

2007

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Recommended Citation

Soto Hernando de, *Putting aside Differing Cultures: It Is Institutions and Systems*, 13 LAW & BUS. REV. AM. 3 (2007)
<https://scholar.smu.edu/lbra/vol13/iss1/2>

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PUTTING ASIDE DIFFERING CULTURES: IT IS INSTITUTIONS AND SYSTEMS

*Dr. Hernando de Soto**

I come from that part of the world which is called the *developing* world. Probably a better name is the *underdeveloped* world, which, together with the former Soviet Union countries, holds five billion of the world's six billion inhabitants. We are striving to create market economies that will generate prosperity and will lay a solid foundation for our countries. But we are not being that successful. We always thought that after the fall of the Berlin Wall things would come automatically; they have not.

Some of the most important schools of thought have been wondering why—from Russia to Peru, through Egypt and the Philippines—we have not been “cutting the mustard.” And their reply, most often, has been *culture*. Supposedly, there is something in the culture of the countries of the North Atlantic that makes them successful and there is something in our part of the world that does not make us successful. And one of the crucial factors—it would seem to be—is *trust*. After all, a market economy or a global economy is an economy of exchange. How can you exchange if you do not trust other people?

To make things worse—a study, recently carried out in Michigan, has been circulating in Latin America and it is making us feel a lot more pessimistic. The study conducted in over eighty countries by a few researchers in Michigan (from 1999 to 2000) established where people do trust each other; and it turns out that 65 percent of the Norwegians who were asked: “Do you trust other Norwegians?” They replied yes. When it came to Sweden, 60 percent said yes. When it came to the United States, 50 percent said yes, they did trust other people of the United States. But when you came to Brazil, it was 4 percent; and Peru was 5 percent.

Recently when I was going through Washington, D.C., I was so happy to finally be coming into a country where people trust each other. When I went through immigrations and was asked to identify myself, I said, “I’m very glad to be here, and I’m very glad you’ve asked me to identify

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myself. My name is Hernando de Soto. I am the son of Alberto Soto de la Jara. My mother is Rosa Polar Ugarteche. She actually comes from the area of Moquegua. My father comes from the area of Arequipa. A large part of our family came in from Spain about 380 years ago.”

The migrations officer said, “Will you just stop this and show me your passport.”

I took out my passport and I saw in the “gringo’s” deep blue eyes—cold ones, by the way—that he started trusting me. As he went through the passport, he seemed to recognize everything that was necessary to trust me.

I said to myself, “Interesting, my *identity* is something that I don’t carry in my body. My *identity is a document* that is produced by institutions and by law that is called a passport.” That is also very important because it justifies the writings of Bertrand Russell who said there are two types of knowledge. There is *knowledge by acquaintance* and there is *knowledge by description*. And the most powerful of the “knowledges” is *description*. For instance, most of the things one learns in a University are not because one is acquainted with them. For example, you all know that Kazakhstan exists but you know it through description. So, I realized through the incident at U.S. immigration entry that *identity* and *trust* had a lot to do with *description*.

I then went back to my favorite hotel in Washington, which has a small lobby. There are really only three people who take turns at the lobby. When I come in, they recognize me. I have been staying there for over 15 years.

As I went in, I said, “Herb, so good to see you.”

“Mr. de Soto,” he replied, “it’s been ages since we’ve seen you. How have you been lately?”

I said, “Fine.”

As he started registering me, he said, “By the way, how will you be paying?”

“Well, hey, I’ve always paid promptly. That’s how I’m going to pay.”

He said, “No, I mean your credit card.”

I realized that this North American, after over 15 years, never really trusted me. He trusted my credit card. Then it came to me again—what you have in your country is *very strong institutions*. Institutions so strong that all the wealth that I own in Peru—whatever it is—can become liquid through a piece of plastic, and can travel immediately to the United States. I can be *trusted* by people I never met.

You see, there are billions or hundreds of millions of us per country, and although we may all be brothers and sisters, we need to find additional ways of linking among ourselves and in ways that we can *trust* each other. In other words, to deal in society you cannot just deal with your bare brains. It is a little bit like carpentry, you cannot do carpentry with your bare hands. You need prosthetic instruments. The same is true for business. These prosthetic instruments—which philosophers have found

out are very common in the United States—can be used to carry out practically any transaction.

For example, I have brought some grapes with me, and these are my grapes. Everybody will tell you that these grapes are mine. But there is nothing on the grapes that says these are Dr. de Soto's grapes. What will tell you if these grapes are really mine is the way I use them: whether I import them or export them, sell them to you, use them as a guarantee or as collateral, transfer them, lease them, or any other 100 different ways of using them commercially—all through instruments of law that identify, describe and register the object of trade. Therefore, what allows us to *cooperate* in the world is not really a world of things, but rather a world of things that are about things.

There are things in the world that define our relationships—that give economic and social relevance and significance to the things that we own. And the economic significance of things *is not in* things, but rather in our minds. The things that are in our minds are captured by documents in which society has put its trust; by systems which actually work and allow us to trust each other. And this is pretty much what both Adam Smith and Marx said. They said that *capital* which is absolutely indispensable to create prosperity is something that *is not* money. *It is value*. And what you absolutely need is a way to *capture* value.

And what we are discovering more and more is that if you look at anything that you value, it is always on a piece of paper or a piece of plastic, or it is a blip on a screen. But it is never the thing itself. Value is like energy. Nobody has seen it. It does not have a color. Nobody has touched it. And so there are many things in the world: energy, capital, credit—which is not necessarily money, either. These are concepts that as a society you have managed to include *in* your laws and *in* your systems.

When you created property, for example, you created something that was much more important than just ownership. You actually laid the basis to create a society in which you trust each other. That allowed you to *capture* capital. That allowed you to *capture* credit. Everybody thinks that credit, for example, comes from money. And money there *is* always—we Latin Americans have produced more money than you ever produced. We had 1,700 percent inflation just fourteen years ago in Peru. It is not money that creates credit. It is property. It is the belief of somebody that you have something you do not want to lose. You know that you have something that you do not want to lose when it is actually embedded in a property title or your *identity* is embedded within a document.

Now, why am I saying all of this? Because a new *revolution* has begun, and we are not all quite aware of where it is going to take us. It is another chapter in the Industrial Revolution. Thanks to the Industrial Revolution—the movement of people who concentrated and organized themselves in ways that they could communicate and trust each other

easily—one billion people in the world have created prosperity and stability. They are mainly in the North Atlantic countries, Western Europe, the United States and Canada, Japan, Taiwan, Korea, maybe two or three other “Tigers.” That makes one billion people.

The other five billion people—the former Soviet Union and we developing countries—have all pretty much agreed since Deng Xiaoping’s revolution in 1978 and the fall of the Berlin Wall in 1989 that there are no alternatives, that we have got to go towards some form of a free society. But, obviously, we are not getting there. And one of the reasons we are not getting there is because we are concentrating many times—much too much—on physical things instead of on *institutions* and on *systems*. In fact, you yourselves, sometimes, take for granted the institutions that you have, to the point that in many countries many of you actually believe that your superiority is based on some kind of cultural element when what you have got is a lot of very good institutions. You sometimes forget what these institutions are all about. There was a time when that was not true.

For example, Japan. Back in the 1930s and 40s, we in Peru and in Brazil welcomed one million families from Japan. They migrated from Japan to South America. Among those families coming to Peru was the Fujimori family. This family produced a son who later became President of Peru from 1990 to 2000. Another was the Yoshiyama family, which went to Brazil. Now, what is interesting about this is not that this family went one way and the other the other way, but rather why did the Toledos not go to Japan? Why did the Lulas not go to Japan? The reason is very simple—in the 1930s and 40s, Peru’s Gross National Product per capita was 25 percent higher than Japan’s, and Brazil’s was 50 percent higher than Japan’s. Now when President Fujimori went back, on an interim basis, to the land of his ancestors in Japan, he went back to a country that is ten times richer than our country Peru.

What has happened in these last fifty years? What, all of a sudden, made Japan—a feudal country with a powerful army in the 1930s and 40s—a developed country that left us behind? Well, the reply is that, from 1942 to 1945, a group of Americans planned a development strategy for Japan. They saw that what was basically lacking was the right institutions and systems—power was concentrated at the top in a feudal class. They felt that the plan had to democratize capital and enterprise. With the right players within Japan, from 1945 to 1950, they absolutely and totally transformed the country, with the Japanese spearheading the effort. The result was that Japan became a developed country. Taiwan and South Korea, both Japanese colonies at that time, also became developed countries, and so outstandingly developed that the Deng Xiaoping revolution in 1978 had no choice but to say, “I don’t care what color the cat is, as long as it catches mice.” And he started to move the PRC toward a market economy.

So you, yourselves, understood half a century ago how important institutions were. How unimportant culture was. All cultures have different ways of, you know, opening beer cans and driving cars. The important thing is systems and institutions because we are all one civilization. That's what the Enlightenment was about, how we should move toward one civilization. Nobody wrote, at the time of the Enlightenment, civilizations, in plural with an *s*. Civilization was written in singular.

About twenty or so years later, you went to Vietnam and you forgot. You did not consider their institutions. Lately, you have also been having other foreign adventures in which you have not looked at institutions: you have focused on cultures. What is going to happen with the Muslims?

I really cannot tell you how to be a better American. I am not an American. But what I can tell you is that you do have superior institutions. You are the most prosperous country in the world and the most powerful one—where most of the inventions come from. And therefore now that *you* move into the real world, you are moving into a world that more and more is highly interdependent. A lot of the futures that most of you face will not only be in the United States, but also abroad. And you have many things to teach, provided of course that you reflect upon it. What is it you have to teach, you have to try to remember. And academia is a great place to remember—to see how much you have forgotten.

Karl Popper, the Austrian philosopher, used to talk about it. He said successful people tend to forget. He talks about the story of Carl [Adolf] Busch. Carl [Adolf] Busch was a famous violinist who played in Zurich. Popper went to see him play Vivaldi. He went with a friend. They were so amazed by the marvelous way Busch had moved from the third to the fourth movement that they visited him in his private chambers afterwards, and said, “Maestro, how did you do it?” Busch answered, “It's very simple,” and put his violin to his neck and started playing. He has never been able to play that music again.

Let me put it to you a different way. A spider with eight legs goes to the centipede, and says, “I've got enough problems managing eight legs, how do you manage 100 legs?” And the centipede said, “It's very simple, first of all you got to move the first twenty-five . . .” It seems the centipede has never been able to move since then.

In other words, as we advance in life, the tendency is to move towards a consciousness of what made us successful in the first place. And I venture to tell you—it is your *institutions*. It is your *systems*. It is your way of cooperating among millions without knowing each other directly by *acquaintance*. The time has come for you to remember that—you are going to be able to teach all the rest of us how it is done, because it is not easy to create a free society.

The only encouragement I can give you as a foreigner is that there is so much that you can do to make your country proud. There is so much that

you can do to help us if you go back to your ancestors in the nineteenth and twentieth century and see for yourselves that although we can be poor, we can become rich. This is because we can create the right political institutions, economic institutions, and societal institutions. Forget about this entire thing of different cultures, because cultures never get in the way of progress.

Articles

