simple GDP elasticity of employment

Annual percentage change in:			
	Total employment	**GDP**	**Elasticity**
1990–1995	0.13%	0.80%	0.16%
1995–2005	2.60%	3.27%	0.80%

The data points to a close link between economic growth and employment; as levels of economic growth have increased, employment has also grown (leaving aside questions surrounding the quality of jobs). This suggests that further increases in economic growth could catalyse significant growth in employment. However, while the economy has shown an ability to create jobs, the labour force has grown more rapidly than employment, and restructuring has resulted in retrenchments. While there are many arguments about what needs to be done to create jobs, research by the Employment, Growth and Development Initiative at the HSRC has shown that even if the government achieves its goal of halving unemployment by 2014, the number of unemployed people will still be very large.

Second, greater equality is important for long-term economic growth and the eradication of poverty. Several studies have shown that high levels of initial inequality – or, more accurately, the absence of an initial redistributive strategy – are closely correlated with low levels of economic growth and poverty reduction. This suggests a complementary relationship between rising equality and sustained economic growth. More specifically, tenure reform will facilitate the transfer of land to more productive rural households by enhancing the fluidity and depth of the agricultural land market.

By contrast, asset and endowment dependency reinforces inequality and low levels of economic growth. A distinction must be drawn between the impact of income inequality on growth and the impact of asset inequality on growth. There is broad consensus about the positive impact of equal access to education and productive farmland on economic growth, and that asset equality is a foundation for reducing income inequality (World Bank 2006, quoted in Hassen, forthcoming)

Third, in a society with a long history of oppression, social justice is the most important policy objective, and it is this objective that underpins the ANC's commitment to addressing the issues facing 'blacks in general, and Africans in particular'. This normative commitment is further reflected in the historical ANC position of the working class as the motive force and primary beneficiary of democracy – a subject debated at its 2007 policy conference. However, achieving this goal in practice is never only a forward march, as democratic government was established at a time when capitalism was triumphant, and orthodox macroeconomics on the rise.

In a society with a long history of oppression, social justice is the most important policy objective

Asset-building: some key questions

This paper has primarily focused on assessing the relevance of de Soto's ideas to the South African situation, and has argued that the state has to change its approach to asset-building if assets are to play a significant developmental role. But some important questions remain:

- Why focus on 'efficient redistribution' when, to paraphrase Keynes, in the long run we will all be dead?
- Being cautious about redistribution on the basis of sustainability, intergenerational costs, and long-term negative consequences might be the prudent governance choice, but does this not replicate the systems that perpetuate inequality and poverty?
- Redistribution might frighten the markets. Under what conditions will powerful private sector stakeholders accept a redistributive programme from government?
- If one accepts that, in the long run, incomes will converge to the mean as a result of growth, it can be argued that time is the biggest ally in the fight against poverty. However, if a bifurcation of incomes is observable now, will time not erode even the modest assets and incomes of the poor?
- Even if one agrees that the government needs to play a significant redistributive role, what will be redistributed: assets and/or incomes? And which specific programmes would achieve the desired outcomes?
- Most demanding of all: given that, in the light of given South Africa's history, the government has a duty to transform material conditions – to use the Marxist catch phrase once fashionable in South Africa – why do the intrinsic arguments for equality always fall short on the criterion of feasibility? Is it not time to dream

again? Will impatience worsen the conditions of the poor, as programmes are implemented in chaotic fashion, under the banner of redress?

These questions ask us to not to search for the silver bullets, including those dressed up as a coherent development strategy. Instead, it asks us to look at the means for breaking through the patterns of structural poverty in South Africa. Assets are a key part of addressing structural poverty. However, de Soto's thinking has shortcomings, and may even inadvertently worsen poverty and inequality traps in South Africa.

This paper reflects work in progress towards a master's dissertation on asset redistribution to be submitted to the Graduate School of Public and Development Management of the University of the Witwatersrand.

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