

Beware of sub-prime prophets

The Third World poor could be the ultimate victims of home-loan pushers

Geoffrey Payne

So, Northern Rock is no longer in a hard place, shares are rising again and all is well with the global economy. We can all relax and continue to hope that a housing price crash has been averted. Or can we? Even more importantly, *should* we?

The crisis of confidence in the housing sector may not be over. Years of inflated prices have been fuelled by developers failing to meet increasing demand, over-indulgent brokers desperate to maintain their sales targets, and a financial system in which risk is passed up the ladder and into the world equities market to infect other economies. Like spoilt children when things go wrong, the private banks have run to the government for protection from the consequences of their actions. And like over-indulgent parents keen to protect other children, the governments have had to bail them out.

Suddenly, the concept of moral hazard is entering the lexicon as even banks no longer trust each other to provide accurate information about their assets, liabilities or credit capacity, or take unusual risks in a desperate attempt to earn a profit. Running economies on debt is fine as long as growth is sustained, but this puts a heavy emphasis on trust which has proved a fragile support. Hence Gordon Brown eventually had to intervene to protect investors and banks alike from the consequences of their actions.

Campaigns to extend home-ownership were, of course, heavily promoted and subsidized by Margaret Thatcher not to lift the poor in council estates out of poverty, but to give them assets which they would need to protect by voting Conservative. So successful was this that the New Labour government has had no option but to continue. Yet the fragility of this arrangement has suddenly been brought into focus and the dreaded word recession is being openly mooted. Excessive loans to "sub-prime" (a euphemism for poor) households to buy into this political philosophy is in danger of blowing the system apart.

But the problem is potentially even more far-reaching than for savers and home-owners In the US and UK. Thatcher was not alone in promoting home ownership for political purposes. The Peruvian economist Hernando de Soto provided a seductive theoretical foundation for such policies in his book "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else". Unsurprisingly, this was music to the ears of Thatcher, Milton Freidman and Jeanne Fitzpatrick, the former US Ambassador to the UN, all of whom endorsed it. Even Gordon Brown has signed up as a member of a commission co-chaired by de Soto.

According to de Soto's analysis, the major stumbling block that keeps the rest of the world from benefiting from capitalism is its inability to produce capital, and whilst the poor already possess the assets they need to make capitalism work for them, they hold these assets in defective forms. By this he means that they lack titles to their properties which they can use to invest in businesses, rendering their assets as 'dead' capital. He estimates the total value of such 'dead' capital is at least US\$9.3 trillion. They have houses but not titles.

By contrast, he claims that the substantial increase of capital in the West over the past two centuries is the consequence of gradually improving property systems, which allowed economic

agents to discover the potential of their assets, and thus to be in a position to produce the non-inflationary money with which to finance and generate additional production. He proposes that if the governments of developing countries provide universal property ownership with clear titles and rights enforceable in law, then the poor will be able to use their assets to obtain credit and capitalism would enable countries to lever themselves, and their poor majorities, out of poverty and achieve capitalist affluence.

De Soto conveniently overlooks the contribution of colonialism and slavery, as well as technological innovation in the growth of Western affluence. In Peru, where his policies have been widely and successfully implemented, there has been virtually no increase in access by the poor to formal credit and poverty levels have not been significantly reduced. Despite the lack of empirical evidence to support home-ownership through land titling programmes, the US government and agencies such as the World Bank, continue to invest vast sums in promoting land titling programmes. The concern is that this is fuelling massive land speculation and corruption by government officials working hand-in-glove with local and even foreign investors.

The fundamental failure of mortgage banks and de Soto's supporters is that they fail to ask the first question of potential borrowers – "can you afford to service the loan?" Collateral only becomes relevant if the answer to this is positive. By lending to those unable to service loans, banks have brought the entire financial system near collapse.

The result is that rather than removing poverty, these policies are actually removing the poor from expanding cities throughout Africa, Asia and Latin America. This is at a time when the world population has just become more urban than rural and when about one in six people are presently living in slums or squatter settlements. This is projected by the UN to double to 2 billion people by 2030 unless concrete action is taken. Many of these households are tenants who risk being evicted by titling programmes, or squatters vulnerable to market-driven displacement. With populations of some cities already far larger than London, the risk to social and economic stability is considerable. The present crisis could therefore easily prove to be a taste of what is in store unless we stop placing all our eggs in the ownership basket and encourage a wide range of tenure options in which all social groups can meet their needs within their budgets. We should beware of 'sub-prime' prophets like de Soto who promise simplistic solutions to complex problems.

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