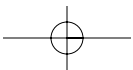
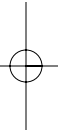
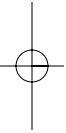
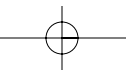
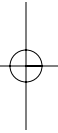
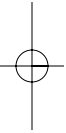


# The Mystery of Capital and the Construction of Social Reality





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*Edited by*

Barry Smith  
David Mark  
Isaac Ehrlich



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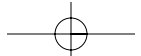
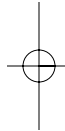
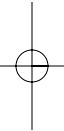
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# Introduction

In his book *The Construction of Social Reality*, John Searle has advanced a new way of understanding human society and its institutions: What holds a human society together? What factors lead to the collapse of a society? What are the roles of power, belief, and trust in sustaining social institutions?

Hernando de Soto's bestselling book *The Mystery of Capital* has contributed to refocusing the attention of development economists and policy makers on the role of property rights in economic development. The somewhat provocative subtitle of de Soto's book is: *Why Capitalism Triumphs in the West and Fails Everywhere Else*. His thesis is simple. The poor in developing countries often have many assets—homes, informal businesses, plots of land. What they lack is formal property rights to these assets. This deficiency diminishes their potential worth as financial assets (for example, by blocking their use as collateral for borrowing) or even as real assets (for example, by preventing utilities such as gas and electricity from being legally connected to them.)

Another asset that the poor in developing countries almost universally lack is human capital including, but not limited to, formal schooling and continuing technological advance. Any solution to the “mystery of capital” thus must address how this intangible, but critical, human asset is produced and accumulated.

The main goal of this book is to discuss the ideas on social ontology proposed by Searle and de Soto, and to further explore the implications of their views, and those of other contributors to this volume, for the understanding of economic growth and development, and the philosophy of social institutions. While de Soto's *Mystery of Capital* was in part influenced by Searle's ideas on social ontology, and while a number of important interconnections between Searle's and de Soto's work can be seen, these interconnections have not hitherto been subjected to analysis.

Contributions to this book also expand de Soto's approach to "capitalization" of tangible assets to include the capitalization of intangible assets such as information and knowledge, or human capital, which are identified as the long-term engine of growth in the fast-growing endogenous-growth-and-development literature in economics.

The prime focus of the volume is: how can philosophers learn from economists, and how can economists learn from philosophers, in understanding what works and what does not work in human societies? De Soto and Searle have themselves provided chapters presenting definitive accounts of their recent thinking on these topics. In the remaining chapters, experts on ontology, information science, land registration, geography, and endogenous growth and development present their views, commenting primarily on the work of de Soto and Searle but also offering their own original contributions to the new social ontology and endogenous economic growth paradigm, which are currently being established.

## A Huge Invisible Ontology

Searle begins *The Construction of Social Reality* with the following simple scene: "I go into a café in Paris and sit in a chair at a table. The waiter comes and I utter a fragment of a French sentence. I say, '*un demi, Munich, à pression, s'il vous plaît.*' The waiter brings the beer and I drink it. I leave some money on the table and leave" (Searle 1995, 3). He then points out that the scene described is more complex than at first appears: "the waiter did not actually *own* the beer he gave me, but he is *employed by* the restaurant which owned it. The restaurant is *required to post* a list of the *prices* of all the *boissons*, and even if I never see such a list, I am *required to pay* only the listed price. The *owner* of the restaurant is *licensed by* the French *government to operate* it. As such, he is *subject to* a thousand *rules and regulations* I know nothing about. I am *entitled* to be there in the first place only because I am a *citizen* of the *United States*, the *bearer of a valid passport*, and I have *entered France legally*" (1995, 3). The task Searle then sets for himself is to describe this "huge invisible ontology," which is to say, to give an analysis of those special powers, functions, acts, events, states, properties, and relations—picked out in italics in the above—which do not belong to the realm of brute physical reality but rather to the realm of institutions. Searle's idea, very roughly, is that by acting collectively in accordance with rules of a special kind—which he calls "constitutive rules"—we are able to impose rights, duties, obligations and various other sorts of what he calls "status functions" and "deontic powers" on our fellow human beings and on the reality around us.

Status functions are functions—such as those of customs officials (with their rubber stamps)—which the human beings involved could not perform exclusively in virtue of their physical properties. Consider the way in which a line of yellow paint can perform the function of a barrier because it has been collectively assigned the status of a boundary marker by human beings. The yellow paint is unable to perform this function by virtue of its physical properties. It performs the function only because we collectively accept it as having a certain status. Money, too, does not perform its function by virtue of the physical properties of paper, ink, or metal, but rather in virtue of the fact that we, collectively, grant the latter a certain status and therewith also certain functions and powers.

Powers can be positive, as when John is awarded a license to practice medicine, or negative, as when Mary has her license to drive taken away for speeding or when Sally is obliged to pay her taxes. Powers can be substantive, as when Margaret is elected Prime Minister, or attenuated, as when Elton is granted the honorary title of Knight Bachelor, Commander of the British Empire. Chess is war in attenuated form, and it seems that very many of the accoutrements of culture have the character of attenuated powers along the lines described by Searle.

Searle's theory of collective intentionality, of status functions, and of deontic powers is a brilliant contribution to the ontology of social reality. As he puts it: "[There is a] continuous line that goes from molecules and mountains to screwdrivers, levers, and beautiful sunsets, and then to legislatures, money, and nation-states. The central span on the bridge from physics to society is collective intentionality, and the decisive movement on that bridge in the creation of social reality is the collective intentional imposition of function on entities that cannot perform these functions without that imposition" (Searle 1995, 41). Searle's account of the way in which so much of what we value in civilization requires the creation and the constant monitoring and adjusting of the institutional power relations which arise through collectively imposed status functions is certainly the most impressive theory of the ontology of social reality we currently have. His account of how the higher levels of institutional reality are created via iteration of the imposition of status functions, and also of how whole systems of such iterated structures (for example the systems of *marriage* and *property*) can interact in multifariously spreading networks, opens up the way for a new type of philosophical understanding of human social organization.

The account presented in *The Construction of Social Reality* is not without its problems, however. These turn primarily on the role of records and representations in the ontology of social reality. One important class of social entities is illustrated by what we loosely think of as the money in our bank accounts as this is recorded in the bank's computers. In *The*

*Construction of Social Reality* we find the following passage: “all sorts of things can be money, but there has to be some physical realization, some brute fact—even if it is only a bit of paper or a blip on a computer disk—on which we can impose our institutional form of status function. Thus there are no institutional facts without brute facts” (Searle 1995, 56). In reformulating his views on this matter Searle has since been led to recognize a new dimension in the scaffolding of institutional reality, the dimension of representations. The blips in the bank’s computers merely *represent* money, just as the deeds to your property merely *record* or *register* the existence of your property right. The deed is not identical with your property right and nor does it *count as* your property right. An IOU note, similarly, records the existence of a debt; it does not *count as* the debt. The very hub and nucleus of institutional reality is indeed, on Searle’s account, constituted by entities which do not coincide with any part of physical reality.

## The Mystery of Capital

Such entities are especially prominent in the higher reaches of institutional reality, and especially in the domain of economic phenomena, where we often take advantage of their abstract status in order to manipulate them in quasi-mathematical ways. Thus we pool and securitize loans, we depreciate and collateralize and amortize assets, we consolidate and apportion debts, we annuitize savings—and these examples make it clear that the entities involved must be of great consequence for any theory of institutional reality.

That this is so is made abundantly clear not least by Hernando de Soto’s *The Mystery of Capital*, which realizes what Searle refers to as the “fascinating project” of working out the role of the different sorts of representations of institutional facts. As de Soto shows, it is the “invisible infrastructure of asset management’ upon which the astonishing fecundity of Western capitalism rests, and this invisible infrastructure consists precisely of *representations*, for example of the property records and titles which capture what is economically meaningful about the corresponding assets—representations which in some cases serve to determine the nature and extent of the assets themselves.

Capital itself, in de Soto’s eyes, belongs precisely to the family of those freestanding Y terms that exist in virtue of our representations: “Capital is born by representing in writing—in a title, a security, a contract, and other such records—the most economically and socially useful qualities [associated with a given asset]. The moment you focus your attention on the title of a house, for example, and not on the house itself, you have automatically stepped from the material world into the conceptual universe where

capital lives” (de Soto 2000, 49–50). As those who live in underdeveloped regions of the world well know, it is not physical dwellings that serve as security in credit transactions, but rather the *equity* that is associated therewith. The latter certainly depends for its existence upon the underlying physical object; but there is no part of physical reality which *counts as* the equity in your house. Rather, as de Soto emphasizes, this equity is something abstract that is *represented* in a legal record or title in such a way that it can be used to provide security to lenders in the form of liens, mortgages, easements, or other covenants in ways which give rise to new types of institutions such as title and property insurance, mortgage securitization, bankruptcy liquidation, and so forth.

While a corporation is not a physical entity, if a corporation is to exist then many physical things must exist, many physical actions must occur, and many physical patterns of activity must be exemplified. Thus there must be notarized articles of incorporation (a physical document), which have been properly filled out and filed. There must be officers (human beings) and an address (a certain physical place), and many of the associated actions (such as for example the payment of a filing fee) are themselves such as to involve the results of the imposition of status functions upon physical phenomena at lower levels. Records and representations themselves are entities which belong to the domain of institutional reality that is at the heart of the new ontology of the social world.

In the broadest possible terms, records, titles, representations, and other formal institutions are no more and no less than self-policing social contracts. But such social contracts themselves are products of a complicated evolutionary process, with probably the most important driving force coming from new ideas, and this is what endogenous growth theory identifies as “human capital”—a complementary theme of this book. Hence, the biggest “mystery of capital,” still awaiting its resolution, is to try to understand how all the remarkable features of capitalism, including its institutional reality, come about and motivate the continuous formation of knowledge that drives economic development and productivity growth.

## Background to the Book

This book was shaped by a two-day workshop held in Amherst, New York (a suburb of Buffalo), April 12–14, 2003. The main goals of the workshop and of the book were to discuss the far-reaching implications of Hernando de Soto’s book *The Mystery of Capital* and John Searle’s book *The Construction of Social Reality*. Several other speakers were invited as well, and an open call for participants was published that provided some additional speakers. Grants from the National Science Foundation’s Geography

and Regional Science program and the Conferences in the Disciplines program of the State University of New York allowed us to invite more than a dozen speakers to Buffalo, where seventeen papers were presented. The workshop also featured some panel discussions and other activities, and about seventy-five people attended.

After the meeting, participants were invited to submit a paper on the conference theme for possible inclusion in the book. Some speakers chose not to propose their presentations for the book, but a few nonspeakers from the workshop audience sent in manuscripts. Each chapter was peer-reviewed by three reviewers. We tried to obtain reviews from two of the other workshop participants, one from the author's discipline and one from some other field. We also obtained a review from at least one person who had not attended the workshop. Several submissions were not included in the book, and those whose chapters are included in this book can feel justifiably proud of their contributions.

The editors wish to express their gratitude to many people and organizations that helped make the workshop and this book possible. First of all we thank John Searle, Hernando de Soto, and the other speakers and workshop participants for their involvement. Funding from the U.S. National Science Foundation (grant BCS-0242145) and the State University of New York also were critical to the success of the workshop. Linda Doerfler, Diane Holfelner, and Patricia Shyhalla of the National Center for Geographic Information and Analysis provided administrative support for the meeting, aided by Andrew Spear, Anneliese Vance, and other Buffalo graduate students. We also thank all the individuals who peer-reviewed the chapters to ensure a high level of quality in this book, and David Steele of Open Court for his patience and his support of the project.

## About the Editors and Featured Authors

**Barry Smith** is Julian Park Professor of Philosophy at SUNY Buffalo, and a SUNY Distinguished Professor. His current research focus is formal ontology and information science, with special reference to medical and geospatial applications, and also to applications in the legal and economic spheres surrounding the institutions of land and landed property. He is Director of the National Center for Ontological Research and one of the Lead Scientists of the National Center for Biomedical Ontology, a part of the Roadmap of the National Institutes of Health. He is the editor of *The Monist: An International Journal of General Philosophical Inquiry* and the author of some four hundred scientific publications. He is also philosophical advisor to the Institute for Liberty and Democracy in Lima, Peru.

**Isaac Ehrlich** is SUNY Distinguished Professor, Melvin H. Baker Professor of American Enterprise, and Chair of the Economics Department at SUNY Buffalo. He is editor-in-chief of the newly established *Journal of Human Capital* published by the University of Chicago Press. His research covers applications of economic theory to law and economics, human capital and health economics, uncertainty and insurance, advertising and information, and economic growth and development. He is the author of highly cited articles in major journals and collections.

**David Mark** is SUNY Distinguished Professor of Geography at SUNY Buffalo and Director of the Buffalo site of the National Center for Geographic Information and Analysis. Mark's research interests focus on many aspects of geographic information science, notably geospatial ontology, spatial cognition, culture, and language, history of geographic information systems, human-computer interaction, and computer mapping. Mark has written or coauthored over two-hundred publications.

**John Searle** is Mills Professor of Philosophy and Cognitive Science, University of California at Berkeley. He is one of the leading philosophers in the United States today. He came to prominence in the 1960s with the publication of *Speech Acts*, a book that has influenced not only philosophers, but also linguists and literary and cultural theorists. Searle has played an important role in debates on artificial intelligence with his notorious "Chinese Room Argument."

**Hernando de Soto** is President of the Institute for Liberty and Democracy, Lima, Peru. He serves or has served as an advisor to more than one hundred governments throughout the world on policies designed to encourage economic development through legal and institutional reform.

## The Chapters

The first chapter, "What I Do, and How Philosophy Has Helped Me," consists of a transcript of Hernando de Soto's lecture at the opening of the workshop. A minimum of editing has been done, to preserve the lively lecturing style of this articulate author. The second chapter, "Social Ontology and Political Power," is John Searle's application of his metaphysical ideas to the political domain. These ideas have been developed over many years and applied to a variety of topics from speech acts and obligations to social reality and the nature of mind.

In chapter 3, "Searle and de Soto: The New Ontology of the Social World," Barry Smith notes that the Western philosophical tradition has been an especially influential component of political philosophy. The classics in the field, from Plato's *Republic* through Rawls's *Theory of Justice* have an importance in our general culture that exceeds even most other

philosophical classics. The subjects discussed in these works include descriptions of the ideal society, the nature of justice, the sources of sovereignty, the origins of political obligation, and the requirements for effective political leadership. In spite of its impressive achievements, our tradition of political philosophy is in various ways unsatisfying and perhaps not the best expression of Western philosophy. The problem is not that it gives wrong answers to the questions it asks, but rather it that it does not ask the questions that need to be asked in the first place. Prior to answering such questions as “What is a just society?” and “What is the proper exercise of political power?” Smith argues that we should answer the more fundamental questions: “What is a society in the first place?” and “What sort of power is political power?” This chapter attempts to answer these questions by exploring the relations between the general ontology of social reality and the specific form of social reality that is political power. It shows why all political power, though exercised from above, comes from below and why, even though the individual is the source of all political power through his or her ability to engage in collective intentionality, the individual still typically feels powerless. Finally it shows why political powers are in large part linguistically constituted and why a monopoly on armed violence is an essential presupposition of government.

In chapter 4, “The Construction of Social Reality: Searle, de Soto, and Disney,” Jeremy Shearmur, after an initial, and somewhat critical, discussion of John Searle’s approach to the understanding of social reality, considers an issue at the center of Hernando de Soto’s work: the transformation of land into property. After some issues connected with the specifics of de Soto’s approach are discussed—in particular, the role that he gives to government, and the problems to which this may give rise—the chapter turns to its central theme. This is that, in addition to seeing the significance of the transition from land to property in terms of its ability to underpin other economic activities, it is also important in relation to property as a space within which ideas may be tried out. This theme is explored, on the one hand, by way of considering the kind of regulatory regime that would be needed to make such experimentation possible; for example, the specification of the limitations upon experimentation in terms of a functional definition of externalities that must be imposed. But it also considers what such arrangements might look like in more practical terms, by way of discussing the Disney town of Celebration, Florida, and some lessons that may be learned from it.

Ingvar Johansson, in chapter 5, “How Philosophy and Science May Interact: A Case Study of Works by John Searle and Hernando de Soto” takes issue with philosophers who consider philosophy to be an enterprise wholly independent of the sciences and with scientists who regard their research as completely independent from philosophical problems and pre-



suppositions. Rather, philosophy and science are and ought to be overlapping and interacting areas. Such an interaction can take many forms. For instance, scientists can learn some very abstract, but nonetheless vitally important, distinctions from philosophy, whereas philosophers can find flaws in their own abstract views by taking seriously the discoveries of science. Both directions of this interchange are highlighted through the examination of de Soto's analysis of capital and of Searle's philosophy. Johansson makes four major claims. First, de Soto says that Searle is one of the philosophers who helped him to unveil "The Mystery of Capital." Johansson, using Searle's philosophy, summarizes this mystery in the claim "Property rights are invisible and can be created *ex nihilo*." Second, while mentioning Searle, de Soto mentions Foucault in the same breath. However, according to Johansson, de Soto has looked only at the similarities between Searle and Foucault. If he had been interested in the differences as well, he would have found that only Searle gives support to the robust materialism that impregnates de Soto's books. Third, de Soto has tried to convince several governments in developing countries that they should start to create a situation in which, with support from poor people, they could say: "We hereby declare this new modern system of property rights as valid." According to Searle's old speech act analysis of declarations, a person making a declaration does not publicly express any intentional state, and the declaration itself contains its own conditions of satisfaction. Even though something tells in favor of such an analysis of "routine declarations," it cannot possibly be true of what might be called a "Searle–de Soto declaration." Fourth, notwithstanding its groundbreaking character, Searle's book *The Construction of Social Reality* has a remarkable feature. It presents an ontology of social reality, but it does not mention human desires. However, an analysis of what conditions of satisfaction there can be for a "Searle–de Soto declaration" shows that Searle's ontology can easily be amended. An ontology of desires can be added to the old structure. Searle's book should not be regarded as presenting a complete ontology of social reality but as laying the ground for such an edifice.

Chapter 6, "Language and Institutions in Searle's *The Construction of Social Reality*" by Josef Moural, focuses on an argument Searle makes in chapter 3 of *The Construction of Social Reality*. Here Searle endeavors to explain and justify his claim that language is essentially constitutive of institutional reality. Unlike other components of his theory of institutions, such as collective intentionality, deontic power, and constitutive rules, this claim, Moural argues, has not been subjected to critical discussion yet. However, there are a number of difficulties connected with this part of Searle's theory. Moural summarizes Searle's main argument for the necessary presence of a linguistic element in institutional reality and then points

out at what seem to be weak spots of the argument. He argues for the relevance of the argument at stake within the overall architecture of Searle's theory, and provides an alternative view of what is going on in chapter 3 of *Construction of Social Reality*, including a modified version of Searle's main argument.

In chapter 7, "The Mystery of Human Capital as Engine of Growth, or Why the U.S. became the Economic Superpower in the Twentieth Century," Isaac Ehrlich, examines an idea common to much of the "new" economic growth and development literature: that persistent, self-sustaining growth in real per-capita income is attributable to "human capital." He finds this concept wrapped up in three layers of mystery. First, since it is not a tangible asset, how do we account for human capital empirically? Second, what dictates its formation over time? Third, how is such formation transformed into growth in real production?

Ehrlich aims to unwrap this apparent mystery through an exposition of a general-equilibrium model of economic development where human capital is the critical engine of growth, its accumulation is enhanced by parental and public investments in children's education, and underlying "exogenous" institutional and policy variables are ultimately responsible for both human capital formation and long-term growth. The model is developed in the context of a competitive market economy in which human capital, measured imperfectly by indicators of schooling and training, is competitively rewarded and efficiently allocated to productive activities. The model also recognizes, however, the role of externalities affecting the accessibility and financing costs of schooling, the efficiency of the economy's labor and product markets, and the spillover effects emanating from workers possessing higher education and skill on the productivity of other workers. The way these externalities are "internalized" may vary, however, as a function of the institutional and legal framework governing the market economy, and as a consequence of accommodating economic and educational public policies, especially insofar as higher education is concerned. Such variations may ultimately explain differential growth patterns across different countries. A more specific objective of the presentation is to illustrate the power of the "human capital hypothesis" to explain observed differences in long-term growth dynamics across different countries, the case in point being the emergence of the U.S. as the world economic superpower.

Serguey Braguinsky addresses the codification of property rights to land and other tangible assets and their conversion into productively employed capital in chapter 8, "Allocation and Misallocation of Human Capital: Some Lessons from Japan and Russia." The engine of growth in the capitalist economy and the main source of the wealth of nations is productively employed human capital. Hence, creating an environment in

which human assets can be accumulated and converted into productively employed human capital is an extremely important task. Braguinsky examines three key elements that must be present in an economy for successful development along those lines and draws some lessons from the experience of Russia and Japan.

First, he argues, adequate supply of human assets (potential human capital) must be forthcoming. Supply of human capital will largely be governed by the prospect of future return as balanced against costs of acquiring it. It is plausible to assume increasing returns to high (tertiary and graduate) education in the environment where most capital can be employed in productive activity so that a bustling free enterprise economy goes a long way to stimulate the accumulation of human capital of potentially most productive type. Second, incentives to employ this human capital in productive, innovative uses must be stronger than incentives to employ it in strategic rent-seeking or other nonproductive activities. If the institutional system primarily rewards promotion within the ranks of a hierarchy, and/or directly unproductive rent seeking, such a system is likely to reduce both the level of wealth accumulated in an economy and, in most cases, also its growth rate. Third, the institutional framework must allow a smooth reallocation of resources to entrepreneurs possessing high human capital and potentially beneficial innovative ideas. Productive innovations generate high social and private returns when innovators can come into possession of a sufficient amount of resources to implement their ideas. Borrowing against human capital can jump-start economic growth and make the codification of property rights to tangible assets as well as the creation of democratic institutions also much easier.

In chapter 9, "On the Essential Nature of Human Capital," Gloria Zúñiga y Postigo endeavors to unravel the nature of human capital by relaxing the assumption that human capital exists in persons. What would it mean for human capital *not to exist* in persons? Her impetus for this unusual approach was triggered by the term *dead capital*, coined by Hernando de Soto in his book *The Mystery of Capital*, which embraces entities such as landed property without title or without any other recognized legal document that representing the property rights associated therewith.

Consider that land, which is physical, has the potential to serve as a constituent object of capital, and that this potentiality is not just apprehendable but also must be apprehended by at least one person who is willing to carry out the transformation of the land as a means of production of some consumption good, for instance, by building a factory upon it, or by turning it into a resort. Nonetheless, if the potentiality of any parcel of land whose character as a constituent of capital is thwarted by its legal status—or, more precisely, its lack of legal identity as property belonging to

one or more persons—then the parcel of land acquires the character of dead capital. There is indeed no other way more precisely to describe the nature of such a social object—an object that could be productive, an object that is apprehendable as a means for production, but whose productivity is not merely wasted but destroyed by an institutional state of affairs that prevents its realization as a capital good. The institutional state of affairs that de Soto blames for this economic tragedy is one in which legal titles for landed property are either not formalized or, if they exist, they are not part of a uniform system of legal representation of landed property.

In chapter 10, “Property Law for Development Policy and Institutional Theory: Problems of Structure, Choice, and Change,” Errol Meidinger brings de Soto’s prescription and Searle’s ontology into a closer conversation with contemporary American property law. He focuses on four topics. First, he briefly describes the complex structure of modern American property interests, which are more variable and broadly distributed through space and time than the concept of “ownership” may be seen to imply. Resources typically are subject to multiple public and private rights, such as easements, servitudes, and rights to be free of public and private nuisances, as well as frequently divided rights to possess, manage, and derive income. Moreover, many of the interests are only partially defined, and are subject to sometimes surprising elaborations over time. Second, despite its great flexibility and variability, modern American property law does not in practice facilitate or incorporate all of the arrangements that rights holders attempt to implement in structuring their relationships. Rather, it limits available property interests to a set number of categories, and often forces putatively new interests into preexisting forms. Third, far from simply absorbing conflicting property systems, the American property system has in fact made difficult and questionable normative choices about which systems to respect and which to reject. The first and still festering one was to override Native American property systems with European ones. Finally, definitions of property rights in national legal systems are increasingly subject to powerful transnational influences. The North American Free Trade Act, for example, has been used to impose a definition of property on Mexico contrary to preexisting Mexican law. Meidinger concludes that while the de Soto and Searle perspectives offer some benefits to property scholarship, they will have to be extended considerably to come to grips with the features of modern property rights.

In chapter 11, “The Institutionalization of Real Property Rights: The Case of Denmark,” Erik Stubkjær observes that the existence of economic discrepancy between North and South and the growing hegemony of liberal capitalism since the end of the cold war have combined to bring about a renewed interest in the issue of individual property rights. He asks the

question, how can we put this magic into operation in countries standing in need of economic development? However, attempts so far have demonstrated it to be an almost impossible task. One approach that has been suggested is that of gaining a better understanding of how real property rights came into being in “the West,” and then applying the knowledge gained from these investigations to the needs of currently developing countries. This chapter aims to contribute to such an approach by providing an account of the institutionalization of real property rights in Denmark. By the time of the Reformation (1536) a governmental bureaucracy was already in operation; one that was reinforced by subsequent Lutheran sovereigns. Religion and the ideas of the Enlightenment co-operated in Denmark to foster development, especially in terms of liberating the peasants from their dependent economic position. Land ownership was gradually extended from a privilege afforded only to royalty and the nobility to peasants and ultimately to workers as well. While mortgaging played a role in this development, its greatest significance occurred only after the 1960s.

Real property is a phenomenon addressed by a number of disciplines: Law, economics, geodetic surveying, and even history, linguistics, and philosophy. Real property is also a dynamic phenomenon. The short-term dynamics are dealt with by lawyers, notaries, and chartered surveyors, as well as by staff in the courts, in government, and in the financial sector. The century-long dynamics are dealt with by historians and institutional economists, among others. Stubkjær draws on findings from a number of these disciplines, and his multidisciplinary approach provides the basis for a discussion of factors of economic development offered by Douglass C. North (1990), a discussion pointing to the various societal costs of creating associations in Catholic and Protestant regions.

Andrew U. Frank begins chapter 12, “A Case for Simple Laws,” with de Soto’s thesis that the poor of the world would prefer capitalism if they could obtain it at a reasonable price. De Soto points out that poor countries typically lack the institutions to convert their wealth into working capital. Legal institutions are in place in nearly all countries: there are laws defining ownership in land, land registration, and mortgages. These laws are just not used, and Frank’s purpose is to explain why. He finds that the simple and general impediment to use the legal institutions to create capital is cost. There is a high nonmonetary cost for the person to learn about the institutions and the procedures to follow, and there is a high monetary cost to obtain the professional advice and assistance to follow them. Registration of land is most often made more difficult than strictly necessary. The simple procedure of land registration is so much burdened by these connections to make them essentially impractical. The corresponding institutions—especially the banks—are not ready to convert the abstract capital created by the legal institution in real working capital. They are not

prepared to grant mortgages because they do not have the experience that their investments are secure. Thus, courts are necessary to enforce legal institutions. Our analysis and simulation of Searle's socially constructed legal realities demonstrate that they depend on the possibility of enforcement. Such procedures are very difficult, time consuming, and costly for the bank. Frank sees a single issue here: The laws have become too complicated, and the effect of complicated laws is high cost..

Frank suggests that the export of the elaborate law systems of developed countries is counter-productive: the related institutions (courts, banks, etc.) cannot cope with the complexity and fine distinctions. We have forgotten how our legal system evolved from simple principles before it arrived at today's complexity. Research to identify the simple core of a legal system is necessary. The historical development of legal institutions from simple rules to the complex constructions we have today can inspire such research, and Frank believes that such "simple laws" could also benefit the developed countries, where complexity of law has probably passed the optimal point. Carlos Alejandro Cabrera Del Valle provides a postscript to this chapter.

Chapter 13, "Sovereigns, Squatters, and Property Rights: From Guano Islands to the Moon by David R. Koepsell, considers legal systems that establish property rights over land to be government-created monopolies similar to such devices as patents. Essentially, they are extensions by the government of monopolistic control over a parcel beyond that which might be able to be established by mere acts or indicia of ownership such as fence-building, planting, or improving. Hernando de Soto's book, *The Mystery of Capital* nicely summarizes the developments and refinement of the U.S. real-property regime. Of particular interest is the recognition, unique in the U.S., of squatting as a legal means of establishing priority of ownership over a parcel.

Squatting, which was not a valid means of acquiring ownership in traditional English common law, or in most code-law systems, was rampant during the colonization of the United States. In fact, hundreds of thousands of acres of land were improved by squatters, necessitating the eventual recognition of their property rights by colonial, and later, state legal systems. Such recognition was more efficient than the alternative—evicting those squatters in favor of registered "title" owners. Arguably, squatting itself, which involves the occupation of a parcel concomitant with indicia of ownership, is more economically efficient than conferring ownership benefits by title in certain circumstances.

Adolf Reinach, in his *Apriori Foundations of the Civil Law*, argues that certain legal rules are "grounded" in what Searle would call "brute facts" whereas others are not. Koepsell contends that intellectual property patents are not grounded in any brute fact, but are merely creatures of the

positive law that can be altered at will with no ramifications for a larger sense of Justice. Based upon de Soto's research into the effect of legitimizing squatting rights, these sorts of rights are in fact "grounded" in the brute facts of occupation, and thus more closely approach justice than mere title ownership. Notably, Koepsell uses the example of the Guano Islands Act, an odd example that reveals how sovereigns may take possession of lands by fiat, and not only legitimizes but also promotes squatting by entrepreneurs. He also brings up the U.S. refusal to sign onto the international Moon treaty under the U.N. Thus, the Moon stands in the same position as guano islands, and may legally become the subject of future analogues to this act, promoting economic efficiency and entrepreneurial activities beyond our planet.

Chapter 14, "The Property Rights Prescription and Urban Migrant versus Rural Customary Land Tenure in the Developing World" by Jon D. Unruh, is concerned with legal difficulties surrounding the economic potential of the undocumented property held by the poor in developing countries. Such property, occupied but not formally owned, is thought to amount to considerable capital and therefore hold much potential. However, those who occupy lands are frequently unable to prove ownership. This legal problem concerns the disconnection between formal law and the customary law that governs how the world's poor intersect with property. The former allows assets to be fungible and used by individuals. The latter has evolved under a different tenurial logic, where it is issues of the maintenance and security of community connection to land in often-risky environments which are of concern.

With different conceptual foundations, customary law and formal law in developing countries have little intersection. In this they are contrasted with the "on the ground" activities that migrants have employed and that merge more successfully with formal law. Migrants can come to share a similar tenurial logic reflected in state law, in some cases because the state facilitates settlement. As a result, formal and informal institutions can be mutually supportive. It would be a significantly long process to move from property tied to community, lineage, and geography to something based on the individual and able to take advantage of aspects of capital as we presently understand the opportunities. What will be needed in the end, Unruh argues, are not just attempts at formalizing aspects of customary law, but also a change in concepts dear to formal law, such as the integrity of the document and the static nature of rules.

In chapter 15, "Geographic Regions as Brute Facts, Social Facts, and Institutional Facts," Dan Montello discusses the ontology of geographic regions?spatially extended pieces of (near) earth surface that share some aspect of similarity, including but not limited to spatial proximity or "locational similarity." He reviews a taxonomy of geographic regions based on

the information and procedures used to identify the regions; this taxonomy incorporates and expands upon traditional conceptualizations of regions by academic geographers. The taxonomy consists of four types of geographic regions: *administrative*, *thematic*, *functional*, and *cognitive*. An important ontological issue in any discussion of regions concerns the nature of their boundaries. Perhaps most interesting about region boundaries in this sense is their vagueness. Montello discusses several causes for boundary vagueness and specifically considers Smith's distinction between fiat and bona fide boundaries. He next considers a mapping of the region taxonomy onto Searle's conceptual distinctions among brute facts, social facts, and institutional facts. Administrative regions are unique in their status as institutional facts. However, several previous discussions of the ontology of regions have proposed that administrative regions are also uniquely independent of physical reality. Contrary to this, all geographic regions are best understood as social facts tied semiotically to a physical earth. They are simultaneously part of a real world and expressions of human attempts to understand reality as meaningful. Insisting that regions are either brute facts *or* social facts creates paradoxes. Mind-body interactionism avoids these paradoxes.

Dan Fitzpatrick, in chapter 16, "Collective Intentionality, Documentation, and Real Estate," raises issues concerning the alleged primacy of intentionality over behavior that is discernible in Searle's account. He argues that, with certain background conditions in place, writing plays a crucial role in such transactions and that the signing of documentation is tantamount to engaging in a real estate transaction, and that the role that intentionality (both collective and individual) plays in Searle's account of social institutions, as it is applied to formal property systems, needs to be revised and expanded. He makes three main points. First, he draws an important distinction between a generalized form of collective intentionality, whereby the whole population or significant groups collectively accept or agree on some general social or institutional facts, and a more specific form of collective intentionality whereby individuals or groups accept or agree on some specific instances of institutional facts. In formal legal systems there is usually some sort of general collective acceptance by the population of certain aspects of the law. But with respect to particular instances of property ownership in formal property systems, the question regarding who owns what is not settled by the collective beliefs or acceptance by those acquainted with a particular property. But in extralegal scenarios, collective intentionality is crucial; as de Soto points out, in such scenarios local communities have to rely on "strong, clear and detailed understandings among themselves of who owns what today." While Searle's account of social institutions is applicable to such extralegal scenarios, it is not applicable to transactions in formal property systems. Second, it is not clear



whether, in formal property systems, collective intentionality plays any further role in specific real estate transactions beyond that required in the use of language and the generalized acceptance of the law by the transacting parties. Fitzpatrick argues for a revision of the role of collective intentionality with respect to such transactions. Third, in the case of real estate transactions, contra Searle, intentions should not be taken to be of utmost importance over and above behavior, such as the signing/uttering of documents and making marks on a page. Signed documentation is often taken to be indicative of the intentions of whoever signed it. In cases involving real estate transactions, if courts were to allow intentionality to trump documentation (or other behavioral evidence), then such transactions could not be legally enforced. In formal property systems, signed documents form the cornerstone of the real estate transaction for another reason; they are the links in the provenance of properties with respect to ownership. This latter point is in keeping with de Soto's empirical finding, namely, that extralegal property systems either lack or have blurry "chains of title."

Eric Palmer, in chapter 17, "Real Institutions, and Really Legitimate Institutions," develops a thesis regarding the manner through which social institutions such as property come to be, and a second thesis regarding how these institutions ought to be legitimated. The first thesis is that the construction of social institutions can be understood clearly only if that topic is distinguished from the topic of their normative status. The second is that the normative status of such institutions can be understood properly only if their legitimacy is distinguished from the legitimacy of government. Each of these theses is in need of explication largely because of the cultural influence of an erroneous reading of social contract theory concerning the origins of the state. Thomas Hobbes mentions a "covenant" of each with all, and the process of generating this covenant is often envisioned as a first meeting of individuals that ultimately generates the state; but such a meeting is not clearly suggested by Hobbes, or by Locke, and it is a meeting that, so far as we know from history, has never taken place. The error yields a pair of myths that are prevalent in current political rhetoric. The first myth is that legitimate political institutions are ultimately grounded in the free choices of existing people, the fundamental "selves" that we have or that we are, prior to politics. The second is that government, as the original exit from the state of nature, is the mother of all other legitimate political institutions. The work of the Institute for Liberty and Democracy provides evidence regarding the extralegal reality and robustness of business entities. Hernando de Soto's writing also makes the case that we should not expect, nor even desire, that institutions related to property and business develop simply and solely through the auspices of legislation and the interpretation of legislation in courts.

To more clearly answer the question, “What makes an institution real, and what else makes it legitimate?” we must begin by distinguishing between its constitutive social reality and its political or moral legitimacy. Legitimacy concerns ends, motives and purposes, and historical events are only accidental, or are symptomatic of legitimacy: by themselves, they will always provide a faulty analysis of legitimacy.

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# What I Do, and How Philosophy Has Helped Me

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*Hernando de Soto*

I am delighted to be here principally because it is a multi-disciplinary event and I strongly believe that this is extremely important. Professor Barry Smith said, “No particular discipline has a monopoly of the truth about human experience, and it’s very important to bring them together.” I am even more delighted, of course, to be here in the presence of Professor John Searle, for whom I have enormous admiration. I very much admire his field of work and his work, which has helped us very much in understanding what this world is about.

Now, I am not a scholar, but the reason that in my book *The Mystery of Capital* I refer to work being done in philosophy, work being done by John Searle, is because I do think it is important to try to come together again. I think it is important to try to come together again because I think that to a great degree we humans have lost our way. I think we’ve got our new world in front of us, and I think that we’ve had difficulty discerning that it is a new world, especially in my part of this planet. I come from a developing country, which like many former Soviet Union countries, is trying to make the transition to a market economy and to a democratic system.

We have all been on that road since just after the fall of the Berlin Wall, and we have not being very successful about making this transition. The reason that it is so important to give attention to our problems is that we are now coming to realize that we comprise five billion of the world’s six billion people. Our problems are connected to everything, to terrorism and to wealth. As distances become shorter between different countries, there is no one way that some people can be happy and others not happy.

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This chapter consists of a transcript of de Soto’s lecture at the opening of the workshop. A minimum of editing has been done, to preserve the lively lecturing style of this articulate author.—Eds

Now, supposedly, after the fall of the Berlin Wall we were all on the right road. The market economy would come and if it functioned, and we did all of the things that we were supposed to do, then we too would become developed countries. The International Monetary Fund gave us all the old recipes: You have to stabilize your currency. You need to have standards in terms of being able to value things. So we did that. You have to control your budget deficits, and we did that. You also have to unburden the load of the state, government, so that it can govern instead of manage enterprises that it is not up to doing, and so forth.

Well, if someone had asked Latin Americans for a view of history, they would have said, "We've tried this before and it didn't work." Since our independence from Spain—since the 1820s to today—we Spanish-speaking Latin Americans have tried to follow what today are called IMF recipes five times. They are not new. These recipes came along with what Adam Smith recommended as good governance. Since the fall of Spain in Latin America, we privatized things. The railways went to the British and some of the mines went to the French and to the Germans. We also lowered our tariffs to practically zero. We stabilized our currencies. And five times, none of this worked and new socialist and authoritarian governments came into power. Therefore, this is the sixth time around for us. From Russia to Peru, we started doing all those things, but it has not really worked that well. People have been unhappy, people have been marching, people have been talking against the market economy, and the question again is, "what went wrong?" Something there is missing.

I talked to a friend of mine, Francis Fukuyama, whom you have undoubtedly heard of, and he said, "The issue is trust. You see, in the end a market economy is essentially based on trust." He is right. This was explained not only by Adam Smith, but also by Karl Marx. Essentially what this is all about, and what the industrial revolution, to a great extent, had behind it was a division of labor. People became more specialized, and as they became more specialized, they became more productive. That is what Adam Smith had in mind when he explained what would happen if someone just specialized—that's what division of labor means—in just making pins. If you have a pin factory and just dedicate yourself to making pins, you can be so much more productive than if you dedicate yourself to raising your family, raising your animals, plowing your field, building your house, taking care of the sick people; if you focus on something, you're going to be much more productive. However, that productivity depends on the capacity to exchange.

Now that, of course—and here comes Francis Fukuyama—involves trust. You need to trade your pins for somebody else's food and gadgets, and that leads to an increase in people's interdependence and, of course, the need for trust. It is only once trust has been established—by means of

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legal representations—that you can start creating a prosperous market economy. If you are able to exchange on a wide scale, then you can specialize because it does not matter if you are just making pins.

Some people have said, “Well, there are certain cultures in the world that trust each other more and there are some that trust each other less, so maybe this is cultural.” A group of American scientists recently surveyed the issue of trust in a variety of countries by asking citizens, “Do you trust the other people in your society?” The results bear out Fukuyama’s suspicions. Up to 65 percent of Europeans, led by the Scandinavians, say, “Yes, I do trust other people in my country.” In the United States, the total is a little bit lower, about 52 percent; but it is still a respectable figure. In Brazil, however, a mere 8 percent admitted to trusting their countrymen; in Peru it was 5 percent, and in Argentina 4 percent. Maybe Anglo-Saxons and people in the West just trust each other more, and Latin Americans, Indians, Middle Eastern peoples, Africans just don’t trust each other so much. So, I was very happy when I was invited here to Buffalo, to a country where people trust one another, and I said, finally someone is going to listen to me and believe what I say. Or at least 52 percent of you.

When I went through customs, and immigration, they asked me, “Would you identify yourself, please.” I said to myself, “This man will trust me.” I said to him, “Of course I can identify myself. I am Hernando de Soto, and I am the son of Alberto Soto from Arequipa, Peru. My mother Rosa is from Moquegua, and I was born in 1941.” He said, “Please, just show me your passport.” I gave him my passport, and, as he read it, I realized that he finally trusted me—not because of my sterling family background or my good looks, but because of that standardized printed document that provides authorized information about my identity and citizenship based on rules that allow me to travel around the world. He had a standardized document and he had everything he needed to know about me. He said, “Thank you very much,” and I entered the country.

Actually, before coming here to Buffalo, I went to Washington DC. Now, I have been going to the same hotel in Washington, called the Washington Suites, for the last fifteen years. Everybody knows me there. The receptionist said, “Good to see you again, Mr. de Soto.”

I said, “Herb, terrific to see you, too.”

“Tell me. How are you going to pay this time?”

“Promptly, as I always have.”

“Could I see your credit card?” he asked.

“Ah”, I thought to myself, “here we go again. He does not really believe me. All these years I thought Herb trusted me, he has really been trusting a representation of my wealth that is embodied in a legally recognized document that I carry around with me called a credit card.”

Interesting. All of this trust is not really trust through knowledge by acquaintance. In fact, my capacity to pay per se didn't work."

That made me think of one other great philosopher, Bertrand Russell. He pointed out that there were two kinds of knowledge in the world: "knowledge by acquaintance" (what I was trying to convey to the man at Immigration) and "knowledge by description" (how he came to trust me). In other words, my identity and anything that was worth saying about me for traveling purposes was in my passport, a legal document that identified me. Therefore, identity is not in me; it is something about me, created by law. Our identity is external to our physical selves. People in Anglo-Saxon cultures trust knowledge by description, and that supports what Bertrand Russell used to say, that is where real objective knowledge comes from, by description. Most of the things that you actually know are by description. I felt that, maybe, what was missing in developing countries were better descriptions, better representations.

I have come here, for example, with my watch. I promise you, this is my watch. My wife knows this is my watch. In fact, I have various witnesses that could say that this is my watch. However, nowhere, no matter how you look at it, does it say that this is Hernando's watch. In effect, there is nothing on the watch that tells you who owns it; it could be anybody's. What actually is important is that somewhere at home I have a piece of paper that says I bought the watch, and that I actually own it. That paper that defines the watch as property actually defines the meaning of the watch in the world of commerce, in the world of a market economy. The property of the watch and the functions we can attribute to it are not contained in the physical object itself. Moreover, it is really that paper that says whether I can sell the watch, pledge it, or use it as collateral. These are the kinds of things that Professor Searle will tell us about afterwards—that we impose functions on things, things that are not obvious. Things that are not very clear, all of a sudden begin to have commercial meaning through the world of property. The question then is, how many of the things that we have in the Third World have commercial meaning, have market meaning, can actually go into the market?

When Americans, for example, decide that they are going to sell ten thousand head of cattle on the Chicago Mercantile Exchange, they do not do it the way they did two hundred years ago, when they took the cows all the way to Chicago and said, "Here they are." One could look at each cow in the eye and say, "This is a good cow" or "This is a bad cow," No, nobody does that. People just take in pieces of property paper that tell you much more about the steer than you can get by looking each cow in the eye. The paper tells you about their economic relevance. You know how many there are, their state of health, their weight, and their value. It is really the paper that inserts them into the market, because if it were about

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physical objects themselves, then market economies as we know them today would be very different.

Similarly, when you go to the London Metal Exchange, there are no forklifts moving copper blister from one side of the room to the other as people trade. People exchange bills of property paper that tell you much more about what you want to know regarding the copper blister than if you examine the copper blister yourself. These pieces of paper represent the assets and their property, but they are not the assets themselves. It is these pieces of paper then that allow you at the same time to impose functions on the copper.

We tried something in Mexico with President Fox that helps to show the importance of these papers. The exercise was to look at a Mexican neighborhood and think of this same street in Denver. There isn't much difference. You have buildings here, some of them used for shelter, others for business, and yet others for factories. It is pretty much like Denver. The difference, however, is that all of those buildings in Denver are carrying out functions that are invisible, functions that the Mexican buildings are not carrying out. The buildings in Denver can be mortgaged or pledged, or can act as a point of reference, as a point of collection of taxes or bills. I can "read" about a hundred things about them thanks to a property system, thanks to their being inscribed within the law where obligations are defined, where accountability can actually be exercised. All of these things indicate that, in effect, a building in Denver is a lot more productive because it will also generate credit.

Getting back to the watch, a stolen watch looks exactly like my watch. There is nothing on it that says whether Hernando can pledge it, rent it, transfer it, buy it, or sell it, or whether he can export it, import it, or cut it up in segments to issue shares. All of that has nothing to do with the watch itself. The economic significance of the watch, however, really has to do with how we think about the watch. Its economic significance comes from our minds and the way this knowledge has been gathered and represented in society through law. It is through descriptive documents governed by law that say who I am, that identify me in the market, and identify me in commercial society. They are the ones that actually establish whether I can pay or not and they establish what I do or do not own.

In other words, property, like my identification or my reputation, is essentially a man-made construct. It has nothing to do with the physical world. These documents, which are created by law, indicate whether we can be trusted, whether we can be identified, and whether our possessions belong to us, as well as specify what we can do with these possessions and how we can leverage them. All of the good things that make a market economy in a country work are not physical things. Rather, they are constructs about physical things. There would seem to be two worlds: the

world of watches, of physical things; and the world of man-made constructs, of representations, which come through law and which allow us to communicate among ourselves about physical things, myself and the watch.

Now how important this is for developing and former Soviet Union countries—we have worked with President Putin, who has the same problems that we have in Latin America—is becoming clearer after fourteen years. We thought that they were somewhat different from us, but now we've discovered that it isn't so much the ethnicities, it's just how difficult it is to create the institutions of property in a country that hasn't developed automatically into a market economy. You have to deal with them differently, the road is not clear.

That road has to become clear if we are all to live under a system where we can continue talking to each other.

So, one of the things my team does in Peru and in other countries, is to help formalize extralegal property. What we have found throughout the world is that it is not that people do not have any assets. They own cows, donkeys, machinery, land, and buildings. They all own things. The question is how many of their assets are represented in such a way that they can be introduced into the market. Another way of asking the question is: How many of them have passports that allow them to travel in the expanded market, and be able to realize a series of functions that are indispensable in order for a market economy to work?

We formalize property in such a way that it can enter the market, and we have a methodology, which consists of actually visiting the shantytowns and the different record-keeping organizations, because, unlike the United States, for instance, most developing and former Soviet Union countries do not have up-to-date central property recording organizations. We literally go to the different places to find out what is happening on the ground. After a while, we are able to figure out what is being governed by law, what rights are being defended by law, what property rights are being carried out according to law, what transactions are being carried out. The activities include analyzing the interaction of the extralegal sector with the rest of society; identifying the extralegal norms that govern extralegal property and enterprises; and identifying the principal institutional obstacles to transforming informally held assets and businesses into more productive formal property. When we finish this initial assessment, we go back to the head of state and we tell him how big the extralegal sector of the country is. In other words, we tell him how many assets he has that, in effect, can or cannot travel in the national or global market.

I am going to give you the example of one country because I think it is useful. I went through it with professor Searle some moons ago, about two years ago in Paris. Here we have Cairo; we show the head of state all



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of the information gathered by summarizing it on one piece of paper, about size A3. It has about six drawings on it, which I will show you. It is accompanied, of course, by four volumes, which includes maps of the some of the principal cities of Egypt. They are similar to this one of Cairo.

President Mubarak, together with his council of ministers, looks at the map as we are delivering our report, and says, "I recognize that city. That is Cairo and I recognize it because of the way the Nile twists and turns, but I would not have recognized it otherwise, because I do not recognize the color coding. What does the color coding mean?" So I say "Well, what we've discovered" (I'm talking about real estate, which is the most obvious of the assets in any country) "is that people do own their assets, but they defend them or they are covered by arrangements among themselves which are informal or extralegal, they're not inside the law. In general, there are nine different ways that people in Cairo organize their property. Those nine color codes represent these different ways."

"You don't have to worry about this," I quickly explain to President Mubarak. "This was the same way it was, for example, in California back in the 1850s. There were eight hundred different ways of holding property outside the law. When settlers came in to California, they set up their own legal systems, eight hundred of them. They were each extralegal jurisdictions. They could understand each other within a community, but not among the different communities, much less in the expanded market. The same thing is happening here in Egypt, and, do not worry, the same thing happens to us in Peru. But I would like to illustrate this better. Let us look at what each of those color codes means in order to better understand all of this."

In other words, let's get away from the property title, and let's get closer to the watch. We then show the Cabinet these nine different color codes. The first one here represents buildings on agricultural land. And the Agriculture Minister says, "But I understand exactly what you're talking about, because it's not only illegal to build on agricultural land, since Nasser's time and the Constitution drawn up during that time, we have determined that it's not only illegal to build on agricultural land, it's unconstitutional. We only have one river, so, how can you build on agricultural land? You're eating up the only parts of the country that can actually produce food."

We say, "You're absolutely right, it's an outrage. Nevertheless, we have quantified it, and we have found that in Egypt since the 1950s you have built four million seven hundred thousand buildings on agricultural land, all of which are not only not legal, but perfectly unconstitutional. Four million seven hundred thousand buildings, at our evaluation of about 10,500 dollars per building. When you add up how much mortar, how much bricks, how much iron, without the furniture, without the factory

that is hidden in the house (in 50 to 60 percent of them), you've got fifty billion dollars of dead capital, things on which you cannot, to use Professor Searle's language, impose functions. You cannot use them as credit, you cannot use them as a guarantee, you cannot use them as collateral, you cannot use them as some kind of token.

Then we indicate the ways in which Egyptians are spontaneously creating laws amongst themselves. For example, in the center picture, to which of course the Minister of Housing jumps and says, "Wait a minute. You have public housing there. The Egyptian government built them. How can that public housing possibly be extralegal, since it was built by government?"

We say, "Well, you're absolutely right to have your doubts, but it is interesting to remember in that connection that this is in Nasser City, and you remember that particular part of the city?"

"Of course I do, I recognize it, I was there, I was a young man at the time".

"Fine, but you will remember then that the buildings there had two stories, these buildings have six stories. The Government built the first two stories. The question is who built the other four."

The reply is, of course, the extralegal sector. That is to say, all people are by nature entrepreneurial. The people in Nasser City found that the foundations were strong enough to carry another four floors and so they built them. If you go back to the records of who owns what, those records cannot tell you who lives on stories three, four, five, and six, because legally they do not exist. However, many of those who were in stories one and two have moved on because it was good business. No matter how you look at your records—whether you are a banker trying to find somebody who could use their building for collateral, or whether you are a policeman looking for Osama Bin Laden—you do not know who's there. Therefore, the market does not work. The functions are not in place.

When you add all of that up, it turns out that 92 percent of the land and buildings in Egypt are outside the legal system. It turns out that about 88 percent of the enterprises are outside the system.

When they hear these figures, everybody starts getting depressed. We say, "Well, this isn't really a problem. Even Mexico, which is a more advanced country, has 80 percent of its economy outside the legal system." Therefore, the rule of law only applies to 20 percent of the population, those people within the blue section here. The other interesting aspect of all of this is what people have been able to do outside the law.

When you add together the value of all the buildings and small enterprises outside the law, it turns out that there is US\$ 245 billion from a replacement perspective. That is, if you had to replace it all, it would take US\$ 245 billion. Their market value might be over that. Now, how much

is US\$ 245 billion in Egyptian terms? Well, it is fifty times the value of all World Bank loans to Egypt since the Second World War. It is fifty-five times the value of all direct foreign investment in Egypt since Napoleon left two hundred and fifty years ago, including the financing of the Suez Canal and the Aswan Dam. It is thirty times the size of the Cairo Stock Exchange.

The issue, therefore, is not whether the Egyptians are entrepreneurial or not—all people in the world are entrepreneurial. The problem is that all of this wealth is created outside the market system. It is created outside of a place where you can specialize, where the division of labor takes place on a grand scale, in such a way that you can create additional wealth.

That tells you then something that is very important to us. I think that one of the first philosophers I read was Gaston Bachelard, who was a structuralist, and he said, “the space in which one looks is very different from the space in which one can see.” In other words, when you look at the buildings and the machinery in developing and former Soviet Union countries, they look just like yours; but what’s missing are the things that you can’t see and that relate to the legal infrastructure. The legal infrastructure allows one to make things liquid. In fact, one of the ways that both Adam Smith and Marx would put it is that when you accumulate a sufficient number of goods and assets together, these things can be converted into capital. It is Adam Smith who said that they could only be converted into capital provided they were *fixed* in another subject that is not themselves. Then they can become liquid and they can help you deploy new production. All assets and human activities have a hidden potential that when represented by law—which was not said by Adam Smith or Karl Marx—can suddenly be brought out or released.

In that connection, in 1990, the government of Peru entrusted my organization to help with the privatization of the Peruvian Telephone Company, which at the time was technically owned by the people who owned telephones but, in fact, was administrated by the State. The value of the shares of the Peruvian Telephone Company were quoted in the Lima stock exchange at about US\$ 53 million, and our job was to go out and sell the company. The kids at the institute went out and tried to sell it; they showed the property title of the company, and nobody wanted to buy it: not AT&T, BellSouth, or Telefónica of Spain. They did not like the title. They did not like the representation, which was not standard. It was not the kind of thing they understood.

At that moment, we found out that privatization was essentially a legal exercise. We asked ourselves how we would go about creating a property system around the telephone company that foreigners and investors would understand—that they could look at, just as you look at pieces of paper representing cows and not at the cows when they are brought into the

Chicago Mercantile Exchange, and understand it much better. Well, we actually spent three years redesigning a property system only for telecommunications in Peru. Once the paper and the law was in place, we Peruvians went out and solicited bids. The telephone company was sold to Telefónica of Spain for US\$ 2 billion. US\$ 2 billion in comparison to what it was worth just three years before—US\$ 55 million! In other words, its price had increased 37 times just because it was legally represented in a way that it had a passport and could travel in the expanded market. That is how we started defining capital.

We started defining capital as the value that things have, hidden in themselves, and that once they are represented so that people can look at them in different ways, use them for different functions, for different purposes, then the surplus value in them can be brought out. When you have standardized, legal representations, you can spot and extract the hidden or potential values of assets as well as interconnect them within the larger market. What is important in many cases is not the buyer-product relationship, as de Saussure would say, “between the asset itself and the signifier”; what is important is the relationship between all aspects of representation at the time, and how these come together. This is probably why Adam Smith said that “the only way you can create capital is by creating a wagon-way through the air” between the banks and the assets. We believe that that “wagon-way” Smith was talking about was actually the law, property law, but it was not clear to people in those times. Marx did not believe much in the law, so he could not carry it further. However, what was interesting about those two philosophers of one hundred and fifty years ago and two hundred and fifty years ago—Karl Marx and Adam Smith—is that for them it was current and explainable. They did not have to do much explaining to understand that value or the meaning of value is not captured in physical things themselves, but is captured essentially in the mind and understood collectively.

They had no problem using metaphysical terms. In fact, Marx himself said, excuse me for getting religious and metaphysical, but this is what capital is about, and whoever controls capital, because it’s so difficult to define, of course, has an enormous control over the rest of society. Which is why it is so important that the assets and the means of production not be put in the hands of only selfish people, and that is why, of course, he did not like property. However, what he probably had not realized was that property provided the passport that allowed one to bring out the hidden potential and value that existed in all the assets and work that all people do.

Therefore, what we have been finding out is that, if you want to take this 80 percent or 90 percent of the Mexican, Egyptian, Filipino, Haitian, Russian, or Kazakh economy that is outside the system, you essentially have to focus on law. You essentially have to focus on institutions.

*What I Do, and How Philosophy Has Helped Me*

11

One of the reasons that I came here is that we economists and lawyers, we have exhausted our capacity to convince. We have exhausted our capacity of seeing the big picture. That is why I got extremely confused when I saw the vigorous way in which certain philosophers—which includes Professor John Searle—were looking at these issues. They were looking at these issues in ways that made a lot of sense to people like myself; that bring it all together the way it was in the eighteenth and nineteenth century, and that we seem to have lost somewhere on the way.

Nevertheless, to us it is quite clear that credit is a result of property. People give you money if you have something to lose against it. Credit comes from the Latin *crede* “I believe in.” The only way that I can burden something so that I can give you credit is with a property document. There is no other way of doing it. The only way I will invest in you is if you give me property against it, whether you call it a share, stock, or equity. The only way that the assets I have in Peru allow me to pay my hotel bill in Washington DC is that they are fungible. Fungibility is essentially transported in the form of property documents. The only way that all of this works—and we can understand it—is that property systems integrate and protect transactions and create networks. To us this is crucial. Yet, if you look at the budgets of the World Bank and your aid agencies, there is hardly any money for this. Everybody is dedicated to doing other things. People do not finance things that they cannot see and that they do not understand.

Moreover, lawyers do not supply these kinds of services. They did before. In the eighteenth and nineteenth centuries, law was essentially defined as a discipline that was designed to discover things. It has ceased being defined as such, and it is rare to find a lawyer who has the big picture. If he or she does, of course, he is away in academia, he is not in practice, and he is not in government. Of course, I was very interested in getting in touch with you, with the academic community, simply because I believe we are in trouble. We have lost the direction in which we were supposed to go, and we are now finding out that it is extremely dangerous not to understand what is happening.

We believe that what is happening among developing countries is something that Dawson called “exceptionation,” that when you created property law, you created it at the beginning to protect pieces of land, but what has in fact happened over time is that law has ended up serving another purpose. Not only the purpose of protecting ownership, but doing something much more important than that, which is relating people in ways that make commercial transactions possible, allowing you to place value on things, allowing you to give meaning to things. Even though law was born out of defining ownership, what it does is create the infrastructure for a market economy, because it allows people to understand each other, make

transactions among each other, hold each other accountable, and, as Francis Fukuyama would say, make them trust each other.

Therefore, the creation of law was very important. The trouble is that, with the exception of certain philosophers, including those present here today, the people who understood the big picture in the developed world have died. It is generally much more interesting for us Latin Americans and Russians to read dead Americans than to read live Americans, to read dead Germans than to read live Germans. The dead Germans of a hundred and fifty years ago were concerned about how you create value, how you create wealth. They were concerned about what the sense of order was, and they understood metaphysics. They understood that certain truths could not be revealed in another dimension that was not actually a philosophical dimension, but that was good enough for them at the time. In fact, they were certainly capable of going to war over it.

The importance of capital formation depends, really, on the capacity of a nation's property rights system to represent economic value. Of course, this is something that all of you really know about. This is what Derrida used to talk about, he said, "It's in the mirror of language that we're able to understand each other," or if you want, in the mirror of law. It is certainly not by looking at things physically, in the face. This is what Karl Popper probably meant when he talked about "World One, World Two, and World Three." Popper said that there was a World Three, which consists of the objects that we have created out of human intelligence, and that this was where we interconnected. That is where I find that property takes place, where law takes place. This is, of course, the area where Michel Foucault talked about *le chant épistémologique* or where the *épistème* is. It is that area where people begin to connect; an area that is unexplored and has not really been looked at very seriously, probably since the time that the Soviet Union began turning Marxism from a philosophy into a communist ideology, and the fight moved away from thinking to the military stuff, and people stopped looking at what was behind wealth. We are now finding out that creating wealth is not simply a question of having well-written laws.

Laws have to actually be able to connect to real people, in reality. There has always been a sense that what is missing in the world is good law, and that what people should simply do is imitate what you people in the developed world are doing. That if we just did that everything would be fine. Some people really believe this in Third World countries. I remember that in 1960 some Peruvians decided to go to Switzerland because they had discovered that on average a Peruvian bus killed eleven more people than a Swiss bus. They said, obviously the Swiss have much better traffic regulations than the Peruvians do. They went to Zurich, then they translated the Zurich regulations for traffic from Swiss German into Spanish, and those

are the laws that are in place now. So the traffic laws in Lima are exactly the same as those in Zurich, but we Peruvians are still killing eleven more people than the Swiss, which indicates that when you create law it just can't be cut out from one country and then applied to every country.

When you create law, you have to connect it to reality. You have to connect it to people's beliefs and people's desires; otherwise, it just is not going to work. One of the things that we at the ILD have found is that 90 percent of Egypt, 80 percent of Mexico, and 75 percent of the Philippines is extralegal. When we go into the shantytowns and throughout the country, we start finding out that there are formal titles, but they apply to only a small percentage of the population. In the case of Egypt, to 10 percent of the population; all the rest have extralegal titles. When we showed these extralegal titles to President Mubarak, his reply was, "Well, why are you showing me titles? What's special about those titles?"

"Well, what's special about these titles, Mr. President, is that you didn't issue them. They were issued by local organizations." This means that people, Muslim, Protestant, or Catholic, have already advanced. Maybe Foucault would say they are already placed within a grid of possibility, *un horizon de possibilités*, that has already centered the world round. Moreover, if they do not get the titles from you, they are going to make them themselves.

Of course, it is not that President Mubarak and other leaders do not want to give people titles to their land and titles to whatever they own. Rather, under the present circumstances, it is an extremely difficult thing to do. For example, we tried to find out how much time it would take somebody in Egypt to get title to a sand dune that was outside the agricultural sector. We found out that it would take some seventy-seven bureaucratic steps, and it would take eight hours a day over seventeen years to get through those seventy-seven steps.

When the Egyptians got very depressed about this figure, we said, "Don't worry, in Peru it takes twenty-one years!" What happens is that you cannot take a legal system from one country and just pass it to another one, because there is no such thing as a rule vacuum in any developing country. There are rules in all countries. The first thing that people do is create rules. What you have to make sure of when you bring in modernity is to find out what the *grassroots* rules are.

Over the last fifty years since the Second World War, a great part of the world—which was only recognized by *National Geographic* magazine and the *Discovery* channel—has moved from the hinterland, where it was observed by anthropologists, to the center of our cities. Wherever you go in the developing world, the population of the cities has increased. The Haitian capital Port-au-Prince has grown fifteen times in the last thirty-five years; Guayaquil in Ecuador eleven times; Algiers fourteen times. All of

these people, who had other forms of arrangement in the hinterlands, are now trying to join the mainstream market economy. It is the Industrial Revolution, again, 150 years after it ended in Britain. It is their turn, and they are finding that the law is not accommodating them.

So, the challenge today, again, is to start questioning whether the legal system and structures that we actually have in the developing and former Soviet nations are adequate for a market economy. It is not enough to get a formula from the United States and put it into place, as in the case of the Zurich traffic law transferred to Lima.

Rules have to start out from the people. You have to find out what people already believe in. When you do, you build from that. You can then systematize their beliefs and practices; you can bring in the new things. Wherever we go, even in Haiti, in the poorest country in the American hemisphere, we have not found a single shack that is not titled and titled by the people themselves. Another interesting thing is that this happens not only in Haiti, but also and in all the developing and former Soviet countries. This is of course what happened to a great degree in Japan.

I come from Peru. From 1990 to 2000, we had a president of Japanese origin; his name is Fujimori. His family, the Fujimoris, was one of one million five hundred thousand families that migrated from Japan to Peru and Brazil, which were open to Asian migration, in the nineteen thirties and the forties. The question that I started asking myself when I went back to live in Peru, was why did Fujimori come to Peru, why did the de Sotos not go to Japan? The reply to that was that our GNP per capita in Peru was 20 percent higher than in Japan. Japan is a tiny country. It was a mighty military empire, but a tiny country. Brazil's GNP per capita was 40 percent higher than that of Japan. Now that Fujimori has decided to go back to Japan, he has found a Japan that is nine times wealthier than Peru. The question is, what did they do? How did they all of a sudden become a more productive country and more prosperous than us?

Since by looking at the history books we were not able to get a good answer, and we felt it might have had to do with the legal system, concretely, the property system, we got some money from Europe to go to Japan. We asked ourselves, what happened between 1945 and 1950 during McArthur's occupation? McArthur had really given a very simple edict, which was "destroy the feudal system, because I want to create a property system." He did not do much more than that. It was about a three-page edict that was very carefully thought out. He had been planning the invasion of Japan from 1942 on in Honolulu. When McArthur arrived in Japan in 1945, he worked with a few American intellectuals there. One of the outstanding ones was Wolf Ladejinsky from the United States Department of Agriculture. These men saw that the primary challenge before them was to ensure that Japan did not attempt military expansion again. The peas-



ants were continuously revolting against the military system and that was one of the reasons why Japan went out to expand in Asia. After assessing the situation, they concluded that since the feudal class had financed the military, the best way to prevent another military expansion would be to eliminate the feudal class. The best way to go about this was to take all the feudal land, convert it into private property, and give to it the people.

There was another important reason for wanting to take this path of giving the land to the people who worked on it: Mao Zedong, in neighboring China. Mao had started moving down from Manchuria to China, defeating his traditional foe Chiang Kai-shek. What he was doing on the way was creating property systems. Not private systems, of course, but rather collective ones, which was still a lot closer to people than simply having a feudal lord own everything.

He told the Japanese, well, there must be something underneath your feudal system upon which you can build a property system. The feudal lords were essentially interested in collecting rent and in collecting taxes. However, underneath them, the Smiths and the de Sotos had owned their plots of land for hundreds of years. And we Smiths and de Sotos bought and sold the land to each other, rented them to each other, and gave each other loans against the others collateral.

Well, we at the ILD thought we had a good idea of what had happened, but we had to make sure. When my colleagues and I went to Japan, the International House of Japan brought together the seven remaining octogenarians who had managed the nation's property reform between 1945 and 1950. After two weeks, we confirmed that the Japanese had built their property rights system from the bottom up—by codifying and standardizing grassroots social contracts that people understood and believed in.

Once we had found out what they had, we asked the seven octogenarians their opinion of what we had be doing in Peru and El Salvador; that is, if what we were doing there was the correct way to go about things. We explained that we thought that this was essentially a political endeavor because it has to do with a change of institutions. They agreed. It turns out that they had used posters to get their message across to the people. Now people use jingles and TV spots, but in those days, they had posters. We managed to obtain one hundred of the posters they used. It took six months, but we got a hundred posters. Actually, we were not given the posters. We had to photograph them. In the Japan of 1946, what the Japanese found out, the people doing the reform, is that underneath the feudal system, farmers and people living in the cities were organized in associations called Burakus. The first poster shows the informal village or neighborhood associations that knew who owned what, and they knew what the rules of the game were. There were 10,900 Burakus in Japan at that time, and the authorities legalized them and converted them into land

commissions. The second thing they did was elect representatives who were then able at this level to tell the prefectures of Japan what the rules of the game were. Then the government took all of this information and created a common denominator. They basically created a systematized system of law, not based on some academic or governmental speculation about what the law should be, but on the basis of a process of discovery of what the law was—understanding that what they had to do was codify, systematize, and professionalize it.

The second poster shows the laws instituted during the Meiji restoration being torn up. In the 1890s, with the Meiji restoration, the Japanese incorporated samples of German property law, the *Grundbuch* system, to consolidate their own property system. Of course, what the *Grundbuch* system had done was defend the property or the assets of the feudal lords. That was not good enough so they tore it up. In the next level, we see how in each hamlet and in each neighborhood it was quickly found out who owned what. And in the last, we see the new law written up. It was essentially an antipoverty program. So, Japan passed from a feudal system to a property system that that has allowed the country to become much more prosperous than any of the systems in Latin America have allowed.

Now the reason that I think we were able to discover this was largely due to Friedrich von Hayek's work. When we started seeing in our own country, Peru, how the poor were effectively organized, there was of course a tendency among our lawyers and our jurists to say "cute, but not the real stuff." Friedrich von Hayek made what we are doing possible because he distinguished between legal orders. He talked about the fact that there existed a deliberate legal order, which he called Praxis (from the Greek) and another legal order that was grown from the bottom up called Cosmos—spontaneously generated rules. If you actually look at the rules of the West that allow Westerners to handle enormous complexities like a market economy, they are, by and large, the products of spontaneous generation. That taught us respect for what is spontaneous. It taught us respect for symbols and systems of meaning that come from below. We discovered then that our rule for developing countries was not substituting something for what already existed, but rather making what already existed more sophisticated, because what does exist does have rules.

That is why today, what we essentially do is put in place a procedure that allows people to transform their assets (dead capital) into live capital. In other words, we have a procedure where we actually pick up the symbols and the rules of the game from every Third World country we go to, and, gradually building from that, we systematize it into the rule of law. We are trying to do in five years what Westerners did in three hundred, four hundred years, because there is no reason for it to take so long today. If the Japanese could do it, and we Peruvians used to be wealthier than they

were, then we can do it, too. Not only did the Japanese make the transition, but the Koreans and the Taiwanese did, too.

So, we Third-Worlders can learn from your mistakes, and we can learn from your successes, especially considering that the systems of law that we have in developing and former Soviet countries are not based on common law, but rather on the civil code. The civil code can be deliberately changed. It was deliberately changed in Germany, in Switzerland, and in France in the nineteenth century. That is why we love to read all these dead people, because they made these changes. They were doing in the nineteenth century what we have to do in the twenty-first century.

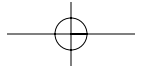
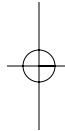
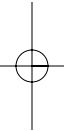
The time has come to recollect this and that the process is essentially an exercise in history, an exercise—to a great degree—in philosophy.

As I said before, I am very happy to be here among you and to be here with Professor John Searle. Once I had finished writing my book—and I had reflected very much on Professor Searle's own writing and everything relating to intentionality—I went to visit him. I tracked him down in Paris. I said to him, "You know, I have a feeling we are both working for the same thing." My concern, of course, is not philosophy per se; my concern is poor people. But, I understand that, somehow or other, the source or the energy that we need to look at these things in the West are the philosophers who basically understand where the meaning of things are. That, and I quote a few of your phrases, "there are things that exist only because we believe them to exist." There are people who believe certain things in all developing and former Soviet countries, but nobody's paying attention to them. We are only paying attention to the few, which is not what nineteenth-century Western politicians did.

We have tried to construct socially a legal system looking at what you did in the nineteenth century. And it has to do very much with the sharing of intentional states, which is what you talk about, collective intentionality. This is your work, of course. In addition, it is the work of Franz Brentano, Daniel C. Dennett, and to a great degree, of Popper, and it is extremely relevant. To many, it seems that academia is over there, and reality is here.

But not to us at the ILD. I happen to be a member of various groups working for G7 proposals that are trying to design the new international order, since the exiting one has obviously failed. Every time I get the opportunity, I say that it is time that we take a lead from academia where some people seem to be on the right track. It is time that we come together to look at solutions that have actually worked throughout time, among other things because they are intellectually solid.

Thank you very much.



# Social Ontology and Political Power

2

*John R. Searle*

The Western philosophical tradition has an especially influential component of political philosophy. The classics in the field, from Plato's *Republic* through Rawls's *Theory of Justice*, have an importance in our general culture that exceeds even most other philosophical classics. The subjects discussed in these works include descriptions of the ideal society, the nature of justice, the sources of sovereignty, the origins of political obligation, and the requirements for effective political leadership. One could even argue that the most influential single strand in the Western philosophical tradition is its political philosophy. This branch of philosophy has an extra interest because it has had at various times an influence on actual political events. The Constitution of the United States, to take a spectacular example, is the expression of the philosophical views of a number of Enlightenment thinkers, some of whom were among the framers of the Constitution itself.

In spite of its impressive achievements, I have always found our tradition of political philosophy in various ways unsatisfying. I do not think it is the best expression of Western philosophy. The problem with the tradition is not that it gives wrong answers to the questions it asks, but rather it seems to me it does not always ask the questions that need to be asked in the first place. Prior to answering such questions as "What is a just society?" and "What is the proper exercise of political power?" it seems to me we should answer the more fundamental questions: "What

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The material in this chapter was presented in various universities as lectures and conference papers in addition to the Buffalo conference. Some versions have been published in several different languages. The most recent publication is in John R. Searle, *Freedom and Neurobiology* (New York: Columbia University press, 2007). I am grateful to Bruce Cain, Felix Oppenheim, and Dagmar Searle for comments on earlier versions of this chapter.

is a society in the first place?” and “What sort of power is political power anyhow?”

In this chapter I do not attempt to make a contribution to the continuing discussion in the Western philosophical tradition, but rather I shall attempt to answer a different set of questions. My aim is to explore some of the relations between the general ontology of social reality, and the specific form of social reality that is political power.

## 1. Social Ontology

I want to begin the discussion by summarizing some of the elements of a theory I expounded in *The Construction of Social Reality* (1995). I say almost nothing about politics in that book, but I believe that if we take that book together with my later book, *Rationality in Action* (2001), there is an implicit political theory contained in these analyses, and in this chapter I want to make that theory explicit, if only in an abbreviated form. I also want to do it in a way that will make fully explicit the role of language and collective intentionality in the constitution of social reality and correspondingly in the constitution of political power.

This project is a part of a much larger project in contemporary philosophy. The most important question in contemporary philosophy is this: how, and to what extent, can we reconcile a certain conception that we have of ourselves as conscious, mindful, free, social and political agents in a world that consists entirely of mindless, meaningless particles in fields of force? How, and to what extent, can we get a coherent account of the totality of the world that will reconcile what we believe about ourselves with what we know for a fact from physics, chemistry, and biology? The question I tried to answer in *The Construction of Social Reality* was about how there can be a social and institutional reality in a world consisting of physical particles. This chapter extends that question to the question “How can there be *political* reality in a world consisting of physical particles?”

To begin, we need to make clear a distinction on which the whole analysis rests, that between those features of reality that are observer- (or intentionality-) independent and those that are observer- (or intentionality-) dependent. A feature is observer-dependent if its very existence depends on the attitudes, thoughts, and intentionality of observers, users, creators, designers, buyers, sellers, and conscious intentional agents generally. Otherwise it is observer- or intentionality-independent. Examples of observer-dependent features include money, property, marriage, and language. Examples of observer-independent features of the world include force, mass, gravitational attraction, the chemical bond, and photosynthesis. A rough test for whether a feature is observer-independent is whether

it could have existed if there had never been any conscious agents in the world. Without conscious agents there would still be force, mass, and the chemical bond, but there would not be money, property, marriage, or language. This test is only rough, because, of course, consciousness and intentionality themselves are observer-independent even though they are the source of all observer-dependent features of the world.

To say that a feature is observer-dependent does not necessarily imply that we cannot have objective knowledge of that feature. For example, the piece of paper in my hand is American money, and as such is observer-dependent: It is only money because we think it is money. But it is an objective fact that this is a ten-dollar bill. It is not, for example, just a matter of my subjective opinion that it is money.

This example shows that in addition to the distinction between observer-dependent and observer-independent features of the world we need a distinction between epistemic objectivity and subjectivity, on the one hand, and ontological objectivity and subjectivity, on the other. *Epistemic* objectivity and subjectivity are features of *claims*. A claim is epistemically objective if its truth or falsity can be established independently of the feeling, attitudes, preferences, and so on of the makers and interpreters of the claim. Thus the claim that Van Gogh was born in Holland is epistemically objective. The claim that Van Gogh was a better painter than Manet is, as they say, a matter of opinion. It is epistemically subjective. On the other hand, *ontological* subjectivity and objectivity are features of *reality*. Pains, tickles, and itches are ontologically subjective because their existence depends on being experienced by a human or animal subject. Mountains, planets, and molecules are ontologically objective because their existence is not dependent on subjective experiences.

The point of these distinctions for the present discussion is this: almost all of political reality is observer-relative. For example, something is an election, a parliament, a president, or a revolution only if people have certain attitudes toward the phenomenon in question. And all such phenomena thereby have an element of ontological subjectivity. The subjective attitudes of the people involved are constitutive elements of the observer-dependent phenomena. But ontological subjectivity does not by itself imply epistemic subjectivity. One can have a domain such as politics or economics whose entities are ontologically subjective, but one can still make epistemically objective claims about elements in that domain. For example, the United States presidency is an observer-relative phenomenon, hence ontologically subjective. But it is an epistemically objective fact that George W. Bush is now president.

With these distinctions in mind, let us turn to social and political reality. Aristotle famously said that man is a social animal. But the same expression in the *Politics*, “Zoon politikon” is sometimes translated as “political

animal”: “Man is a political animal.” Quite apart from Aristotelian scholarship, that ambiguity should be interesting to us. There are lots of social animals, but man is the only political animal. So one way to put our question is to ask: “What has to be added to the fact that we are *social* animals to get the fact that we are *political* animals? And more generally, what has to be added to social reality to get to the special case of political reality?” Let us start with social facts.

The capacity for social cooperation is a biologically based capacity shared by humans and many other species. It is the capacity for collective intentionality, and collective intentionality is just the phenomenon of shared forms of intentionality in human or animal cooperation. So, for example, collective intentionality exists when a group of animals cooperates in hunting their prey, or two people are having a conversation, or a group of people are trying to organize a revolution. Collective intentionality exists both in the form of cooperative behavior and in consciously shared attitudes such as shared desires, beliefs, and intentions. Whenever two or more agents share a belief, desire, intention, or other intentional state, and where they are aware of so sharing, the agents in question have collective intentionality. It is a familiar point, often made by sociological theorists, that collective intentionality is the foundation of society. This point is made in different ways by Durkheim, Simmel, and Weber. Though they did not have the jargon I am using, and did not have a theory of intentionality, I think they were making this point, using the nineteenth-century vocabulary that was available to them. The question that—as far as I know—they did not address, and that I am addressing now, is: How do you get from social facts to institutional facts?

Collective intentionality is all that is necessary for the creation of simple forms of social reality and social facts. Indeed, I define a social fact as any fact involving the collective intentionality of two or more human or animal agents. But it is a long way from simple collective intentionality to money, property, marriage, or government, and consequently it is a long way from being a social animal to being an institutional or a political animal. What specifically has to be added to collective intentionality to get the forms of institutional reality that are characteristic of human beings, and in particular characteristic of human political reality? It seems to me that exactly two further elements are necessary: First, the imposition of function and, second, certain sorts of rules that I call “constitutive rules.” It is this combination, in addition to collective intentionality, that is the foundation of what we think of as specifically *human* society.

Let us go through these features in order. Human beings use all sorts of objects to perform functions that can be performed by virtue of the physical features of the objects. At the most primitive level, we use sticks for levers and stumps to sit on. At a more advanced level we create objects



so that they can perform particular functions. So early humans have chiseled stones to use them to cut with. At a more advanced level we manufacture knives to use for cutting, and chairs to sit on. Some animals are capable of very simple forms of the imposition of function. Famously, K€hler's apes were able to use a stick and a box in order to bring down bananas that were otherwise out of reach. And the famous Japanese macaque monkey Imo learned how to use seawater to wash sweet potatoes and thus improve their flavor by removing dirt and adding salt. But, in general, the use of objects with imposed functions is very limited among animals. Once animals have the capacity for collective intentionality and for the imposition of function, it is an easy step to combine the two. If one of us can use a stump to sit on, several of us can use a log as a bench or a big stick as a lever operated by us together. When we consider human capacities specifically we discover a truly remarkable phenomenon. Human beings have the capacity to impose functions on objects, which, unlike sticks, levers, boxes, and salt water, cannot perform the function solely in virtue of their physical structure, but only in virtue of a certain form of the collective acceptance of the objects as having a certain sort of status. With that status comes a function that can only be performed in virtue of the collective acceptance or recognition by the community that the object has that status, and that the status carries the function with it. Perhaps the simplest and the most obvious example of this is money. The bits of paper are able to perform their function not in virtue of their physical structure, but in virtue of the fact that we have a certain set of attitudes toward them. We acknowledge that they have a certain status, we count them as money, and consequently they are able to perform their function in virtue of our acceptance or recognition of them as having that status. I propose to call such functions "status functions."

How is it possible that there can be such things as status functions? In order to explain this possibility, I have to introduce a third notion, in addition to the already explained notions of collective intentionality and the assignment of function. The third notion is that of the constitutive rule. In order to explain it, I need to note the distinction between what I call brute facts and institutional facts. Brute facts can exist without human institutions; institutional facts require human institutions for their very existence. An example of a brute fact is that this stone is larger than that stone, or that the Earth is 93 million miles from the sun. An example of institutional facts is that I am a citizen of the United States and that this is a twenty-dollar bill. And how are institutional facts possible? Institutional facts require human institutions. To explain such institutions we need to make a distinction between two kinds of rules, which, years ago, I baptized as "regulative rules" and "constitutive rules." Regulative rules regulate antecedently existing forms of behavior. A rule such as "drive on the right

hand side of the road” regulates driving, for example. But constitutive rules not only regulate, they also create the very possibility, or define, new forms of behavior. An obvious example is the rules of chess. Chess rules do not just regulate the playing of chess, but rather, playing chess is constituted by acting according to the rules in a certain sort of way. Constitutive rules typically have the form: “X counts as Y,” or “X counts as Y in context C.” Such-and-such counts as a legal move of a knight in chess, such and such a position counts as checkmate, such-and-such a person that meets certain qualifications counts as president of the United States, and so on.

The key element in the move from the brute to the institutional, and correspondingly the move from assigned physical functions to status functions, is the move expressed in the constitutive rule. It is the move whereby we count something as having a certain status, and with that status, a certain function. So the key element that gets us from the sheer animal imposition of function and collective intentionality to the imposition of status functions is our ability to follow a set of rules, procedures, or practices, whereby we count certain things as having a certain status. Such-and-such a person who satisfies certain conditions counts as our president, such-and-such a type of object counts as money in our society, and, most important of all, as we shall see, such-and-such a sequence of sounds or marks counts as a sentence, and, indeed, counts as a speech act in our language. It is this feature, the distinctly human feature, to count certain things as having a status that they do not have intrinsically, and then to grant, with that status, a set of functions, which can only be performed in virtue of the collective acceptance of the status and the corresponding function, that creates the very possibility of institutional facts. Institutional facts are constituted by the existence of status functions.

At this point in the analysis a philosophical paradox arises. It has the form of a traditional paradox concerning the origin of obligations. Here is how it goes. If the existence of institutional facts requires constitutive rules, then where do the constitutive rules come from? It looks like their existence might itself be an institutional fact, and if so we would plunge into an infinite regress or circularity. Either way the analysis would collapse. The traditional form in which this paradox arises has to do with the obligation to keep promises. If the origin of the obligation to keep a promise comes from the fact that everybody has made a promise to the effect that they will keep their promises, then the analysis is obviously circular. If, on the other hand, that is not the origin of the obligation to keep a promise, then it looks like we have no analysis of where the obligation to keep a promise comes from. I hope it is clear that the form of the paradox for constitutive rules has the same logical form as the traditional puzzle about the nature of promises. For promises the puzzle is: How can the

obligation of promises come into existence without a prior promise to abide by promises? For institutional facts the puzzle is: How can the constitutive rules that underlie institutional facts exist without some institution consisting of constitutive rules within which we can create constitutive rules?

In the case of the logical form of constitutive rules the problem can be stated without putting it in the form of a paradox. Even if the existence of the constitutive rule is not itself an institutional fact, at least it is an observer-relative fact. And that already makes it dependent on the consciousness and intentionality of agents, and one wants to know, what exactly is the structure of that consciousness and intentionality? How rich an apparatus is necessary in order to have the appropriate mental contents?

Here, I believe, is the solution to the paradox. Human beings have the capacity to impose status functions on objects. The imposition of those status functions can be represented in the form, "X counts as Y in C." In primitive cases you do not require an established procedure or rule in order to do this; consequently, for the simplest kind of cases of the imposition of status functions, a general procedure in the form of a constitutive rule is not yet required. Consider the following sort of example. Let us suppose that a primitive tribe just regards a certain person as their chief or leader. We may suppose that they do this without being fully conscious of what they are doing, and even without having the vocabulary of "chief" or "leader." For example, suppose they do not make decisions without first consulting him, his voice carries a special weight in the decision-making process, people look to him to adjudicate conflict situations, members of the tribe obey his orders, he leads the tribe in battle, and so on. All of those features constitute his being a leader, and leadership is a case of an imposed status function on an entity that does not have that function solely in virtue of its physical structure. They accord to him a status, and with that status a function. He now *counts as* their leader.

When the practice of imposing a status function becomes regularized and established, then it becomes a constitutive rule. If the tribe makes it a matter of policy that he is the leader because he has such and such features and that any successor as leader must have these features, then they have established a constitutive rule of leadership. It is especially important that there should be publicly available constitutive rules, because the nature of status functions requires that they be collectively recognized in order to do their work, and the collective recognition requires that there be some antecedently accepted procedure in accordance with which the institutional facts can be acknowledged. Language is the obvious case of this. That is, we have procedures by which we make statements, ask questions, and give promises. And these are made possible in a way that is communicable to other people, only because of publicly recognized constitutive

rules. But constitutive rules do not require other constitutive rules for their existence, at least not to the point of an infinite regress. So the solution to our initial puzzle is to grant that a regularized practice can become a constitutive rule, but there does not always have to be a constitutive rule in order that a status function be imposed in the simplest sorts of cases.

Two things to notice about status functions. First, they are always matters of positive and negative powers. The person who possesses money or property or is married has powers, rights, and obligations that he or she would not otherwise have. Notice that these powers are of a peculiar kind because they are not like, for example, electrical power or the power that one person might have over another because of brute physical force. Indeed it seems to me a kind of pun to call both the power of my car engine and the power of George W. Bush as president “powers” because they are totally different. The power of my car engine is brute power. But the powers that are constitutive of institutional facts are always matters of rights, duties, obligations, commitments, authorizations, requirements, permissions, and privileges. Notice that such powers only exist as long as they are acknowledged, recognized, or otherwise accepted. I propose to call all such powers *deontic powers*. Institutional facts are always matters of deontic powers.

The second feature to notice is that where status functions are concerned, language and symbolism have not only the function to describe the phenomena but also are partly constitutive of the very phenomena described. How can that be? After all, when I say that George W. Bush is president, that is a simple statement of fact, like the statement that it is raining. Why is language more constitutive of the fact in the case where the fact is that George W. Bush is president, than it is in the fact that it is raining? In order to understand this we have to understand the nature of the move from X to Y whereby we count something as having a certain status that it does not have intrinsically, but has only relative to our attitudes. The reason that language is constitutive of institutional facts, in a way that it is not constitutive of brute facts, or other sorts of social facts, or intentional facts in general, is that the move from X to Y in the formula X counts as Y in C can only exist insofar as it is represented as existing. There is no physical feature present in the Y term that was not present in the X term. Rather the Y term just is the X term *represented* in a certain way. The ten-dollar bill is a piece of paper, the president is a man. Their new statuses exist only insofar as they are represented as existing. But in order that they should be represented as existing there must be some device for representing them. And that device is some system of representation, or at the minimum some symbolic device, whereby we represent the X phenomenon as having the Y status. In order that Bush be president, people must be able to think that he is president, but in order that they be able to think that he is president,

they have to have some means for thinking that, and that means has to be linguistic or symbolic.

But what about language itself? Isn't language itself an institutional fact, and would it not thereby require some means of representing its institutional status? Language is the basic social institution, not only in the sense that language is required for the existence of other social institutions, but also that linguistic elements are, so to speak, self-identifying as linguistic. The child has an innate capacity to acquire the language to which it is exposed in infancy. The linguistic elements are self-identifying as linguistic precisely because we are brought up in a culture where we treat them as linguistic, and we have an innate capacity so to treat them. But in that way, money, property, marriage, government, and presidents of the United States are not self-identifying as such. We have to have some device for identifying them and that device is symbolic or linguistic.

It is often said, and indeed I have said it myself, that the primary function of language is to communicate, that we use language to communicate with other people, and in a limiting case, to communicate with ourselves in our thinking. But language plays an extra role, which I did not see when I wrote *Speech Acts* (1969), and that is that language is partly constitutive of all institutional reality. In order that something can be money, property, marriage, or government, people have to have appropriate thoughts about it. But in order that they have these appropriate thoughts, they have to have the devices for thinking those thoughts, and those are essentially symbolic or linguistic devices.

So far I have gone, rather rapidly, through a summary of the basic ideas that I need in order to explore the nature of political power in its relation to language. In a sense our enterprise is Aristotelian, in that we are seeking progressively more refined *differentia*, to get from the *genus* of social facts to progressively more refined specifications, that will give us the *species* of political reality. We are now on the verge of being able to do that, though, of course, we need to remind ourselves that we are not following the essentialism that characterized Aristotle's approach.

## 2. The Paradox of Political Power: Government and Violence

So far the account is fairly neutral about the distinctions between different sorts of institutional structures, and it might seem from such an account that there is nothing special about government, that it is just one institutional structure among others, along with families, marriages, churches, universities, and so forth. But there is a sense in which in most organized societies, the government is the ultimate institutional structure. Of course

the power of governments varies enormously from liberal democracies to totalitarian states; but, all the same, governments have the power to regulate other institutional structures such as family, education, money, the economy generally, private property, and even the church. Again, governments tend to be the most highly accepted system of status functions, rivaled by the family and the church. Indeed, one of the most stunning cultural developments of the past few centuries was the rise of the nation-state as the ultimate focus of collective loyalty in a society. People have, for example, been willing to fight and die for the United States, or Germany, or France, or Japan, in a way that they would not be willing to fight and die for Kansas City or Vitry-le-Francois.

How do governments, so to speak, get away with it? That is, how does the government manage as a system of status function superior to others status functions? One of the keys, perhaps the most important key, is that typically governments have a monopoly on organized violence. Furthermore, because they have a monopoly on the police and the armed forces, they in effect have control of a territory in a way that corporations, churches, and ski clubs do not control a territory. The combination of control of the land plus a monopoly on organized violence guarantees government the ultimate power role within competing systems of status functions. The paradox of government could be put as follows: governmental power is a system of status functions and thus rests on collective acceptance, but the collective acceptance, though not itself based on violence, can continue to function only if there is a permanent threat of violence in the form of the military and the police. Though military and police powers are different from political power, there is no such thing as government, no such thing as political power without police power and military power (more about this later).

The sense in which the government is the ultimate system of status functions is the sense that old-time political philosophers were trying to get at when they talked about sovereignty. I think the notion of sovereignty is relatively confused because it implies transitivity. But most systems of sovereignty, at least in democratic societies, are not transitive. In a dictatorship, if A has power over B and B has power over C, then A has power over C, but that is not really true in a democracy. In the United States, there is a complex series of interlocking constitutional arrangements between the three branches of government and between them and the citizenry. So the traditional notion of sovereignty may not be as useful as the traditional political philosophers had hoped. Nonetheless, I think we will need a notion of the ultimate status-function power in order to explain government.

Because I do not have a lot of space I am going to summarize some of the essential points about political power as a set of numbered propositions.

*1. All political power is a matter of status functions, and for that reason all political power is deontic power.*

Deontic powers are rights, duties, obligations, authorizations, permissions, privileges, authority, and the like. The power of the local party bosses and the village council as well as the power of such grander figures as presidents, prime ministers, Congress, and the Supreme Court are all derived from the possession by these entities of recognized status functions. And these status functions assign deontic powers. Political power thus differs from military power, police power, or the brute physical power that the strong have over the weak. An army that occupies a foreign country has power over its citizens but such power is based on brute physical force. Among the invaders there is a recognized system of status functions and thus there can be political relations within the army, but the relation of the occupiers to the occupied is not political unless the occupied come to accept and recognize the validity of the status functions. To the extent that the victims accept the orders of the occupiers without accepting the validity of the status functions they act from fear and prudence. They act on reasons which are desire-dependent.

I realize, of course, that all of these different forms of power—political, military, police, economic, and so on—interact and overlap in all sorts of ways. I do not suppose for a moment that there is a sharp dividing line, and I am not much concerned with the ordinary use of the word “political” as it is distinct from “economic” or “military.” The point I am making, however, is that there is a different logical structure to the ontology where the power is deontic from the cases where it is, for example, based on brute force or self-interest.

The form of motivation that goes with a system of accepted status functions is essential to our concept of the political and I will say more about it shortly. Historically, the awareness of its centrality was the underlying intuition that motivated the old Social Contract theorists. They thought that there is no way that we could have a system of political obligations, and indeed, no way we could have a political society, without something like a promise, an original promise, that would create the deontic system necessary to maintain political reality.

*2. Because all political power is a matter of status functions, all political power, though exercised from above, comes from below.*

Because the system of status functions requires collective acceptance or recognition, all genuine political power comes from the bottom up. This is as much true in dictatorships as it is in democracies. Hitler and Stalin, for example, were both constantly obsessed by the need for security. They could never take the system of status functions as having been accepted, as a given part of reality. It had to be constantly maintained by a system of

rewards and punishments and by terror. In the case of recent totalitarian systems, such as Mussolini's fascism, Hitler's Nazi Germany, and Soviet communism, the intermediate level of status functions was that of the Party. The dictator is able to control the populace by way of having the unswerving loyalty of an elite group, the party members, and they in turn control the other institutions of a society, including such systems of status functions as the bureaucracy, the police, and the military. In Stalin's Soviet Union in particular, anyone suspected of disloyalty was subject to imprisonment or death. I would argue indeed that Lenin's great contribution to institutional practice was the invention of the revolutionary party, which was supposed to overthrow the existing system of status functions and on its overthrow, immediately seize power in a systematic and disciplined way.

The single most stunning political event of the second half of the twentieth century was the collapse of communism. It collapsed when the structure of collective intentionality was no longer able to maintain the system of status functions. On a smaller scale a similar collapse of status functions occurred with the abandonment of Apartheid in South Africa. In both cases, as far as I can tell, the key element in the collapse of the system of status functions was the withdrawal of acceptance on the part of large numbers of the people involved, especially the elites.

*3. Even though the individual is the source of all political power by his or her ability to engage in collective intentionality, all the same, the individual typically feels powerless.*

The individual typically feels that the powers that be are not in any way dependent on him or her. This is why it is so important for revolutionaries to introduce some kind of collective intentionality: class consciousness, identification with the proletariat, student solidarity, consciousness raising among women, or some such. Because the entire structure rests on collective intentionality its destruction can be attained by creating an alternative and inconsistent form of collective intentionality

I have so far been emphasizing the role of status functions and consequently of deontic powers in the constitution of social and political reality. But that naturally forces a question on us: How does it work? How does all this stuff about status functions and deontic powers work when it comes to voting in an election or paying income taxes? How does it work in such a way as to provide motivations for actual human behavior? It is a unique characteristic of human beings that they can create and act on desire-independent reasons for action. As far as we know, not even the higher primates have this ability. This I believe is one of the keys to understanding political ontology. Human beings have the capacity to be motivated by desire-independent reasons for action. And this leads to point number 4.



4. *The system of political status functions works at least in part because recognized deontic powers provide desire-independent reasons for action.*

Typically we think of desire-independent reasons for action as intentionally created by the agent, and promising is simply the most famous case of this. But one of the keys to understanding political ontology and political power is to see that the entire system of status functions is a system of providing desire-independent reasons for action. The recognition by the agent, that is to say by the citizen of a political community, of a status function as valid gives the agent a desire-independent reason for doing something. Without this there is no such thing as organized political and institutional reality.

What we are trying to explain is the difference between humans and other social animals. The first step in explaining the difference is to identify institutional reality. Institutional reality is a system of status functions, and those status functions always involve deontic powers. For example, the person who occupies an office near mine in Berkeley is the Chair of the Philosophy Department. But the status function of being Chair of the Department imposes rights and obligations that the occupant did not otherwise have. In such ways there is an essential connection between status function and deontic power. But, and this is the next key step, the recognition of a status function by a conscious agent, such as me, can give me reasons for acting, which are independent of my immediate desires. If my Chairman asks me to serve on a committee then, if I recognize his position as Chairman, I have a reason for doing so, even if committees are boring and there are no penalties for my refusal.

More generally, if I have an obligation, for example, to meet someone by 9:00 a.m., I have a reason to do so, even if in the morning I do not feel like it, and the fact that the obligation requires it gives me a reason to want to do it. Thus, in the case of human society, unlike animal societies, reasons can motivate desires, instead of all reasons having to start with desires. The most obvious example of this is promising. I promise something to you and thus create a desire-independent reason for doing it. But it is important to see that where political reality is concerned, we do not need to make or create desire-independent reasons for action explicitly, as when we make promises or undertake various other commitments. The simple recognition of a set of institutional facts as valid, as binding on us, creates desire-independent reasons for action. To take an important contemporary example, many Americans do not want George W. Bush as president, and some of them even think he got the status function in an illegitimate fashion. But the important thing for the structure of deontic power in the United States is that with very few exceptions they continue to recognize his deontic powers and thus they will recognize that they have reasons for doing things that they would not otherwise have a desire to do.

It is a consequence of what I am saying that, if I am right, not all political motivation is self-interested or prudential. You can see this by contrasting political and economic motivation. The logical relations between political and economic power are extremely complex: both the economic and the political systems are systems of status functions. The political system consists of the machinery of government, together with the attendant apparatus of political parties, interest groups, and the like. The economic system consists of the economic apparatus for creating, distributing, and sustaining the distribution of wealth. Though the logical structures are similar, the systems of rational motivations are interestingly different. Economic power is mostly a matter of being able to offer economic awards, incentives, and penalties. The rich have more power than the poor because the poor want what the rich can pay them and thus will do what the rich want. Political power is often like that, but not always. It is like that when the political leaders can exercise power only as long as they offer greater rewards. This has led to any number of confused theories that try to treat political relations as having the same logical structure as economic relations. But such desire-based reasons for action, even when they are in a deontic system, are not deontological. The important point to emphasize is that the essence of political power is deontic power.

*5. It is a consequence of the analysis so far that there is a distinction between political power and political leadership.*

Roughly speaking, power is the ability to make people do something whether they want to do it or not. Leadership is the ability to make them want to do something they would not otherwise have wanted to do. Thus different people occupying the same position of political power with the same official status functions may differ in their effectiveness because one is an effective leader and the other is not. They have the same *official* position of deontic power, but different *effective* positions of deontic power. Thus both Roosevelt and Carter had the same official deontic powers—both were presidents of the United States and leaders of the Democratic Party—but Roosevelt was far more effective because he maintained deontic powers in excess of his constitutionally assigned powers. The ability to do that is part of what constitutes political leadership. Furthermore, the effective leader can continue to exercise power and to maintain an informal status function even when he or she is out of office.

*6. Because political powers are matters of status functions they are, in large part, linguistically constituted.*

I have said that political power is in general deontic power. It is a matter of rights, duties, obligations, authorizations, permissions, and the like. Such powers have a special ontology. The fact that George W. Bush is president has a different logical structure altogether from the fact that it is rain-

ing. The fact that it is raining consists of water drops falling out of the sky, together with facts about their meteorological history, but the fact that George W. Bush is president is not in that way a natural phenomenon. That fact is constituted by an extremely complex set of explicitly verbal phenomena. There is no way that fact can exist without language. The essential component in that fact is that people regard him and accept him as president, and consequently accept a whole system of deontic powers that goes with that original acceptance. Status functions can only exist as long as they are represented as existing, and for them to be represented as existing, there needs to be some means of representation, and those are typically linguistic. Where political status functions are concerned it is almost invariably linguistic. It is important to emphasize that the content of the representation need not match the actual content of the logical structure of the deontic power. For example, in order for Bush to be president people do not have to think, "We have imposed on him a status function according to the formula X counts as Y in C," even though that is exactly what they have done. But they do have to be able to think something. For example, they typically think, "He is president" and such thoughts are sufficient to maintain the status function.

7. *In order for a society to have a political reality in the contemporary sense, it needs several other distinguishing features: First, a distinction between the public and the private sphere with the political as part of the public sphere; second, the existence of nonviolent group conflicts; and third, the group conflicts must be over social goods within a structure of deontology.*

I said I would suggest some of the differentia that distinguish political facts from other sorts of social and institutional facts. But, with the important exception of the point about violence, the ontology I have given so far might fit nonpolitical structures such as religions or organized sports. They too involve collective forms of status function and consequently collective forms of deontic powers. What is special about the concept of *the political* within these sorts of systems of deontic powers?

I am not endorsing any kind of essentialism, and the concept of the political is clearly a family resemblance concept. There is no set of necessary and sufficient conditions that define the essence of the political. But there are, I believe, a number of typical distinguishing features. First, our concept of the political requires, I believe, a distinction between the public and private spheres, with politics as the paradigm public activity. Second, the concept of the political requires a concept of group conflict. But not just any group conflict is political. Organized sports involve group conflict, but they are not typically political. The essence of political conflict is that it is a conflict over social goods, and many of these social goods include deontic powers. So, for example, the right to abortion is a

political issue because it involves a deontic power, the legal right of women to have their fetuses killed.

*8. A monopoly on armed violence is an essential presupposition of government.*

As I suggested earlier, the paradox of the political is this: in order that the political system can function there has to be an acceptance or recognition of a set of status functions by a sufficient number of members of the group sharing collective intentionality. But, in general, in the political system that set of status functions can only work if it is backed by the threat of armed violence. This feature distinguishes governments from churches, universities, ski clubs, and marching bands. The reason that the government can sustain itself as the ultimate system of status functions is that it maintains a constant threat of physical force. The miracle, so to speak, of democratic societies is that the system of status functions that constitutes the government has been able to exercise a control through deontic powers over the systems of status functions that constitute the military and the police. In societies where that collective acceptance ceases to work, as for example in the German Democratic Republic in 1989, the government, as they say, collapses.

### 3. Conclusion

One way to get at the aim of this chapter is to say that it is an attempt to describe those features of human political reality that distinguish it from other sorts of collective animal behavior. The answer that I have proposed to this question proceeds by a number of steps. Humans are distinct from other animals in that they have a capacity to create not merely a social but an institutional reality. This institutional reality is, above all, a system of deontic powers. These deontic powers provide human agents with the fundamental key for organized human society: the capacity to create and act on desire independent reasons for action.

Some of the distinguishing features of the political, within the system of desire independent reasons for action, are that the concept of the political requires that a distinction between the public and the private spheres, with the political as the preeminent public sphere; it requires the existence of group conflicts settled by nonviolent means, and it requires that the group conflict be over social goods. And the whole system has to be backed by a credible threat of armed violence. Governmental power is not the same as police power and military power, but with few exceptions, if no police and no army, then no government.

# Searle and de Soto: The New Ontology of the Social World

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## 1. A Game of Chess

What is a game of chess? This simple question has, in the simplest case, a simple answer:

A game of chess is a sequence of deliberate moves of certain distinctively shaped pieces across a distinctively patterned board made by two opposing players who alternate in making their moves in accordance with certain well-defined rules of which the players are aware.

In short: a game of chess is a sequence of events of a certain patterned sort.

Each move in the game is associated with a certain intention on the part of the responsible player, and these intentions—above all the intention to win, and not just to move pieces in accordance with the rules—are indispensable to the game. But they are not *parts* of the game, any more than the thoughts in the minds of staff officers behind the lines are parts of the battle raging at the front.

We can write down the moves made by each player and so keep a record of the game. But this record is not a *part* of the game either. Indeed it may come into existence only long after the game has been concluded. Like the thoughts in the minds of the players, and like published histories of military engagements, it belongs rather to what we shall call *the domain of records and representations*.

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Chess reality then consists of two complementary dimensions: the dimension of the game itself, which consists of moves of pieces on a board; and the dimension of thoughts, ideas, intentions, and deliberations. The latter is an indispensable accompaniment of the game, but it is not a part thereof.

The above, however, describes only the simple case. Suppose, instead, that two people play a game of blind chess. Here there are no pieces, no board, and no moves; rather there are just players, their intentions, and the announcements of these intentions in an alternating rhythm that enables each intention to be registered by the opposing player. What is the game itself, in this case? Is it the passage of messages back and forth? I will argue that it is not, but rather that these messages, like the intentions, are again a part of the domain of records and representations.

To see why this is so, consider a game of normal chess that is being played on a giant chessboard in which the players send messages to surrogates who are called upon to move the pieces. These messages, again, are not a part of the game, any more than the messages sent from headquarters to the troops on the battlefield are part of the battle. Certainly in both cases the messages, like the intentions which underlie them, have an important causal connection to the game itself. But the events and processes that cause an enduring entity to exist is not a part of that entity—at least not on standard views of the relation between cause and effect.

And the same applies also in the case of blind chess: only here, the giant chessboard is absent. What we have instead are images of a chessboard in the minds of the players. But these images, too, cannot constitute the game of chess—for they are present also when board and pieces truly do exist.

A parallel problem arises in the case of a game of internet chess. Here the player's intentions are conveyed by movements of electrons along wires, with resulting changes in computer memory and monitor displays. Here again, the signs conveyed, and the associated blips inside computers, belong to the domain of records and representations.

But if not a sequence of messages, or images, then what, in the case of blind chess or internet chess, is the game itself? Some might be tempted to suggest that the game itself in such cases is some sort of *conceptual* entity. But concepts, too, belong on the side of representations; entities such as chess games, chessboards, and chess pieces belong to the side of what concepts represent. (And the fact that the dichotomy between representations and objects is not absolute—there are, for example, paintings which fall under both headings—does not affect our argument here.)

A thesis to the effect that a game of blind chess is a conceptual entity faces the further problem that concepts as normally conceived are timeless entities. Chess games, however, including blind chess games, are tied

essentially to time. In fact, they have a double temporal structure, in that they occur in a specific time interval and they unfold themselves within this interval in a specific order of before-and-after of successive moves (the same order which is captured in the spatial form of above-and-below in the written record).<sup>1</sup>

An alternative answer to our question might consist in the claim that, when we play blind chess, then *there is no game at all*. It is merely *as if* such an entity exists—as in the cinema it is merely as if the represented events were actually taking place in the theater. The players in a game of blind chess are, according to this account, just pretending to play chess, as a pianist may pretend to play the piano by touching the keys but without actually depressing them. This amounts to a doctrine of fictionalism: it asserts that talk about entities of given sorts is only putatively about such entities. When talking about *a game of blind chess*, just as when we talk about *the absence of a pulse*, or about *the average Spaniard*, we are using the corresponding words as mere *façons de parler* about something else. But this fictionalist alternative, too, is to be rejected. For we can indeed imagine that two people do in fact *pretend* to play a game of blind chess; but then, on the reading in question, we would have to say that they were in such circumstances in fact pretending to be pretending.

The correct answer to our question is rather the following. A game of blind chess is what we shall call a *quasi-abstract pattern*, something that is: (i) like abstract entities such as numbers or forms, in that it is both *non-physical* and *nonpsychological*; but at the same time, (ii) through its association with specific players and a specific occasion, *tied to time and history*. A quasi-abstract pattern thus has two properties that are normally assumed to be incompatible. On the one hand it has no physical parts, and is not able to stand in physical relations of cause and effect. But on the other hand it is a historical entity, which means that its existence is tied to a certain interval of time and to certain actions of specific players. Already Plato would have regarded such a combination of properties as something impossible. For Plato the *forms* are essentially nonhistorical, indeed atemporal; the objects participating in these forms are essentially bound to time and change. To do justice to phenomena like the blind chess game, we need to recognize that there are entities of a third sort, entities which are both abstract (nonphysical) but yet historical (they are tied to time).

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1. In this respect a game of chess is analogous to a reading of a work of literature, where we can in fact distinguish *three* levels of temporal order: the level of the reading itself, as a succession of events in real time; the level of the sentences succeeding each other in an abstract temporal order that is reflected in the spatial order of the corresponding printed marks on the page; and finally the level that is constituted by the plot of the work itself, that is to say, by the fictional events which these sentences depict. See Ingarden 1973.

A normal game of chess includes the movements of the pieces as its parts. It is part of physical reality. Interestingly, however, normal chess too has a certain abstract character, since it contains these movements as *granular* parts. This means that certain parts of these movements, for example the interactions of the molecules inside the pieces, are not themselves parts of the game. Rather, they are traced over, in the same way in which, when we look at an oil painting, we trace over the fine-grained structure of the molecules of which the pigment is made.<sup>2</sup> A game of blind chess, in contrast, is a wholly abstract entity. It has no physical parts of any sort.

The messages communicated by the players in the course of the game are, like the game itself, ephemeral. They can be transformed, however, into representations that have a lasting existence by being written down. And we note in passing that on the basis of such records a new dimension of chess reality can come into existence: the dimension of *status*. Chess masters enjoy a special status not least because there exist records of the games they have played. In virtue of the existence of such records, the game has the chance to shape the lives of those involved in new and lasting ways.

## 2. Two Sorts of Social Reality

The ontology advanced by Searle in his *The Construction of Social Reality* (1995) focuses primarily on the physical domain of the social world—on dollar bills, presidents, and driving licenses, on promisings, marryings, and buyings of beer.

The formula at the heart of this ontology is:

X counts as Y in context C.

This formula, which lies at the center of Searle's thinking all the way from his book *Speech Acts* to *Construction*, is satisfied first of all by objects—by husbands, cathedrals, and the *listes des prix* posted in Paris *bistros*. In each case there is some physical X term (a human being, a building, a piece of printed cardboard), which *counts as* a social object of a certain kind in a corresponding context. It is satisfied also by events—by votings and goal-scorings and launchings of ships. In all such courses we have certain distinctively patterned parts of physical reality which in certain specific kinds of contexts fall under certain specific kinds of descriptions. The corresponding objects and events, correspondingly, come to be ascribed certain

2. See Bittner and Smith 2003; Smith and Brogaard 2002.



properties or powers of nonphysical sorts. As falling under such descriptions the X term *counts as a* Y term of a certain sort. This account works particularly well for the pieces in a game of chess. (Johansson 2005)

Unfortunately, however, there are entities in social reality—debts, rights, obligations, bond derivatives (and games of blind chess), which do not fit well with Searle's formula. For here there is no physical X term to which the corresponding properties or powers could be ascribed. They are, rather, in the terminology introduced above, quasi-abstract patterns tied to time and to specific bearers by the speech acts and associated thoughts and intentions that brought them into being. A debt, for example, is in this respect like a game of blind chess. It differs only in what we might think of as its inner temporal structure and also in its possession of a *deontic* element: if you have incurred a debt, then this means that you are subject to a certain *obligation to repay in the future*. A debt is tied to a specific initiating event and to specific initiating partners, but it is able thereafter to float free and to enjoy an existence of its own. This existence is however in normal cases an entirely humdrum affair which involves merely enduring through time in a changeless fashion until, through one or other terminating event (such as being paid off or waived), it comes to an end.

Debts depend for their existence on representations, which may enjoy a merely ephemeral existence in the form of memory traces, or which may be transformed into enduring representations by being written down. Note that on the basis of such records a new dimension of economic reality can come into existence: the dimension of *formal debts*. The latter enjoy a special status as a result of the fact that they are registered and recorded according to official procedures laid down in advance. As a result, such debts can be bought and sold, bundled and unbundled, inherited, bartered, negotiated away. And as we shall see, they thereby also have a chance to shape the lives of those involved in new and lasting ways.

### 3. Constitutive Rules

As the rules of chess create the very possibility of our engaging in the type of activity we call playing chess, so, Searle holds, constitutive rules in general, rules of the form *X counts as Y in C*, create and allow the forms of behavior we call electing, promising, marrying, and buying beer.

Examples of the formula at work are:

- X = moving an arm;
- Y = commanding an infantry troop to stop advancing; knocking over one's king; refusing an offer; waving to a friend;
- C = war; chess; business; everyday life.

As we can see, the movement of an arm can mean different things in different contexts. This variety reflects the many different sorts of things we do together. We participate in meetings, attend concerts, compete in football games, sell stock, pay taxes, and engage in a huge variety of other types of cooperative behavior, which involve the bringing into existence of what Searle calls *social facts* through the application of constitutive rules.

Human beings enjoy the capacity for what Searle calls collective intentionality. They are able to engage with others in cooperative behavior in such a way which involves *sui generis* types of beliefs, desires, and intentions. Often these involve human beings collectively awarding *status functions* to physical parts of reality—which means: functions those parts of reality could not perform in virtue of their physical properties alone: the function of a traffic signal in compelling drivers to turn left or the function of a railway ticket in allowing its bearer to travel on a certain train are in this respect to be contrasted with the function of a screwdriver to insert and extract screws; only in the case of the screwdriver does the exercise of a function depend on specific physical properties of the object in question. Note, though, that functions of all types share many ontological features in common with debts and other quasi-abstract entities of the social world (including those entities which Searle calls “social facts”). The function of my heart (to pump blood) begins to exist at a certain point in time and continues to exist unchangingly until the terminating event which is my death. The function of the screwdriver, similarly, begins to exist at a certain point in time (the point of first assembly) and continues to exist unchangingly until some terminating event when the screwdriver is broken or destroyed. And the function of the dollar bill, similarly, begins to exist from the point in time when it is issued to the later point in time when it is destroyed or withdrawn from circulation.

In each case we can tell a complicated story about the *functionings* of these functions (the processes, of pumping, inserting and extracting of screws, of being used as medium of exchange). The functions themselves, however, endure invariantly throughout such changes.<sup>3</sup> It is presumably this character of quasi-abstractness which explains Searle’s view that functions are in every case socially constructed (they are a matter of *imposition* against the background of values that we take for granted (Searle 1995, 13–23). Note, however, that since Searle insists at the same time that he is a realist about functions—admitting that we can “discover” functions in nature (p. 15)—this means that he is to this extent already at this point lending ontological credence to the reality of the quasi-abstract. (And we note that similar remarks could be addressed also to both constitutive and

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3. See Smith, Papakin, and Munn 2004.

regulative *rules*; these, too, satisfy all the conditions of quasi-abstract entities as these have been described in the foregoing. The game of chess itself—as type rather than as the tokens we have been considering elsewhere in this essay—might then be subjected to a similar treatment.)

In the case of those functions which exist as a result of constitutive rules, they characteristically mark the potentiality for consequences of a specific sort, for example in the form of rewards, penalties, obligations, reasons to act. When, in the right context, I make an utterance of the form “I promise to pay you a hundred dollars tomorrow,” then my utterance *counts as* the making of a promise. This means that it has highly specific consequences which include a mutually correlated claim and obligation together with a certain tendency to act. These are deontic consequences which go far beyond the realm of purely physical causality.

A certain entity (in this case, an utterance) has what Searle calls *deontic powers* in virtue of the fact that the participants involved (for example, as speaker and as hearer) have imposed those powers on the entity in question. Such an imposition must rest always on a foundation of “brute facts,” by which Searle means facts of natural science, facts which obtain independently of all human institutions, including language. In the final part of *Construction* Searle rightly attacks those who hold that reality consists of social facts all the way down, so that the facts of the natural sciences would be no different in this respect from facts concerning politics or styles in footwear. Certainly the *sentences* of natural science are parts of social reality—but, as Searle shows, the same cannot be said, on pain of absurdity, of the facts which make these sentences true.

Unfortunately, however, Searle misinterprets the implications of his own insight when he takes it to imply that social reality must in every case be made up of physical parts. On almost every page of *Construction* Searle either assumes, or states explicitly, or employs examples and arguments which reinforce, the thesis that the X term in his formula must be a part of physical reality. This is so even in those cases where there is some iteration involved, so that the Y term resulting from the imposition of deontic powers on an initial X term itself serves as the X term in a new application of the formula. For the X and Y (and Z . . .) terms within the scope of a given instance of the formula are in any case identical: they differ only as to the descriptions under which they fall in different contexts. All human institutions, from money and marriage to government, property, and inheritance are, Searle repeatedly suggests, to be understood in terms of a reading of the formula in which the ultimate X term is physical in nature.

This insistence that the X term must be part of physical reality (of the realm of what, in Searle’s idiolect, are called “brute facts”) derives from Searle’s standpoint as a naturalist, which is to say, as a defender of the view according to which everything in reality is governed by the laws of physics

(and thus also by the laws of chemistry, biology, neurology, and so forth). The challenge which Searle embraces in *Construction* is precisely that of building an ontology that is both realist about social reality and naturalist in just this sense.

“Realism,” here, means the opposite of fictionalism. It consists in the doctrine that social reality exists, that entities such as claims, prices, financial transactions, elections, trials, and weddings are not mere fictions and that our talk of such entities is not a mere collection of roundabout ways of talking about other things.

#### 4. The Ontology of Social Reality

Naturalism asserts that everything in reality is constituted by physical particles or fields of force or by the patterns of movement of such entities. For a naturalist like Searle to be convinced of the existence of God would be for him to have some *physical* evidence of this existence. In fact for a naturalist like Searle, not only the X term but also the Y term in every application of the *counts as* formula must be physical through and through—the X and Y terms are after all in each case *one and the same entity*, merely viewed as falling under two distinct descriptions.<sup>4</sup> George W. is still George W. even when he *counts as* president. Miss Anscombe is still Miss Anscombe even when she *counts as* Mrs. Geach.

But what of those values of Y terms where no candidate X term drawn from the realm of physical reality is available? How can Searle’s naturalism allow a realist ontology of those parts of social reality which are constituted by prices, licenses, debts, and taxes?

The assumption that X and Y terms are identical works well when the Y term exists simultaneously with the X term, for example, when the issuing of sounds from John’s mouth *counts as* an utterance in English: the two events are here quite reasonably conceived as identical parts of physical reality, merely conceived under different descriptions. But an event of promising might last several seconds while the deontic powers to which it gives rise—the claims and obligations—might exist for several months. An event in which Jane gives her watch to Joan might exist for only two seconds while the new relation of ownership that is founded in this event might go on existing for many years thereafter. There is here no piece of paper, no organism, no building, no movement of molecules to serve as

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4. We are dealing in each case with different contexts, but the differences between these contexts, for Searle—for example, differences in thought or speech patterns on the part of those involved—would be physical through and through.

physical X term in the future. The watch itself cannot serve this purpose (the watch itself does not *count as* the relation of ownership by which it becomes tied to Joan) and the same applies, too, to other physical phenomena such as the relevant memory traces in Jane's brain. The relation of ownership is, rather, what we shall henceforth call a freestanding Y term—it is a *sui generis* social object of a quasi-abstract sort. Certainly it depends on physical bearers—in this case Joan and the watch. But these physical bearers do not overlap with the relation of ownership itself, as is seen in the fact that the latter has no physical parts.

Only in one or two isolated passages does Searle recognize the existence of entities of this sort. He points out that when I promise something on Tuesday, the obligation continues to exist over Wednesday, Thursday, Friday. This “is not just an odd feature of speech acts, it is characteristic of the deontic structure of institutional reality. . . . think for example, of creating a corporation. Once the act of creation of the corporation is completed, the corporation exists. . . . *It need have no physical realization, it may be just a set of status functions*” (Smith and Searle 2003, 305; italics added). What Searle does not recognize is that such a set of status functions, even though it depends on physical reality, is not itself a *part* of physical reality. It is, precisely, a quasi-abstract pattern that is tied to history and time in virtue of its relation to certain persons and events.

In the following passage, too, Searle accepts that freestanding Y terms exist:

The whole point of institutional facts is that once created they continue to exist as long as they are recognized. . . . You do not need the X term once you have created the Y status function. . . . At least you do not need it for such abstract entities as obligations, responsibilities, rights, duties, and other deontic phenomena, and these are, or so I maintain, the heart of the ontology of institutional reality. (Smith and Searle 2003, 305)

With this, Searle effectively abandons the naturalist horn of the dilemma upon which he has thus far been impaled. In his official stance, however (reproduced also in the comments from Searle appended below), he continues to insist on the correctness of the naturalistic doctrine.

## 5. Towards Documents

Searle correctly emphasizes that the world cannot consist of social facts all the way down with no brute reality to serve as their foundation. But he is in error when he takes this to mean that social reality must be furnished through and through by Y terms which coincide with parts of physical reality. Certainly Y terms cannot float entirely free of all phenomena whose

existence is not a matter of human agreement. But this anchorage need not take the same (X counts as Y) form in every case. For there is a second and no less important kind of anchorage, an anchorage in the realm of records and representations.

Searle comes close to recognizing the importance of this second kind of anchorage in a post-*Construction* passage in which he corrects his earlier view according to which credit cards and blips in bank's computers can *count as* money (Smith and Searle 2003). Rather, as Searle now recognizes, they are both more properly speaking different *representations* of money (or more precisely, in the case of credit cards, they are representations of a commitment on the part of a bank to meet liabilities incurred by the card owner). Similarly, title deeds are not themselves property rights, but rather representations of property rights. An IOU note merely records the existence of a debt; it does not *count as* the debt, and its destruction need not in and of itself cause the debt to cease to exist. When Juan and Hank need to fly together from Lima to Oakland, Juan lends escudos to Hank at the beginning of the trip, which Hank then repays in dollars on arrival. But no physical money changes hands until they reach their final destination. Rather, in keeping track in their minds of who paid for what in the course of the journey Juan and Hank move quasi-abstract money around in a quasi-abstract space in a way that very much resembles the quasi-abstract movements of quasi-abstract pieces that is a game of blind chess. And when Hank uses his credit card to guarantee his hotel bill upon arrival in Lima, then he and the owners of his hotel are playing what is very like a game of internet chess with their respective banks' computers.

## 6. The Mystery of Capital

In *The Mystery of Capital* (2000), Hernando de Soto expounds an ontology of social reality in which not physics but rather precisely the realm of records and representations is awarded a central role. The subtitle of de Soto's book is: *Why Capitalism Triumphs in the West and Fails Everywhere Else* and its thesis is summarized in the following sentence: "It is the 'invisible infrastructure of asset management' upon which the astonishing fecundity of Western capitalism rests." By "invisible infrastructure," de Soto means precisely the realm of those quasi-abstract structures which exist not as parts of physical reality but rather in virtue of an anchorage in the domain of records and representations.

*Mystery* covers, though in a different terminology, much of the ground explored by Searle in his theory of collective intentionality and deontic powers. Searle, too, as we have seen, accepts that there is a nonphysical side to the ontology of social reality. But he does this only reluctantly. And in

focusing on the realm of property records and titles, de Soto shows us how what I have been calling freestanding Y terms work to add a new dimension of economic powers in addition to the deontic powers recognized by Searle.

It is property, and formal property records, which lie at the heart of de Soto's analysis. Such records do more than sustain the corresponding property relations in existence; they also bring into being a new phenomenon, called *capital*. They do this by capturing in concentrated form the economically significant facts about the corresponding physical assets—their economic powers—in ways which allow the latter to be parceled out and manipulated in new sorts of ways. “The formal property system that breaks down assets into capital is,” de Soto tells us, “extremely difficult to visualize.” The nature of freestanding Y terms allows us to explain why this is so: the system consists of quasi-abstract entities not carved out within the realm of physics.

## 7. The Construction of Economic Reality

When Searle, in *Construction*, describes how we are able to impose special rights, duties, and obligations on our fellow human beings by acting in accordance with constitutive rules, he confesses that this seems to involve “a kind of magic” (45). He then attempts to dispel the air of magic with his notion of collective intentionality. De Soto, similarly, recognizes that there is an air of mystery attached to the way in which capital is born out of physical assets. He tackles the same problem with his account of the role of records and representations.

As de Soto shows, “Capital is born by representing in writing—in a title, a security, a contract, and other such records—the most economically and socially useful qualities” of assets. “The moment you focus your attention on the title of a house, for example, and not on the house itself, you have automatically stepped from the material world into the . . . universe where capital lives” (2000, 50).

This is, be it noted, a nonphysical universe, a universe populated by freestanding Y terms, where we can take advantage of the quasi-abstract status of its denizens in order to manipulate them in quasi-mathematical ways. We can create ever-new types of such entities by composition, division, and derivation. We can pool and collateralize assets; we can securitize loans; we can consolidate debts. Shareholders can buy and sell property rights in a factory without affecting the integrity of the physical asset. Individuals and institutions in different countries can trade unlimited quantities of these entities without the need for any physical items to be shifted from one place to another and without the need to build any spe-

cial storage facilities to house them. Pension funds can exploit the mathematical divisibility of capital to bring about a state of affairs in which the ownership of capital is no longer the privilege of the few.

Most importantly, for de Soto, the quasi-abstract nature of capital allows it to serve as security in credit transactions by being moved about, virtually, between different owners and lien- and mortgage-holders. It is not land or buildings, but rather the associated equity—something represented in a legal record or title—which provides security to lenders for liens, mortgages, easements, and other covenants. We add a codicil to a title deed thereby certifying who has access to the property and under what conditions. We present the title deed to a bank and thereby allow the equity associated with the underlying asset to be set free for purposes of investment in other things. In this way the records and representations constituting the formal property system bring a new domain of quasi-abstract reality into existence, whose growth is intimately associated with those advances in human welfare which are associated with economic development. Title deeds, stock certificates, mortgage contracts, and their computerized counterparts are the reliable means to discover, with great facility and on an ongoing basis, the most potentially productive qualities of resources, and “As Aristotle discovered 2,300 years ago, what you can do with things increases infinitely when you focus your thinking on their potential” (de Soto 2000, 51). By unleashing the potential of physical assets in the form of credit, thereby allowing new sorts of ventures and new sorts of risk, and new sorts of sharing of risk, the development of the formal property system gave rise to that quantum leap in human welfare which we associate with the success of Western capitalism.

The formal property system also fosters accountability and thereby promotes higher levels of trustworthiness among those who participate in its development. For accountability means that those who abuse the system, for example, those who do not pay back their loans, are diminished in their ability to draw on its benefits in the future. Calling people to account for their actions in this way has positive effects of a range of familiar sorts (Klein 1997) and we can compare the dissemination of institutions of credit checking, debt collecting, payment insurance, and the like with the development of the formal accreditation systems for chess masters administered by the *Fédération Internationale des Échecs*. Both have spurred those involved on to new heights of achievement.

From de Soto’s perspective, the modern world can be defined as a common system of enforceable formal property registrations. These registrations make knowledge functional by securing all the information and rules governing accumulated wealth and its potentialities in one knowledge base that makes people accountable across the entire property jurisdiction. This single property system, through trade and the concomitant division of



labor, makes possible the astonishing economic development that has been the privilege above all of Western societies in the age of industrial civilization. To be part of the system means to be represented therein with the help of such proxies as one's name or social security number. With these are associated in turn formal records (of domicile, creditworthiness, ownership) together with those informal estimations which exist in potential investors' and customers' minds of the skills and reliability and resourcefulness of those with whom they have to deal. Because the bank knows your address, and has the title to your property in its vaults, the bank trusts you with resources to invest in new ways. You then have the means to try out new ideas. And because you know that failure will bring real loss, you have a real incentive to succeed with these ideas, and thus to acquire a reputation for reliability, honesty, and integrity. All these things contribute to your own wealth and to the wealth of those around you, and the reason that you can use credit cards when you travel from Oakland to Lima and back is because of the records that tell the card-issuing authorities who should and who should not be given credit.

## 8. The Realm of the Quasi-Abstract

De Soto errs, however, when, as in the following passage, he talks of freestanding Y terms as if they were mere concepts: "The proof that property is pure concept comes when a house changes hands; nothing physically changes."<sup>5</sup> For concepts, as we have already noted, belong with ideas and intentions to the realm of representations. Property itself, by contrast, belongs to the realm of that which is represented. More precisely, property relations belong to the realm of the quasi-abstract and they are in this respect comparable to symphonies, laws, and other quasi-abstract denizens of the social world. That they exist on the side of the objects and not on the side of the concepts in people's heads can be seen from the fact that concepts can exist even where there are no corresponding objects.

To be sure, concepts are important. Without concepts, and without associated thoughts and intentions, the corresponding freestanding Y entities would not have been brought into existence. When we buy and sell, however, we are interested not in concepts but in the objects themselves: in equity and capital, and in all that goes together therewith—starting with the simple trading, offering, and splitting of stock and moving on to the unimaginably complex edifices of contemporary derivatives markets.

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5. de Soto 2000, 50. In the passage already quoted above, de Soto talks of stepping "from the material world into the conceptual universe where capital lives."

Formal property requires the existence of two distinct sorts of entities. It requires on the one hand quasi-abstract freestanding Y terms, and on the other hand records upon which the existence of the former depends. Note—in case this is still not clear—that the latter are not X terms according to the letter of Searle’s formula. The pieces of paper in the bank vaults do not *count as* the ownership rights that are documented therein. Rather, they represent them. But the pieces of paper are like X terms at least in this: they are physical entities which serve, through the workings of collective intentionality, to provide the basis for the corresponding Y terms. The pieces of paper can also serve to *represent* the associated objects and relations in another sense: they serve as their proxies—so that control over paper deeds or titles implies a form of control, too, over the quasi-abstract entities for which they stand.

We have seen that Plato would have rejected the existence of quasi-abstract entities of the sorts which populate those rapidly growing suburbs of the social world which are so important for the sorts of economic development. The same applies, too, though for different reasons, to Marxist economists, who cast aspersions on the “speculators” and others who tend the realms of the quasi-abstract—because of their conviction that all that is of value must flow from *physical* labor. In this they are, like the defenders of legal positivism, and like naturalists of various other stripes, manifesting a prejudice in favor of what you can touch and see. De Soto with his analysis of the workings of the formal property system, and Searle with his doctrine of the “huge invisible ontology” of social reality (1995, 3), have taught us that we need to slough off this prejudice in favor of a more adequate system of categories. Searle, now, should have the confidence of his convictions and recognize that the social world contains more, much more, than appendings of nonphysical descriptions to physical objects and events.

#### C O D A : S E A R L E V E R S U S S M I T H

**Searle:** I agree with most of what Barry has said, but I think that he is being needlessly paradoxical when he suggests that there is some challenge to naturalism here; that somehow or other, in addition to physical particles and fields of force, there are all these abstract entities running around between the molecules. That’s a misleading picture, which comes from treating the object as the unit of analysis. We’re not interested in the object, we’re interested in the processes or, as I like to put it, we’re interested in the facts. It isn’t the obligation as an object that is the topic of our investigation, rather it is our undertaking an obligation, our recognizing a preexisting obligation, our fulfilling an obligation. And when you realize this the threat to naturalism disappears.

In fact I like the example of blind chess: here representations of the pieces take the place of the pieces. So when blind chess players play a game, they keep a record and say PK4 will be the first entry on the sheet, which means white moves pawn to king 4, and then they fill in the rest and they can always go back and look at the record and see what the position on the board is. Well, of course, there's an abstract character to all this; but the record is part of the real world and I think part of the difficulty with his presentation is that Barry is really attached to the old notion of the physical and to this dumb Cartesian vocabulary we've inherited. But I think we shouldn't be misled by it. The world contains everything it contains; we're used to calling it "physical" because we think that physics is somehow or other the basic science, which it is. But if you describe what Barry said without using the ontological categories that he seems to be committed to, then it contains no threat to naturalism at all. I think Barry made a valuable contribution in recognizing that in many cases the representation is all the reality we need to make the entity function. Interestingly, my very first examples were cases of that: paper money was originally a representation; it was a note that said "I promise to pay the bearer on demand." Then the representation of money became money. In the other cases you have representations of chess pieces that now function the way that chess pieces do. So I agree with the general thrust of the argument, but I think it's needlessly paradoxical to suggest that we've somehow got to alter our whole metaphysics; we don't.

**Smith:** I agree with John that we should get rid of these old Cartesian dualist notions; I disagree with him when he thinks that there are no problems here for naturalism. He thinks that we can solve the problem by turning away from social objects and by looking at facts. Do you own stock, John?

**Searle:** Well, in the aspect that I . . .

**Smith:** Just say "yes," John.

**Searle:** All right, I'll say yes. . . .

**Smith:** And when you're lying in bed at night, are you thinking about the facts and processes that pertain to when you bought them and the transactions that you made? Or are you thinking about the stocks themselves, the objects?

**Searle:** I don't think about the stock *an sich*. No, what I think about are not the stocks themselves, but rather their current market value and how it is declining. Because, you see, the subject-predicate structure of language makes it look as if there's this preexisting set of objects, my stock, but in fact what we're talking about is a process: the stocks go up and

down, the stocks split, and when they split this doesn't mean that they physically split, it means that there's a different entry in the system of representations.

**Smith:** I think that if we are going to understand the wondrous ways of capital, then we need to think very precisely about this process called "splitting stock." But that means also that we need to take seriously the fact that such processes involve *objects*—and that this is so even when the stock itself exists only in virtue of certain representations which themselves exist in the form of blips on computers. Do you agree with that?

**Searle:** No I don't, I think that that's the wrong picture. The real picture is this: we have a set of processes and we have a set of representations which enable these processes to function, and in the case of the stocks splitting the corporation makes certain entries into their databases, into the system of records and representations whereby you are now represented as having twice as many shares of a stock as you did before and that is the reality, that representation is constitutive of your having twice as many shares as you did before.

**Smith:** I agree with all of that, I just think that, in the spirit of the First Axiom of Realism for Social Reality, you should take equally seriously every single word in the description you just gave.

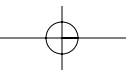
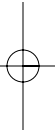
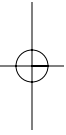
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# The Construction of Social Reality: Searle, de Soto, and Disney

*Jeremy Shearmur*

## 1. Introduction: On Method in Social Ontology

If we are interested in what the world is like, how should we proceed? John Searle's work on social ontology offers us a powerful, but also a challenging, response to this question. Searle's account is acute. Not only does he offer a clear and systematic approach to a range of issues in social ontology, but also he advances some innovative ideas of a more general kind, including ideas about the "background," as discussed at some length in *The Construction of Social Reality*. He also offers what seem to me some particularly useful ways of developing points that have been made by others. (I have in mind here, for example, what seem to me Searle's improvements over the issues that Hayek described in terms of the interrelation between "subjectivism" and function (see, for example, Hayek 1979), and Peter Winch's emphasis on the role of rules in the construction of social reality (see Winch 1958). In addition, Searle offers his classificatory system in such a way as to leave space within it for approaches which differ from his own. By this I mean the space that he accords to the possible role of nonagentive functions in social life (Searle 1996, 123). My personal view is that these nonagentive functions are of greater significance for our understanding of the social than Searle's writing might suggest. This point I will pursue shortly. But first, I need to say something briefly about an issue in methodology.

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I would like to thank the organizers of the conference to which this paper was contributed for a most interesting intellectual event; those present at the conference for excellent discussion, the academic referees of an earlier version of this paper for some tough—but very useful—criticism, and especially David Wall for his comments on successive versions of, especially, the first part of this paper.

My broad view is that science—considered in its widest sense so as to include also knowledge in the humanities—is to be seen as a product of the critical revision of our commonsense knowledge, and that ontology is, broadly speaking, what we will discover the world to consist of when the enterprise of science so understood is completed. But science—like all our significant knowledge—is fallible. It is fallible not just in the sense that it is always possible that we may be mistaken about particular claims, but also that our knowledge may always be open to significant theoretical and hence conceptual revisions. This does not mean that we have to be overly concerned about G. E. Moore-style issues, such as whether—when I am waving them in the air in front of me—I in fact have two hands. But it does mean that how we should best describe even commonsensical knowledge may be an open question. (My argument is thus that, while commonsense knowledge is important, we do not know how it is best conceptualized; this has to be held open to the growth of knowledge of various different forms.) This does not mean that we should not try to draw lessons from reflection on what we are familiar with, and from our current state of knowledge more generally. But it is, I would suggest, important to bear in mind that the lessons that we draw may be significantly open to correction, not least from work done in the sciences.

Philosophy, from such a perspective, cannot sensibly be foundationalist. There are the by now well-known problems facing the programmatic idea that one can start with ideas that are both contentful and certain and build up something significant therefrom. But also what we take to be undeniable may well be simply a testament to our lack of imagination and something that we can well expect may be questioned over time, not least by developments in the sciences. Of course, we may set out to describe what we think the foundations of anything might be; my argument is that we can't be sure that we are *correct* in respect of such claims.

What does this mean, in terms of how we should best proceed, if our interest is in what exists? In my view, it means that, outside of specific and limited technical problems where important intellectual issues rest on whether or not something can be demonstrated, there is simply no point in working as if one were a kind of technician, undertaking puzzle solving within a framework whose correctness is tacitly assumed to be beyond argument. Rather, it is important to work in a manner that is readily intelligible, makes clear to the reader what the point is of what one is doing (i.e., just what is supposed to hinge on it), and introduces rigor not by restricting itself to minutiae, but by way of the range of problems that it commits itself to being able to address in theoretical terms.<sup>1</sup>

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1. See, for a longer account and some defence of such an approach, chapter 1 of my *Hayek and After* (1996a).



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In such a context, work may be of various kinds. It may set out to draw attention to some problem about existing theories, an enterprise that may require argument of a detailed and quite precise kind. Alternatively, it might set out to comment on existing work by way of drawing attention to the *kinds* of problems with which the approaches in question may need to deal if they are to be fully adequate. Such work—and the present paper is intended to be of this kind—is critical rather than constructive; it may be wide-ranging in its character, and it may be concerned with broad problems and issues, rather than with criticism of the first, detailed kind. Finally, work may be positive, and attempt to resolve problems of one kind or another, in whole or in part; it may also set out to do this in detail, or to suggest a *kind* of solution to problems of a certain sort, which may subsequently be collaboratively explored in more detail.

I have set these matters out in what I hope has not been too tedious a detail just so that it may be clearer what kind of exercise I am engaged in. My concern with Searle will thus be to outline what seem to me to be some general problems concerning his approach to social ontology. They are, in particular, arguments that suggest that we need for the task of social ontology to draw to a greater extent upon the social sciences and on philosophical reflection upon them than Searle's own approach might suggest. To put this another way, I wish here to offer some limited argument (limited, because I am drawing only on a few corners of the social sciences) to the effect that, while social ontology might usefully be undertaken by philosophers, we need to do this work not just by reflection on common sense, but also by means of continuing critical reflection on the substance of what is taking place in the various social sciences and, indeed, the humanities. My language will be tentative, just because my concern is to suggest lines of argument, rather than to offer detailed engagement after the fashion of the first, negative, kind of argument referred to in the previous paragraph.

## **2. Searle and the Centrality of Agentive Functions**

In Searle's account of social ontology, pride of place is accorded to collective intentionality, the assignment of function, and constitutive rules. He is surely right that these play an important role in the constitution of society. But I wish to argue three points in qualification of his approach.

The first is that important work in the social sciences—and most associated commentary—draws our attention to the significance of what, from Searle's perspective, must be seen as nonagentive functions in social life. These, to be sure, are the products of intentional action, both individual and collective. But the unintended consequences of such actions—what

Hayek has written of as the products of human action but not of human design (see, for example, Hayek 1967 and Hayek 1978)—can be seen as having a thinglike structure that may be apprehended theoretically. Further, how we understand such things may need in some respects to depart from understanding at the level of the individually and collectively intentional action that gives rise to, and sustains, such phenomena.

Second, such entities may have, in their turn, feedback effects upon us as agents. They may structure the situations in which we act and—by virtue of their specific character—may serve to enable or to frustrate our plans. (As, say, in the case of the rate of interest that is available to us, should we wish to borrow money to purchase a house.)

All this, Searle might argue, might be understood as embraced by his inclusion—albeit not a very enthusiastic one—of nonagentive functions in the context of his discussion of so-called latent functions. But more, surely, might be drawn from this point. Searle, himself, discusses the idea of “the background” in his account of what is going on when people conform to the rules of an institution. His discussion seems to me acute. But it leaves open the possibility that what goes into people’s conforming to rules may differ from person to person, and in ways that are structured by patterns created by the unintended consequences of human action. And this, in turn, may suggest a way in which the effects of the entities to which I have referred may play a significant role.

My point here is as follows. Searle’s emphasis, in his discussion, is upon collective intentionality and on “we consciousness.” In stressing this, he is surely right about much in the social world. But in some cases—how significant this is would seem to me a matter for empirical investigation—we may find that beneath a shared rule or a we-function there are different meanings for different subjects. For some, the rule may just be how they proceed; for others, it may be what is imposed on them, and to which they have no real alternative because of how our society is structured. Accordingly, behind we-functions there may lurk a different kind of power, dependent—and here Searle is surely right—on other we-intentions in its turn, but where, to the extent to which the things to which I am referring hold good, the character of social reality may be rather different than if it were constituted simply by shared we-intentions, and so on.

Third, I will argue that not only may the character of we-intentions be variable in its content but also empirical work by ethnomethodologists, and some work in philosophy and the sociology of science, may suggest that we should not overrate the extent to which what occurs should be explained in terms of a *shared* context of we-intentions.

Let me start with the social division of labor. In Western societies—in anything having the broad characteristics of “commercial society” in the sense with which we are familiar from Adam Smith onwards—this is not

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only a distinctive phenomenon, but also one the importance of which has been recognized and about the significance of which there has been much discussion.<sup>2</sup> On the face of it, the division of labor is a social institution, but it neither originated in nor is sustained by a “we-intention” (although clearly, some of the phenomena that give rise to it, are).

Searle is willing to write of “collective intentionality” in very broad terms. When discussing the origin of paper money, Searle notes that “the participants need not be consciously aware of the form of the collective intentionality by which they are imposing functions on objects” (Searle 1996, 47). But it is not clear that in such cases there will be more to talking about “collective intentionality” than recognizing that there is some social institution present. However, there would seem to be a significant difference between cases in which people are participating in a standardized way of doing things that the observer may sum up in terms of a rule, and those in which the following of some rule or convention is constitutive of or regulative of the activity in question, at least in the sense that it could be articulated by those involved. Consider some of the early stages in the development of money of the kind with which we are familiar from the account given by Carl Menger (1892), and which Searle himself describes. Initially, on Menger’s account, people who were trading by barter may have started to exchange whatever they had brought to a market for other goods which could be more easily traded (rather than for what they eventually wanted), just on the grounds that it would be easier to trade these readily tradable commodities for something that they wanted than it would for me to find someone who was “selling” potatoes but wanted philosophy books in return. One can, by such means, see the “natural” emergence of a particular commodity or commodities as a currency. And clearly one can see further how substances that are durable, of high value, and such that their purity can be easily tested will win out over others. Now in all this there may be a point where it becomes important to recognize that people are not just participating in a social institution of a certain kind but that they understand themselves to be so doing. Not only may people’s conduct be different when they can—or when it is possible for them to be able to—conceptualize what they are doing in terms of some collective intention; but if problems of some kinds develop they may need not only to understand what is going on in explicit terms but also to reflect critically upon it and make changes to their practices. However, some significant social institutions, such as the social division of

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2. See Smith 1976 and Hont and Ignatieff 1983. Think only of Smith’s own discussions of its pros and cons, the way in which it plays an important role in Rousseau’s Second Discourse; of its role in Hegel’s *Philosophy of Right*; in Marx’s early writings and in Durkheim’s *Division of Labour in Society*, to say nothing of a plethora of recent works.

labor and the early stages in the development of money, seem not to fit such a model. It might be asked, however, whether any harm is done if we follow Searle's wide usage and refer to both cases where there are and cases where there are not collective understandings in terms of we-intentions.

First, there are problems as it were from the top down. The sufficiency of Searle's approach seems to me to be called into question once we recognize the existence of emergent social phenomena that constrain the actions of individuals in ways that differ from how they are constrained by social norms.<sup>3</sup> Once we have an advanced market economy, then there are phenomena within it—such as things to do with interest rates, or the rates at which currencies exchange—that are products of actions within frameworks constituted by various we-intentions, but where these products themselves have a (dependent) reality, that is autonomous of those we-intentions. That, say, I can currently exchange an Australian dollar for about seventy-seven U.S. cents *could* be talked about as relating to a we-intention relating to the exchangeability of currencies. But what governs the specific content of such exchangeability (that the value of the Australian dollar is currently about seventy-seven cents), and how it constrains us, is in an important way an emergent product of ever-changing transactions between individuals and institutions, and sometimes of the actions of governments. To assimilate such constraints—which are after all very much the stuff of social life and thus a key concern of the social ontologist—to we-intentions after the model of the rules of rugby, or even to various formations on the rugby field, seems to me an invitation to misunderstand badly what is taking place in society, and, thus, to misunderstand social ontology.

Next, one emphatically does not have to be a Marxist to recognize that the opportunities available to individuals at any one time are in a significant sense the emergent products of systems of unintended consequences of human action and of people's reactions to these things. The number of professional philosophy positions is clearly at one level a matter of the decisions of presidents of universities and of internal lobbying. But the resources potentially available for the creation of such positions are emergent products of the state of the economy, the tax system, the budgetary process of funding authorities, and so on. More brutally, one could also say that an economy and an administrative structure of a certain kind and certain patterns of material expectations on the part of citizens can together only be compatible with certain quantities of resources being spent by the state on higher education in the humanities. Presidents of universities—

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3. For one useful picture of the character of such constraints, see Robert Nozick's discussion of "filter mechanisms" in his *Anarchy, State and Utopia* (1974, 21–22; 312–18).

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however humanistically inclined—are constrained by such things, yet what constrains them is not itself a we-intention, even though it can be seen, in part, as the product of such things.

To this, Searle could obviously respond: well, insofar as such things are significant, they are surely covered by my discussion of the possible role of nonagentive functions in social life. This would be fair enough—although as I have suggested it might imply a modification of the emphasis that Searle places upon the role of agentive functions in social life. However, as I indicated earlier, one may see nonagentive functions as also playing a role in affecting what Searle has called the “background”—and so as affecting what leads people to conform to the rules of some institution (cf. Searle 1996, 144). This in turn may serve to undermine the idea—suggested by describing these things as “we-intentions”—that the individuals involved must share an understanding of the practices in question. What is involved, say, in the application of the criminal law may be very different for the judge, lawyers, police, and criminal. However, how significant these matters will prove to be is, as I have suggested, a matter for empirical investigation.

One final point in regard to this initial top-down perspective: a phenomenon such as inflation may have the following rather odd character. It is typically understood as a product of the actions of social agents of various kinds, both individual and institutional. Their actions create and sustain the phenomenon question. They may further have an understanding of this phenomenon—they may have theories about it, and they may act on the basis of such theories. But while we may need to understand the theories upon which they are acting in order to understand their actions, those theories may be wrong—they may include theoretical accounts of how the phenomenon works that are descriptively incorrect. (The error is not the same as in the case of Searle’s example of people misunderstanding the status of a king [Searle 1996, 96], since the latter still shares the key features of the we-intention, assignment of function, etc.) To understand what takes place when individuals act in this way on the basis of theories, we may need both to know what is in fact responsible for the resultant phenomenon—that is, to have a correct theory about it—and to understand what will occur if actors act in their various social situations on the basis of their incorrect theories as to the character of the phenomenon in question.

But there is yet more to this problem. For, in seeking to understand the character of the phenomenon of inflation, economists will have to understand how it comes about as the product of the actions of social actors. In this context they may need, for theoretical purposes, to describe how people are acting at odds with the way they describe their actions from the “internal first-person perspective.” It isn’t that the economists are then holding that the individuals in question are not doing what they think are doing when their actions are conceived from a certain perspective; rather,

it is that they are holding that to understand the phenomenon in question, one needs to group certain things together in ways that individuals do not themselves do in the first-person view. Consider, say, monetarist economists' different measures of money:  $M_1$ ,  $M_2$ , and so on. To be sure, the financially savvy could come swiftly to recognize what the economists were doing, and might come to use this terminology themselves to talk about their financial affairs; such talk could even gradually become very widely adopted. But what is going on is surely very different from the we-intentions involved in, say, our game of rugby. In particular, the concepts in question are not ones that ordinarily govern the actions of social *agents*; they are, rather, ones that are formed by social *scientists* in order better to understand the character of social entities which emerge from the actions of those agents.

A further twist to this issue is given by a point that was made many years ago by Pierre Duhem in the context of the physical sciences. In his *The Aim and Structure of Physical Theory* (1954) Duhem discusses the discontinuity between the mathematical theoretician and the experimentalist in science. An "experimental law" might be established. The theoretician is concerned to give it a mathematical representation. But there are many ways in which the experimental phenomenon might be represented in terms of mathematical theories compatible with the experimental law. The same, I have argued, is the case in the social sciences, and this despite Lionel Robbins's arguments to the effect that economics has commonsense foundations. For in the social sciences, too, there is the same problem of underdetermination of the choice of mathematical theory by those commonsense foundations.<sup>4</sup> My argument would be that the choice of a theory has to be made on the basis of the adequacy of the theory to the explanation of the phenomenon with which it is dealing. This is because ideas from common sense and the ideas of those performing the salient actions are insufficient to determine our choice of theories. All this points to the need for us to recognize that there is much more to the social world than Searle is allowing for—and that we may expect to learn about it from reflection on the social sciences themselves.

Let me now turn to a different aspect of work in the social sciences that seems to me to pose problems for Searle. In his "The Idea of a Social Science," Alastair MacIntyre made a critical comment on Peter Winch's stress on the significance of social rules by asking whether, if I am going for a walk, my actions are rule-governed in the sense in which my actions when playing chess are rule-governed (MacIntyre 1971, 218). I take the point of his comment to be that while what someone is doing is made

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4. See, for discussion and references, Shearmur 1991.

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intelligible by saying that he is going for a walk, the intelligibility in question is not very informative about what he is likely to be doing. Clearly, there are some things that would not count as going for a walk. But there is a vast range of actual conduct, all of which would be compatible with engaging in this activity, so that, to talk about the person's "following a rule" is not very helpful: it certainly does not tell us what he is doing with any specificity. The same would seem to be true of we-concepts in respect to similar activities.

This point may lead us in two directions. On the one side, it may lead us to look at what the relationships are between rules or shared concepts, and actions. In some cases, while there may be room for variation, it may not matter (e.g., if one is getting married, it may not matter how one behaves—within the scope of the rules—so long as one actually does what are recognized as the right key things at the right key times). In other cases, while rules and we-concepts do indeed form a framework that has to be complied with, what matters much more is what people *do* in bringing about this compliance as, say, in games of rugby or chess. In yet other cases, the rules or shared concepts may be needed to understand what kind of thing is going on, but they may be of little help in understanding what specifically someone is doing—as in "she is engaged in a business transaction," or "he is writing a philosophy paper." An obvious issue that is then opened up is how those approaches to the social sciences relevant to these distinctions, such as rational choice theory,<sup>5</sup> may help us in interplay with the kind of phenomena the significance of which Searle has stressed.

However, there is also work dealing with such issues that might seem to challenge rather than to complement Searle's approach. I have in mind here developments in the social sciences that have raised questions about the usefulness of viewing people's conduct as norm-governed.

First, consider the work that was done by those practicing "ethnomethodology" and related approaches in sociology (Garfinkle 1967; Douglas 1967; McHugh 1968). The wholesale questioning of order and shared ideas that informed this work seems to me both implausible and nihilistic. Yet specific studies in the creation of meaning are interesting, and may subvert the confidence that we might otherwise feel in the ubiquity and determinacy of shared concepts. Second, some members of the "Edinburgh School" in the sociology of science have suggested that striking lessons must be drawn from the finitism of some of Wittgenstein's later philosophical work (See Barnes 1982; Bloor 1983; Bloor 1997) and from Kripke-style readings of the *Philosophical Investigations* (Kripke 1982). The

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5. Compare particularly, for example, the sophisticated interpretation of this approach, offered by Pettit 1990.

kind of work to which this had led involves taking issue with the idea that what people do is determined by the content of their concepts and, by contrast, to the view that agents are better seen as “making out” in a variety of institutional settings.

I do not wish to argue that this work is as a whole successful, and I have been critical of it myself, not least because I think that it underrates the way in which we may impose intellectual constraints upon ourselves that we are not able easily to overcome (if we can do so at all). But nonetheless, interesting empirical and historical work has been undertaken under its influence (see Shapin 1982), and this work may repay study as a corrective to our perhaps natural inclination to see the activities of ourselves and others as strongly controlled by the shared content of concepts.

Let me sum up briefly this part of the chapter. Searle’s discussion seems to me to be truly valuable. I have, however, argued that our approach to these issues should be opened to the possibility it may need to be corrected by social science and reflections thereon.

### 3. de Soto

The second part of this paper deals with de Soto’s work. I will draw, here, just upon the ideas set out in his *The Other Path* and *The Mystery of Capital*. I am both sympathetic to and appreciative of his arguments. Rather than discuss the specific situations in South America that are his prime concern in these works,<sup>6</sup> I will take a step back and address his ideas at the broader level of social theory.

I will develop two themes. The first is that, while in the situation with which de Soto is dealing, his approach may be fine, some of the material upon which he draws in its support—namely, his discussion of illegal occupation and its subsequent legitimation in the U.S.—may point to some problems. In particular, I suggest that de Soto’s approach may run into difficulties in “settler” societies in relation to prior land holdings on the part of aboriginal peoples. This I illustrate by drawing upon aspects of Australian history.

My second theme is that de Soto’s approach requires that informal holdings of land be regularized so as to unlock the value of people’s capital for other purposes. This—in the situations with which he was dealing<sup>7</sup>—requires the agreement of politicians. Such a move provides the

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6. Not least because of my personal ignorance of the specific conditions with which he is dealing.

7. I write this way just because in other circumstances landholdings—and law, more generally—may be a product of the recognition of custom.



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legal title that de Soto has argued is so important. But it also serves to bring the land within a political system and thus to subject it to the pressures of interest-group politics. Clearly, solutions must be found to problems of the environment, planning, and so on. But the political path also has its dangers. The value of land, buildings, and so forth may be radically and deleteriously affected by the way in which it is impinged upon by the political process. It is striking, say, that the value of some farming land in Australia has been dramatically affected by the imposition of regulations that limit the clearing of existing vegetation from the land. To make this point is not to argue that such regulations may not need to be imposed. Rather, the problem is with the way in which political processes might operate, and with whether, say, the owners of the land receive compensation from general tax revenue should such regulation be introduced. All this, however, may depend on the more general character of the political process, and the extent to which the people in question have sufficient political clout to defend their interests on a continuing basis.

Obviously, I am not arguing that the owners of property should be free to do what they like in the sense of imposing negative externalities upon their neighbors in a manner that they cannot do at present, or that they should be able to obtain special benefits for themselves at the public expense.<sup>8</sup> But, as I shall argue, there may be something to be said for the possibility that private corporations may combine land ownership with planning powers, as was the case in respect of Disney World and Celebration, in Florida, and in this role act as intermediaries between ordinary citizens and the government.

In these cases, the Disney Corporation's concern was with the development of a greenfield site. But provided that the tax regime allowed for it<sup>9</sup> there might seem to be advantages in exploring the possibility of dealing with problems of social and economic change by retaining the control of land use in corporate hands, to see how this differs from simple political control. (Under such circumstances, individual landholdings, the character of which would be specified, would be tradable, and would thus still constitute capital in the way that meets de Soto's concerns. Clearly, they would be subject to limitations, but the limitations would be of a different character from those subject to the forces of democratic politics.) This difference, I am suggesting, might merit investigation by way of practical experimentation.

De Soto makes a powerful case for the legal legitimation of land rights and of other forms of informal capital, so that people can make full use of

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8. A point of some significance in light of the fact that I will be referring, later, to some activities of the Disney corporation as a positive exemplification of some of the ideas that I here have in mind. See, for a cautionary tale from the actual history on this point, Fogelsang 2001.

9. Compare, on this, McCallum 2002.

them. He discusses the range of disadvantages that people suffer if they do not have a full legal title to such land and to the investments—in housing, and in businesses—that they construct upon it. He also tells a fascinating story about the way in which a regularization of what had been illegal settlement, similar to that which he is proposing, was in fact accomplished, historically, in the U.S. It would be both interesting and important for other scholars to take up his lead and to explore the ways in which these things have happened elsewhere in the past—and what their pros and cons have been. De Soto's analysis seems to me both acute and telling. In what follows, I will explain two themes that I extrapolate from his work in somewhat different directions.

### 3.1. *Squatting*

The first concerns issues about the legitimization of land occupation and equity. My topic here relates to the question whether, if one takes de Soto's model as applicable universally, there arise problems that we need to bear in mind to balance against its obvious advantages. In considering this, I will call on some historical evidence from the situation in Australia, which also parallels issues that arose in the United States. (While it might be thought that this is pushing the applicability of de Soto's approach beyond its proper limits, it is worth recalling that he made use of U.S.-derived material to illustrate his own argument.) This historical material, I believe, also illustrates a more general philosophical problem. Consider James M. Buchanan's *The Limits of Liberty* (1975). In his reworking of Hobbesian problems, there arises the issue of precontractual activity. On Buchanan's account, there are advantages for all to the formal legitimization of precontractual holdings in land and so forth. But if people know that this will take place, it gives them an incentive to get what they can by any means possible prior to the formation of a social contract. As a result, the promise of order and collective protection of property rights may itself give rise to an incentive for some very grim behavior that it will pay people to undertake prior to the contract, in the hope that at the point when the contract is formed they will be in an advantaged position.

For someone living in Australia, de Soto's ideas about the illegal occupation of land and the subsequent granting of legal property rights to those who have done this successfully call up the memory of the "squatters."<sup>10</sup> ("Squatter," it might be noted, was originally a term of abuse; however, with the subsequent change in the fortunes of the people who

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10. An old but nonetheless interesting study is Roberts 1935.

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did it successfully, it came to refer in a morally neutral manner to families with extensive land-based wealth derived initially from such activities.) This is a topic worthy of exploration because of some general problems that it serves to highlight.

In colonial Australia, the British authorities wished to confine settlement to restricted areas to make sure that settlement was relatively concentrated. But the economic return to the grazing of sheep and cattle on lands hitherto unsettled by Europeans was immense. Prohibition of settlement was unenforceable, and a governor of New South Wales eventually allowed unlimited occupation (but not ownership) of Crown land for the payment of a small fee. This, in turn, and against the explicit conditions under which these rights had initially been granted, was subsequently converted to a form of ownership. “Squatters” became, in time, the “squatocracy”—people who acquired immense and productive landholdings. Their wealth had originated in pressures placed on the colonial government, initially by totally illegal settlement, and subsequently by the conversion of rights of a highly informal kind to full property rights or to fully legitimated pastoral leases.

In 1935, Stephen H. Roberts published an interesting study of this process, which drew on a variety of primary sources. The policy issues upon which he reported were all formulated in terms of an interplay between settlers and “Crown land,” and the interplay between the squatters’ concerns, those of colonial officials, and those of the British government. A compilation of regulations issued in 1858 dealing with land settlement is—tellingly—entitled *Laws and Regulations Relative to the Waste Lands in the Colony of New South Wales* (1858). But the reference to “waste” here is in some ways highly misleading. For the land in question had been used for a variety of purposes for tens of thousands of years by Aboriginal Australians, who had—and in some cases still have—deep relationships with their land and who identify themselves in terms of it. The British government, on a basis whose legitimacy does not seem easily able to pass critical scrutiny,<sup>11</sup> claimed ownership of the land for itself (not simply sovereignty, but also ownership). Australia was treated as *Terra Nullius*—devoid of legitimate land ownership claims—and the entire con-

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11. Cf. Reynolds 1987. The problems have, in some ways, become more interesting still, with the High Court of Australia’s recognition of Native Land Title in common law, in its *Mabo and others v. Queensland* 1992). While the High Court stressed that its decisions related only to Australian domestic law, if they were right that native title should have been recognized by common law, this would seem flatly at odds with the idea that Australia was *Terra Nullius* when the British arrived, and, thus, that rights to land could simply be assumed by the British Government, as a consequence of a claim to the country made on a beach in New South Wales.

continent was thus treated simply as the property of the British government. They seem to have taken the view that the aboriginal inhabitants were either so few in number that the bulk of Australia was, literally, deserted, or that the kind of use that Aboriginal people made of the land involved migration over it rather than ownership of it (a view that could draw support from some seventeenth- and eighteenth-century writings on natural law). As Henry Reynolds has documented in his *The Law of the Land*, as settlers came to understand something about conditions in Australia, these assumptions swiftly proved to be incorrect. But a combination of the initial errors together with the thirst for land on the part of settlers meant that the original decision stood—at least until very recently.

Insofar as the settlers addressed deeper issues of the legitimacy of their occupation of the land, they seem to have made use of ideas that they found in John Locke's writings to legitimize what they were doing.<sup>12</sup> Locke offers a theory that tied land rights to making productive use of land. It suggested how persons could acquire a legitimate title independently of government and without everyone having actually agreed to it by virtue of mixing their labor with the land.<sup>13</sup> One further line of argument—in some ways in the spirit of Locke, who linked ownership to making productive use of the land—was that a case for this appropriation might be made simply in terms of productivity. In the *Second Treatise* Locke wrote that “God gave the World . . . to the use of the Industrious and Rational” (§34) and that land that had been enclosed “was still to be looked on as waste” if its fruits were allowed to spoil (§38). Through the eyes of the settlers, aboriginal use of land appeared to be unproductive.<sup>14</sup>

What of the country's aboriginal inhabitants (for the lands in question were already being used by Aboriginal peoples)? They were often (but not always) practicing different modes of subsistence from those that the Europeans wished to practice, but nonetheless they had a very strong sense of identification with the land and of ownership of it vis-à-vis outsiders. (For example, if members of other aboriginal groups wished to cross people's land, permission or some other form of acknowledgment was typically called for.) The authorities against whom squatters were often rebelling were sometimes engaged in paternalistic attempts to defend the rights of

12. For (highly critical) accounts of this, compare Reynolds 1987 and Tully 1994.

13. There was a certain irony in this, in that the key form of land use in which settlers were engaged was sheep herding and cattle grazing. While Locke does refer to ‘the grass my horse has bit’ as becoming my property John Locke, *Second Treatise of Government*, §29, this clearly relates to the grass itself, rather than the land on which it is growing.

14. Whether this was in fact the case, is a moot point; not least in the light of ecological problems that have emerged, in the longer term, from the forms of agriculture used by settlers.

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their aboriginal subjects. Broadly speaking, the situation seems to have been that the British authorities had some real sympathy for the aboriginal people's rights (at least at some periods), the settlers and would-be settlers were opposed to their recognition, while the colonial authorities in Australia were caught somewhere in the middle. The settlers' views won out.

There would seem every reason to say that Aboriginal people were treated in a terrible manner. While in Locke and in some of the "conjectural histories" of writers in the eighteenth century that also seem to have influenced early settlers in Australia, hunters and gatherers may have been nomadic and not attached to particular pieces of land, that was just not the case in Australia. At the same time, there was a genuine problem if the kind of use that was being made of the land, while efficient when considered as the basis of a hunter-gatherer existence, represented a poor use of resources if it was used in another way. The obvious response—that aboriginal peoples' land rights should have been recognized, and that they should be asked to sell some of their land—would not necessarily have worked. Not only did aboriginal peoples seem attached to their traditional way of life (which would often have required the full range of their resources in order to be sustainable), but also the view that they often had of their land—that they, in some sense, belonged to it—did not seem obviously compatible with its commercial alienation.

All told, what happened was grim. Yet it is not clear, once the forces of European settlement had been unleashed, that it would have been easy to avoid a grim outcome of one kind or another.<sup>15</sup> The problems are similar to those that occur today, when valuable minerals are to be found in the remote lands of aboriginal peoples in South America. The logistics of effective policing, and the disruption that effective policing would itself cause, may make protection of these vulnerable people very difficult. At the same time, a clear legal recognition of prior ownership would at least have furnished a basis for recognition, negotiation, and, if necessary, legal action.

Settlement itself, however, even when land was not alienated, had another effect. It introduced commercial society. The speculations of Adam Smith and his contemporaries about ancient hunter-gatherer societies, illustrated by Biblical and classical sources, may not have been a good guide to Aboriginal Australia. But these writers did have an acute insight into the kind of society in which they were living and into its dynamics. This is in some respects still very much with us today, and it provides the setting in which we are now all living or are coming to live.

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15. Henry Reynolds, a historian strongly sympathetic to Aboriginal land rights, writes: "Could it have been different? Not completely. Australian geography alone made control of frontier contact almost impossible" (1987, 160).

An acceptance of the fact that aboriginal people were dispossessed from land to which they had rights, albeit of a customary character,<sup>16</sup> is important. At the same time, it is not clear that it offers in itself a solution to the problems we now face. At one level, ideas in Locke—and subsequently in Nozick—that cases where rights are violated require restitution, may seem attractive. At another level, who should receive what kind of restitution and from whom, in a society in which there has been continuing immigration and also a history of cohabitation and intermarriage between aboriginal and non-aboriginal peoples, becomes a complex matter. It is further complicated by all that has taken place since expropriation. Numerous transactions have taken place concerning the land, and a wide range of activities have taken place upon it. There is also the shattering of aboriginal life and culture that followed the destruction of aboriginal societies as a consequence of the appropriation of their land—something that cannot easily be put to rights.

But there is also another problem. It is posed by the fact that while Aboriginal people clearly owned the land upon which they were living (albeit not in a manner of which a legal positivist might approve), there is a real problem about how that ownership is to be related to what is involved in commercial society. The kinds of land use that is involved there, in which land is a commodity the use of which is reshaped in response to different kinds of consumer demand across a whole society and now across the world, do not seem to fit readily with the kinds of understanding that aboriginal peoples had of their land. While the sorts of pressures and incentives that commercial society unleashes make it unlikely that aboriginal peoples will be left in peace to pursue their lives as they have done in the past—unless no one in commercial society can see anything of value in alternative uses of the land in question, seen as a commodity or a potential commodity.

One recent reaction to the sad case of the denial of Aboriginal land rights, notably in Canada but also in Australia following Canada's lead, has been to recognize aboriginal people's land rights insofar as this can now be done. In Australia, the Mabo judgment by Australia's High Court (the

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16. It might be questioned whether it is correct to refer to these things as rights. Clearly, if what one has in mind, are rights that are the product of the declarations of a sovereign, Western-style state, then they are not. But, on the one hand, most people living in English-speaking jurisdictions are living in common-law jurisdictions; and common law is, in its origin, a matter of custom rather than of declarations by a sovereign, so there seems to me no reason to accept a legal positivist view of the origin of rights. On the other, there seems to be good documentation for the idea that, among Aboriginal peoples in Australia, it was typically the case that members of some other group required the permission of the traditional owners of land, to cross it; which indicates the existence of something close to the idea of (collective) land rights. Compare, for some general discussion, chapter 1 of Goodall 1996.

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equivalent of the U.S. Supreme Court, but sitting as a Common Law court) recognized native title where it had not been extinguished by a grant of land on the part of the government to settlers, and where there was a continuing tradition of aboriginal attachment to the land. Subsequently, in the Wik judgement (1996), native title was recognized as continuing on land that had been given to settlers on so-called pastoral leases, provided that it was not in conflict with the rights that had been conveyed in the pastoral lease (cf. *High Court of Australia Judgements* 1996). Limited funds have also been allocated for the purchase of land by Aboriginal peoples.

One can hardly but feel that it is important that something be done to redress an ancient—or in some cases not so ancient—wrong. But there are various problems about the form that the solution has taken. One is that the recognition of native title has amounted to the recognition of rights on a collective basis, so that while some individual may be a part-owner of a large tract of land, it cannot be used for any of the kinds of things—such as serving as the basis for a loan—that have concerned de Soto. This may be fair enough, if the people in question all wish to live upon such land as their ancestors have done, or in some modified form of collective life. But one consequence of European settlement has been that it brought such forms of life up against commercial society. And this—even in the miserable opportunities that it sometimes offers to aboriginal people—has its attractions. The combination of dispossession, paternalistic but nonetheless cruel and exploitative policies (cf. *Bringing Them Home* 1997), and the simple presence of commercial society and its products has had its effect. It is not clear how many aboriginal people will be living anything like a traditional style of life in, say, three generations' time. But the fact that their landholdings are in a collective form may mean that it becomes difficult if not impossible for them to make fruitful use of them in the commercial societies in which they could well be living as individuals, and within which they will wish to make something of their lives.

It might seem that the obvious response is to convert traditional land rights to freehold, distributed to individual members of the groups in question. But these issues are fraught with complications.<sup>17</sup> Further, in the U.S., the General Allotment Act of 1887, which tried to address an in some ways similar problem, was based on the idea that “[i]t is doubtful whether any high degree of civilization is possible without individual ownership of land.”<sup>18</sup> The purpose of the act was to facilitate the breaking up

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17. Not least as, in Australia, “native title” sometimes coexists with pastoral leases granted—for specific purposes, by the government to non-Aboriginal people.

18. Compare Wilkinson 1987. The material is quoted on p. 8.

of Native American reservations into individual property holdings, but it served also as the basis for the acquisition of Native American land by non-Native Americans, under what in many cases may have been dubious circumstances. The consequences of the act were highly problematic, and certainly serve as a warning against any imposition of a system of individual landholdings where the people in question do not want it, or, if they are not used to the ways in which commercial society operates, are not protected from exploitation. I will not, however, explore these difficult issues further here, other than to note that there do not seem to be easy ways to handle some of them.

All this serves to indicate that there are other precedents—and highly significant ones—for the legitimization of squatting. But it also highlights the fact that more may be involved than just issues of what is good for the squatters and for the economy. The problems to which squatting and its legitimization have led, in both Australia and North America, are serious, and have left us with some difficulties which do not seem open to any obvious solution. Accordingly, despite their real advantages, one needs to bear in mind that de Soto's arguments for the legitimization of squatting could also in some settings lead to problems, not least by way of setting up incentives for the occupation of vulnerable people's land by way of the prospect of the eventual legal legitimization of what is acquired through such activities.

### 3.2. *Title: Government, Companies—and the Mouse*

On de Soto's account, once illegal settlement takes place, those who have settled face a range of problems. While they may be granted a certificate of some sort by an informal body—to whom they may have had to make a payment—their title is not secure. Not only, in some circumstances, may they have physically to occupy the property at all times in order to secure occupation but, as de Soto argues at length, the fact that they have no formal title means that they cannot use their land and buildings located upon it as security for a loan. Wealth, which could potentially be productive in many other ways, remains locked up unproductively in this insecure form.

De Soto's argument is, essentially, for governmental action to legitimate these landholdings. One problem that initially concerned me about his approach is that he expected government to act in ways that advantage not just ordinary people but those who are at the bottom of the social pile: people who are newcomers, who may not have voting rights in the unofficial places where they are living, and who certainly do not have the resources to make large campaign contributions. De Soto responded in private conversation that politicians may become sympathetic, once they



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understand that if these people's landholdings are legitimated, they will also become voters—and may be expected to show good will towards those politicians who assisted them. This is an important argument. But it would seem somewhat optimistic to suppose that the political system will be responsive to these people's needs on a *continuing* basis. Accordingly, I wish to suggest that it may be at least worth exploring an alternative.

My underlying concern is as follows. There is, as de Soto has argued, a reason for politicians to legitimate these landholdings in return for votes. But it is not obvious that the people in question will continue to do well out of the political process. Things *could* work out to their advantage. But if the political systems were to work out even as well as they do in the United States, one could expect that such relatively poor people could do badly, over time, if they are competing for political influence with richer and better-organized groups: organization, money and effective lobbying are typically more significant than votes in the detail of policymaking.

I would here like to suggest a somewhat wild idea as an alternative, albeit one which has a range of partial historical exemplars (cf. Beito, Gordon, and Tabarrok 2002). The suggestion is that it might be worth experimenting with the possible role of corporations as intermediaries between government and ordinary individuals of the kind with whom de Soto is concerned. Such corporations would clearly need to receive legitimation of their titles to land from government, and here, selection by the existing population on the basis of election could also play a key role, not least in terms of the deals that were offered by competing corporations. But from that point onwards, issues of development and land use would be in the hands of corporations. This might seem to depend on the idea—in Locke's words, written in rebuke to Filmer—that “men are so foolish that they take care to avoid what mischiefs may be done them by polecats or foxes, but are content, nay, think it safety, to be devoured by lions.”<sup>19</sup> But such corporations would have every incentive to develop and improve in such a way as to make the areas that they control productive, just as the owners of a shopping mall have incentives to increase the economic productivity of the mall. Indeed, they could be expected to assist those within these areas in achieving greater economic productivity. In addition, however, such corporations could be expected to have a kind of clout with government to foster these concerns—or at least to avoid them being hindered—that individual small players would not possess.

Such possibilities may also foster experimentation of a kind that government itself could not feasibly undertake. Should it do so, then there is

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19. John Locke, *Second Treatise of Government*, paragraph 93.

also scope for learning from such experimentation and from the customs and traditions that grow up and may embody various forms of tacit knowledge. Consider, here, the argument of Jane Jacobs in her *Death and Life of Great American Cities* (1961), about our need to learn from what worked when we design cities, rather than to imagine that the secret of how to conduct successful urban life could spring forth, full-grown, from the mind of some architect or planning committee.

We need to allow for two things: on the one hand for ideas to be tried out systematically; on the other, for innovation, and for people to be willing to put resources into activities hitherto untried. Above all, however, we need to have structures within which learning can take place: that incentives be set up to make it possible for people to learn from what others have accomplished, and at the same time, for those undertaking the activities themselves to be ready to learn when things are not going well, and to be ready to make the appropriate changes. This suggests that what we need is not to make use of government (politicians will typically be unwilling to admit to having made mistakes, not least because the mechanisms of democratic politics make it difficult for them to do so). Rather, there are advantages to private commercial activity (supplemented, if people so wish, with various communal and cooperative efforts—though they are not as likely to be ready to learn if things are going wrong).

Let us, however, return to de Soto's ideas. Even if someone owns private property, certain kinds of regulation may have the effect of their being unable to make use of it for the kinds of purpose that de Soto has in mind. For example, if the property cannot be alienated, people will not be likely to be able to borrow upon it. If it is subject to certain forms of tradition-dictated collective ownership it may be difficult to get the agreement of everyone concerned to undertake any kind of innovatory activity. If it is subject to governmental land-use regulations (imposed, for example, for the sake of conservation) then this will similarly limit what they may do with a piece of land and hence its value as capital. But now recall that it is the function of property to enable learning to take place by trial and error with which I am here concerned. I am not arguing that no regulation (or its equivalent) is needed. Rather, I suggest that it is salutary to consider the way in which government ownership, or heavy government regulation, can have the effect of freezing what is done with land, and in a way of turning back the assets in question into something that freezes wealth almost as effectively as did the initial situation that de Soto was addressing. In some cases there may be arguments for the desirability of this (e.g., in the case of public parks, although even here open public access may bring with it problems of safety and of antisocial behavior). But in many others, it is useful to contrast the kinds of changes that take place in property that is not

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subject to such regulation over the years<sup>20</sup> with the lack of movement of regulated property and to ask, did government really get things right, back when the regulations were originally made?

One additional problem is that we do not try out different kinds of systems of regulations by allowing them to compete (cf. Tiebout 1956). Clearly, one would not wish to enable a group of people to impose its unwanted externalities on others. But on the face of it there would seem every reason to allow companies to purchase large areas of land, and to replace, in respect of them, the existing functions of local (and possibly state) government, provided that they were not imposing negative externalities on others. (They would thus not be able to impose more pollution on others than did any other neighborhood, and they would be required to make contributions to infrastructure affecting other areas—e.g., road construction outside their boundaries—to match the kinds of costs that they, like other neighborhoods, would be imposing on surrounding areas, and on the same financial basis.)

What this would mean, however, is that not only could one get away from the kind of dull uniformity imposed upon us by our existing regulations, but also it might be possible to try out different ideals, or to develop ways of life that would speak to the needs of different people. (Here, one might see such arrangements as playing a social role in some ways similar to Michael Flanders's description of the goal of his and Donald Swann's musical entertainment: "The purpose of satire, it has been rightfully said, is to strip off the veneer of comforting illusion and cozy half-truth; and our job, as I see it, is to put it back again" (cf. Flanders). Similarly, it would be possible to set up designs for ways of living that draw upon the successes, and learn from the lessons, of what has been accomplished in the past.

The underlying lesson, however, would be that just as with regard to de Soto's problems, we should try to set up the kind of property regime that could be most conducive to making the best use of capital tied up in land, by way of picking the kind of regulation for property which would be likely to offer the best results (something that may combine learning from experience with theoretical analysis; for example, after the fashion of law and economics). We should be looking for the best kind of property and regulatory regime for learning. Here we can look both to legal ideas, to experience, and also to ideas in methodology and epistemology. I have, elsewhere, argued that Karl Popper's work has made some important contributions to this problem.<sup>21</sup> He has suggested that for us to learn we need to constrain

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20. Interesting in this context is Brand 1995.

21. See, on this, Shearmur 1980; Shearmur 1985, and Shearmur 1996b. See also, for a much fuller development of the "social" aspects of Popper's thought, Jarvie 2001.

ourselves by various methodological rules. We may, I have subsequently suggested, consider the way in which various sociological, legal, and regulatory procedures act as methodological rules. But this means that, in turn, when we address our problem of what makes for the best property and regulatory regime for the purposes of the exemplification of ideas and learning, we might usefully look to epistemology for suggestions.

Rather than exploring these ideas in more detail here, I will, instead, turn to the question of whether anything of this kind is likely to be of practical value.

We may, here, usefully look to the Disney Corporation's town of Celebration, Florida,<sup>22</sup> as a partial exemplar of some of the ideas with which I have in mind—and as pointing one way towards possible future developments. Celebration is interesting because it was built upon land owned by Disney, where they had—for reasons connected with the conditions under which they constructed Disney World—been able to get the Florida legislature to grant them powers comparable to those of a county.<sup>23</sup> Their Reedy Creek Development Corporation operated in effect as a private government. Celebration—an actual residential town (or, perhaps better, a large subdivision with some urban facilities)—was constructed upon land from this area which Disney negotiated to return to a local county, not least, because, as the area was developed, the inhabitants would otherwise have attained political control of Reedy Creek. This, however, meant that they were able to negotiate with the local county in such a way that they retained a kind of control that residential developers seldom attain over their creations.

What Disney then did was to create a remarkably attractive town in which strict design rules were developed and enforced. They drew—Jane Jacobs-like—upon many other American towns, and on the architecture of “new urbanism.”<sup>24</sup> The result was intended to give people the kind of experience of neighborliness they would have in a small town, but combined with intranet facilities, good medical services, and also architect-designed public facilities and attractive restaurant and boutique shopping facilities by the side of one of the town's many artificial lakes. The town was designed, physically, to enhance interaction between inhabitants. In

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22. On which, see Franz and Collins, 1999; Ross 1999; and for my own treatment, with further references, Shearmur 2002.

23. For a useful overview of these issues (written about Disney World, prior to Celebration), see Foldvary 1994.

24. By contrast with Seaside, for example, there are limits to the extent to which properties can be let out. Its suburban setting also means that it can be a lived-in community, rather than just a collection of holiday homes. (For some problems about Seaside, see Jacobsen 2003.)

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addition, Disney set up the Celebration Foundation, financed by a levy upon house sales, which set out to promote participation in charitable, educational, and other activities. It thus, for those who choose to live there, serves to overcome the kinds of problems caused by the fall-off in social participation and volunteering that have been so bemoaned by Robert Putnam in his *Bowling Alone* (2000).

I would not wish to depict Celebration as an ideal. But it does suggest what is possible. What is particularly striking about it is that it would obviously be chosen as a location only by those who favored the kind of lifestyle that it was offering. At the same time, however, it would seem to exemplify a model that could be adapted to other needs. And—as is illustrated by the materials in the recent collection *The Voluntary City*<sup>25</sup>—one might develop such ideas in different ways, as suggested by actual historical examples. However, for this to be possible, one would need to make the possibility of areas extracting themselves from local and state governmental regulation much easier—provided, of course, that this did not mean that they were able to impose externalities upon others of a kind that differed from those imposed by other areas. Another way of looking at this is to point out that what is needed is the possibility for private companies to take over the kinds of functions currently discharged by local government, while at the same time their residents would be exempted from local taxation (insofar as they would be paying for services they received by way of fees that they paid directly to the companies). This would offer the possibility for both the exemplification of difference and for experimentation of a kind that one could not expect from government, and which it would also probably be inappropriate for government to undertake.

It is, indeed, this kind of model that I would commend to de Soto as an alternative to having governments solve all the problems with which he is concerned. Clearly, such things would have to be approved by government. But, however unlikely it might currently seem, I think that it would be at least worth exploring the possibilities open up by such commercial activity in this field—not least in the light of the impressive case that de Soto made for the problems of depending just on government in his *The Other Path*.

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25. Beito, Gordon, and Tabarrok

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# How Philosophy and Science May Interact: A Case Study of Works by John Searle and Hernando de Soto

*Ingvar Johansson*

## 1. Science and Philosophy

Many philosophers have taken philosophy to be an enterprise that is wholly independent of the substantial content of the sciences. Some philosophers (especially rationalists such as Descartes and Hegel) place philosophy above science, claiming both that all philosophical problems can be solved independently of science and that science has to stay within a framework laid down by philosophy. Other philosophers (especially the logical positivists) place philosophy below science, regarding it as an enterprise which can at best contribute to sharpening the conceptual weapons that scientists use in their struggle to understand the structure of the world. In my opinion, both views are wrong. In what follows I argue, in relation to the work of John Searle and Hernando de Soto, that philosophy and science are overlapping disciplines. More precisely, I will show that philosophers can help scientists to see abstract ontological relations more clearly, and that scientists can help philosophers to see more clearly what might be called the limits of the scientific significance of their philosophy.

The aim of the paper is fourfold:

- (i) to clarify, under the heading of a “Searle–de Soto Declaration” the primary philosophical-scientific idea that de Soto utilizes from Searle’s speech act theory and ontology of social reality (section 3);

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- (ii) to show that, philosophically speaking, de Soto could have learned a little more from Searle, even though this extra insight would not affect de Soto's economic-political proposal (section 4);
- (iii) to show, with the help of de Soto's economic-political proposal, that in abstracting away from what have been called "misfiring acts" Searle's speech act theory has the potential to lead to an overestimation of how much help social scientists can expect from philosophical accounts such as Searle's (section 5);
- (iv) to show, again on the basis of de Soto's work, that Searle's ontology of social reality is, even from a purely ontological perspective, too restricted regarding the phenomena it takes into account (section 6).

## 2. The Views of de Soto and Searle

Real science, like real philosophy, is hard, and it is sometimes hard not only to find a solution but also to state precisely the nature of the problem with which one is dealing. Usually, however, once a substantial solution has been proposed then the original problem comes into sharper focus as well. In relation to the work of de Soto and Searle under consideration here, we have reached a point where it is relatively easy to specify both the problems and their solutions. This section is a brief presentation of the relevant problems and solutions in the works of both thinkers.

### 2.1. *Hernando de Soto*

**Problem:** What is to be done in order to create better and wealthier societies and to eliminate or at least reduce poverty in the Third World?

**Solution:** According to de Soto's analysis, poor people, at least the poor in the big cities of the Third World, are just as entrepreneurial as respected and successful entrepreneurs in other parts of the world. The main cause of these people's poverty is not, therefore, to be found in their attitudes or culture. Rather, the cause is to be found in the institutional reality in which they live. Though most of these people already live in capitalist societies, the problem is that their primary social setting is, in a sense, not capitalist enough. While these people produce, own, and save, what they produce and own nevertheless cannot be turned into capital. They can own things only in an informal or "extralegal" way and therefore their social setting does not contain the kind of legal property system that is necessary for

real economic development. The basic solution to this problem is to turn the informal ownership structures of the Third World into modern legally formalized systems of property rights, which will make it possible for people to easily acquire title to, sell, and buy what they have produced. The key feature of such systems is that they make it possible for people to own, buy, and sell things by means of making changes in legal representations of what is owned. Therefore: impose a modern formal system of property rights on the assets that the poor in an informal way already own.

**Background ideas:** Material things that are formally owned can be seen, but the fact *that* they are owned cannot be directly seen. In order to come to know such a thing, one has to look at the corresponding ownership representations, at documents and records. In a sense, therefore, capital has a merely linguistic reality. It can be seen only in its representations; in itself it is invisible. This fact is part of “the mystery of capital.” De Soto credits his reading of philosophers such as Daniel Dennett, John Searle, Michel Foucault, and Karl Popper (2001, 234–35), and of economists such as Adam Smith and Karl Marx (38–42), with helping him become clear about the idea that social facts and objects can have such a peculiar character.

## 2.2. John Searle

**Problem:** How can there be an *objective* social reality (that is, a world of money, property, marriage, governments, elections, football games, cocktail parties, law courts, and so forth) in a world that consists entirely of physical entities?

**Solution:** According to Searle’s ontology, there is only one world, our spatiotemporal world. Everything that exists exists in this world. The existentially basic entities are material entities. Some material entities, however, at least human organisms, have a very special feature. Apart from properties such as having a shape, having a volume, having a mass, and having causal capacities, they can also have intentional states. Intentional states differ from those studied by the natural sciences in being in a certain sense *directed* towards entities that are (normally) distinct from themselves. Examples of such intentional states include perceptions, speech acts, and desires. In contrast to physically directed magnitudes (vectors) such as velocities and forces, what distinguishes intentional states is that they have *conditions of satisfaction*; for details about this contrast, see Johansson 1992. For example, when a perception is veridical it is satisfied, when an assertion is true it is satisfied, and when a desire results in the acquisition of its desired object it is satisfied. When a group of people have the same

kind and object of directedness, there is a collective intention. In such an intersubjective context (C), material entities (X) can be ascribed “status functions” (Y) such as being money, being owned, being married, and so forth. The logical structure of *institutional* facts (which make up a subset of all *social* facts) can be captured, Searle says, by the formula

“X counts as Y in C.”

Thus there can be an objective social reality because (i) some material entities (human organisms) can have intentional states and, in turn, (ii) can by means of collective intentional states impose status functions on, in principle, any kind of material entity whatsoever. A certain person is a president because he is collectively counted as a president, and certain metal coins are counted as dollars because, by virtue of collective intentionality they count as dollars in certain intersubjectively recognized contexts. They are what they are counted as because, as institutional entities, they are created by what they are believed to be.

**Background ideas:** According to Searle, there can be no institutional facts without language. Therefore, his philosophy of language is important. He belongs to the so-called speech act theoretical tradition, founded by the Oxford philosopher J. L. Austin, to whose work Searle has added several lasting theoretical improvements and extensions. His views on intentional states are, at one and the same time, both a generalization from and an underpinning of his views about language (introduction to Searle 1983); for an overview of Searle’s development, see Smith 2003b.

### 3. What de Soto May Have Learned from Searle

As already mentioned, de Soto has said that he was helped in getting some of his ideas clear by reading Searle. In spite of this, he has not told us exactly and in detail which ideas he has in mind. Here I will argue that what de Soto calls *The Mystery of Capital* can, using Searle’s philosophy, be summarized in the sentence “Property rights are invisible and they can be created *ex nihilo*.”

Every speech act, according to Searle (1979, chapter 1), belongs to one of five generic kinds of such acts:

1. **Assertives**, e.g., “The cat is on the mat”; used to tell people how things are.
2. **Directives**, e.g., “I order you to leave!”; used to try to get people to do things.

3. **Commissives**, e.g., “I promise to pay”; used to commit oneself to doing things.
4. **Expressives**, e.g., “I thank you for paying”; used to express feelings and attitudes.
5. **Declarations**, e.g., “I hereby declare the meeting open”; used to bring about changes in the world through one’s utterance.

The most important kind of speech act for the purpose of elucidating de Soto’s ideas is declarations. De Soto’s proposal can succeed only when and where some kind of authority, accepted by the poor in question, puts forward a declaration that can be given the Searlean form “X counts as Y in C.” Let me call it a *Searle–de Soto Declaration*:

*We, the authorities, hereby declare that these hitherto informally owned assets (X) should in the future be (count as being) owned by means of the following formal property rights (Y) in the context of our society (C).*

In the moment when such a declaration is made and accepted, the social world is changed. A new institutional fact has come into existence. However, in order to prepare the way for understanding the ontological structure of such a declaration, I will start with some words about a simpler case: the commissive speech act expressed by the utterance “I promise to pay.”

When I say, “I promise to pay,” I put myself under an obligation; publicly, I commit myself. By my mere utterance and its being heard, a social fact, the existence of my promise, comes into being. If I want to create something in the material world, for instance a house, then I need to acquire a lot of different kinds of material and engage in a certain amount of manual labor. But in order to create a promise, no physical matter at all and very little labor is needed, only language. Promises are, the existence of language being taken for granted, created *ex nihilo*. Similarly, wizards use language in the form of magical formulas in order to execute their magic tricks, and, says the Bible, God used language in order to create the world. He started by *saying*, “Let there be light!”

My first Searlean point can be put like this: only gods and magicians can create natural facts *ex nihilo*, but human beings can create social facts in such a way (Searle 1989, 535, 549).

Promise-generated obligations exist even after the speech act in question has been made. But where and how do they exist? Would the obligations exist even if the *whole* human race went out of existence? Answer: no. Would they exist even if everybody has forgotten that the promise has been made? Answer: Both yes and no. Yes, if it is regarded as

possible that someone suddenly could once again remember it; no if such a re-remembering is regarded as completely impossible. Obligations have vaguely defined conditions of existence in relation to people's thoughts. In order for an obligation to continue to exist, there must be some people that have some kind of dispositions to remember the promise in which it had its origin. If the promise was written down, then the existence of the corresponding piece of paper might suffice.

A promise-generated obligation is visible (audible) only at the moment when the promise is made. Leaving aside the case where all existing human beings irreversibly forget about the original promise, obligations can exist even at times when they are not visible at all or are merely indirectly visible in virtue of certain representations (for example, in the forms of memories of the original promising act or of enduring written documents).

My second Searlean point can thus be put like this: Some social facts can exist even though they are invisible.

Obligations are normally invisible, and they are always created *ex nihilo*. The same two points can be made in relation to the consequences of many types of declarations, too; but with a difference (one I will come back to later): a promise by an individual is in a certain sense a one-person affair, whereas declarations are normally many-person affairs. When I say "I promise," I put only myself under an obligation. But if I am the chair of a board and say "I hereby declare the meeting open," then I put all the members of the board under a vaguely defined set of obligations. When this difference between promises and declarations is disregarded, and property rights are regarded as the result of declarations, then one can truly claim:

*Property rights are invisible and they can be created ex nihilo.*

This claim is, in my opinion, both a philosophical-ontological truth and a social-scientific truth. It belongs to both philosophy and science. How is this possible? Answer: because these disciplines have overlapping research domains. In principle, this and similar truths can be discovered by philosophers alone, by scientists alone, and by a cooperation between philosophers and scientists; according to the scientist de Soto himself, he was, in fact, helped in his discovery of this by the philosopher Searle.

#### **4. What de Soto Could Have Learned, but Did Not Learn, from Searle**

The four philosophers mentioned by de Soto—Searle, Popper, Dennett, and Foucault—have something very abstract in common. None of them

is a reductive materialist, and all of them stress the existence of some linguistic or conceptual kind of reality. But the differences between the four philosophers are also important. Put briefly and without argument: Searle alone among them is of the opinion that a linguistic reality can exist only on the basis of and in a mind-independent material external world. Popper's so-called World 3 has some clearly Platonist features; Dennett is an instrumentalist who tells us not to care about what the world really looks like since he thinks that we can freely choose to take on different kinds of "stances" (for instance, an intentionalist stance or a materialist stance) which then seemingly create a corresponding kind of world; Foucault is part of the French poststructuralist movement that claims that nothing at all (be it material entities, Platonic entities, or intentional states) can as such exist in the present, and that, therefore, we have to get rid of all "metaphysics of the present."

De Soto seems not to have been concerned with the differences between the philosophers he refers to. Implicitly, however, he gives the impression of being closer to Searle than to the others. In his books, the world, apart from capital, comes out very much like the common sense world we perceive and ordinarily take ourselves to be living in. And, among the philosophers mentioned, only Searle defends this view. The others, especially Dennett and Foucault, let their thoughts about linguistic reality lead them in a direction that comes into conflict with ordinary robust materialism.

## **5. What Searle Could Have Learned by Taking Searle–de Soto Declarations Seriously: (I) An Improved Analysis of Declarations**

Back to Searle-de Soto Declarations: *We, the authorities, hereby declare that these hitherto informally owned assets (X) should in the future be (count as being) owned by means of the following formal property rights (Y) in the context of our society (C).*

In order to be able successfully to make such a declaration, a lot of preparatory work has to have occurred. De Soto and the Institute for Liberty and Democracy have been working both with governments and with poor people whose property systems they want to transform. Through efforts of "enlightenment" they try to change the beliefs and desires both at the top and at the bottom of society. The kind of new institutional reality that a Searle–de Soto Declaration attempts to create can successfully be brought into and maintained in existence only if many people are in favor of it. Therefore, let us take a careful look at Searle's analysis of declarations.

As already stated, Searle distinguishes between assertives, directives, commissives, expressives, and declarations. In order for a speech act to belong to any of these kinds, there has to be an “uptake,” that is, there has to be at least one listener who understands the speech act in question. Situations where this is not the case have not been discussed in detail by either Austin or Searle, and they are the key issue in the revision of Searle’s account of declarations that I wish to propose. However, many other dimensions of speech acts have been profitably investigated by Searle, and it is necessary to understand something about these before the need for a revision to the account of declarations will be clear. In the table below I summarize some of the major components of Searle’s theory of speech acts based on his classic paper “A Taxonomy of Illocutionary Acts” (Searle 1979, chapter 1).

Kind of act:	Direction of fit:	Publicly expressed psychological state:	Conditions speech of satisfaction: <sup>1</sup>
1. Assertive	Mind-to-world ( ↓ )	Belief	World in general
2. Directive	World-to-mind ( ↗ )	Wish	Other people
3. Commissive	World-to-mind ( ↗ )	Intention	Speaker in the future
4. Expressive	None ( ∅ )	Varies	None
5. Declaration	Both ways ( ↑↓ )	None	The utterance itself

I agree with everything in the table except the last row, but I will give some explanatory comments for all of them.

1. Assertives: A person who utters an assertive such as “The cat is on the mat” is thereby necessarily *publicly* claiming that his mind has managed to fit the world in a certain respect, and he is necessarily also publicly expressing a belief to this effect. Whether he is lying or not is another matter that is outside the scope of what is publicly expressed. Note, though, that one cannot lie without claiming that one is not lying. The assertive “The cat is on the mat” is satisfied (true) if the cat in question is on the mat in question.

1. Searle makes a distinction between “external” and “internal” conditions of satisfaction that I will not discuss here, though I find it problematic; see Johansson 2003. If this distinction is used in the table above, rows 1–4 describe only external conditions of satisfaction, whereas in the fifth row external and internal conditions become identical. In the modified row 5 that I will propose at the end of this section, all conditions of satisfaction are external only.



2. Directives: A person who utters a directive like “I order you to leave!” is thereby necessarily publicly trying to make the world fit his mind in a certain respect, and he is necessarily publicly expressing a wish to this effect. An order is satisfied when it is obeyed. Whether or not it *is* satisfied thus depends on other people.

3. Commissives: A person who utters a commissive (“I promise to pay”) is thereby necessarily publicly committing himself to trying to make the world in the future fit the present content of his mind. He is also necessarily publicly expressing a corresponding intention. A promise is satisfied if the speaker keeps it and fulfils its content in his actions.

4. Expressives: A person who expresses a feeling or an attitude thereby publicly creates something—an expression—that has no direction of fit. Necessarily, though, a corresponding psychological state is (whether truly or falsely) publicly expressed. Since expressives have no direction of fit, they have no conditions of satisfaction either.

5. Declarations: According to Searle, a person who makes a declaration like “I hereby declare the meeting open” is thereby necessarily publicly claiming both that he is trying to make the world fit his mind ( $\neq$ ) and that his mind already fits the world ( $\emptyset$ ). In his 1979 paper, Searle claims that such a speaker publicly expresses no psychological state at all (see last row, column three in the table); today, however (Searle at a workshop in Buffalo, April 12, 2003), he has the much more reasonable view that the speaker expresses *two* psychological states: a wish and a belief, that is, there is one state for each arrow and direction of fit. In the example used, the speaker has then (i) a wish that the meeting will be opened by means of his declaration and (ii) a belief that this state of affairs is currently coming into existence. This change of opinion on Searle’s part, however, has repercussions on what ought to be placed in row 5 under “conditions of satisfaction.” Regarding declarations Searle claims that such utterances comprise their own conditions of satisfaction, that is, they both fulfill themselves (the wish) and make themselves true (the belief). How is such a feat possible? Searle himself has addressed this question. I quote: “with the declarations we discover a very peculiar relation. The performance of a declaration brings about a fit by its very successful performance. How is such a thing possible?” (1979, 18). In answering this question, he distinguishes between those declarations that do and those that do not require extralinguistic institutions. With respect to the former, the kind of declaration pertinent to our interest here, Searle says that “speaker and hearer must occupy special places within [some relevant] institution. It is only given such institutions as the church, the law, private property, the state and a special position of the speaker and hearer within these institutions

that one can excommunicate, appoint, give and bequeath one's possessions or declare war" (1979, 18).

Rephrased in a negative form, this view reads as follows: If speaker and hearer do not occupy special places within institutions such as the church, the law, private property, the state, then it is impossible successfully to excommunicate, appoint, give and bequeath one's possessions or declare war.

According to the whole tradition of speech act theory, speech acts that rely on extralinguistic institutions can "misfire" (Austin's term). They do so when speakers or hearers do not occupy the right kind of position within the relevant institution. For instance, if someone who is not supposed to open a meeting of a certain organization says, "I hereby declare the meeting open," then the meeting is not opened; the presumed declarational act misfires. Austin places misfires outside his area of investigation, and Searle follows suit. Thus, though in the table above the condition of satisfaction for a declarational speech act is the utterance itself, this is only because it has already been assumed that the utterance does not misfire. The relevant portion of the table thus tells us merely that a *nonmisfiring declaration* can be regarded as being satisfied by the declaration itself. Such a restriction, however, makes this part of speech act theory lose much of its significance for social scientific purposes and interests.

Speech act misfiring can be due to problems on both the side of the speaker and that of the hearer. For example, if de Soto alone makes a Searle-de Soto Declaration, then it will certainly misfire, and the same goes for declarations made by the poor themselves. Is it then, contrariwise, the case that no Searle-de Soto Declaration made by a legitimate government can misfire? No, it is not. If such a declaration is immediately contested by riots and turmoil in the streets, then it is as much a misfire as a declaration made by a speaker who is not in a formal position to make it. Some more words about this.

When a promise is given, the promise exists as soon as the speech act is completed and heard. However, the keeping of the promise, namely, the realization of its (external) condition of satisfaction, lies outside of the speech act itself; it lies somewhere in the future. The promise is connected with its satisfaction by means of an obligation. In analogy with this, my view is that as soon as a declarational speech act is completed, then a declaration exists, but its main conditions of satisfaction lie outside the speech act, namely in the acceptance of the declaration by the relevant group of people. My claim is that acceptance is to declarations what keeping is to promises and obeying is to orders. A declaration-generated new institution does not exist if that declaration is not accepted by others and, thereby, satisfied. The fifth row of the table above should be replaced by the following one:

Kind of speech act:	Direction of fit:	Publicly expressed psychological state:	Conditions speech of satisfaction: <sup>1</sup>
5. Declaration	Both ways (↑↓)	Both wish and belief	Acceptance by all or most other persons involved

One reason why this view of declarations has not been discussed before is, I think, that speech act theoreticians have abstracted away from the issue of misfires, and thus left them out of the domain of their research. However, it is impossible to make such an abstraction when one is interested in the analysis of problematic political declarations in the real world, as a social scientist and reformer such as de Soto actually is.

## 6. What Searle Could Have Learned by Taking Searle–de Soto Declarations Seriously: (II) The Need for an Ontology of Desires

When reading de Soto's two books, one becomes very aware of the fact that politics can be peaceful and consensual, peaceful and conflictual, and also conflictual and violent. This last point is particularly clear if one considers the history of de Soto's own Institute for Liberty and Democracy and its relationship to the Shining Path guerilla movement in Peru (de Soto 2002, preface). Searle rightly stresses that language is a crucial factor in creating institutional reality. However, his way of doing this implicitly neglects the conflictual side of institutional reality; see also Smith 2003a.

Searle's general formula for the logical structure of institutional reality is

X counts as Y in C;

but the formula below is, Searle says (1995, 104), more basic to the existence of institutional facts:

We accept (S has power [S does A]).

Equally important, I think, is the following:

*We* accept (S has power [S does A]), and we force *them* to accept the same thing.

Of course, Searle can reply that people who are being forced to accept something nonetheless accept, and that, therefore, his formula is more basic. However, there is still something missing. Quite obviously, a lot of human conflict has to do with conflicting human desires, and a lot of human consensus is due to harmonized human desires. I find it a bit astonishing that in a book like Searle's *The Construction of Social Reality*, which is concerned with the basic features of the ontology of social reality, human desires are not discussed at all. Indeed, Searle does not even draw attention to the fact that they are being disregarded. Can something that so many social scientists take so seriously really be left out of account in an ontology of the social? I think not, and Searle seems in recent times to be closer to such a view as well. In particular, this can be seen in his clearly stated Weberian view: "A monopoly on armed violence is an essential presupposition of government" (2003, 209). Both the existence of violence and the need for a monopoly on it within a society arise from the existence of conflicting desires.

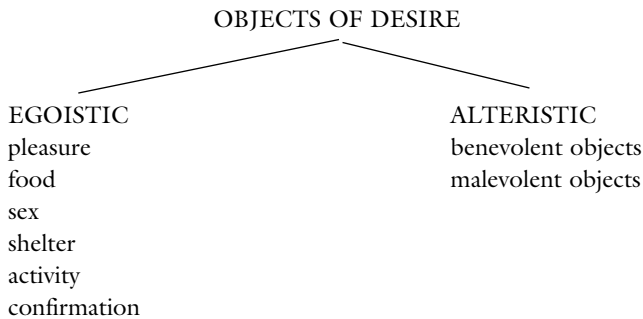
When, for instance, a new property system really has become institutionalized by means of an accepted declaration, it is also normally taken for granted that the system will last for some time. It is, I would say, taken for granted that conflicts among human desires will not make the property system fall apart at once. Searle claims that we cannot grasp the basics of the ontology of social reality without an ontology of language. I will claim that an ontology of human desires and their objects is no less indispensable. However, the question must first be asked, is such an ontology possible?

Perhaps human desires and their objects are structured the way Wittgenstein thought that speech acts are structured, that is, in such a way that a *theory* of the corresponding open-ended phenomena is impossible. It could be argued that there is such a multitude of concretely different desires, with only family resemblances between them, that no taxonomy whatsoever could possibly encompass this variation. This seems to be the view held by some social constructivists. However, just as Searle claims (1979, vii–viii) that Wittgenstein is wrong and that there is a definite number (five) of generically different kinds of speech acts, I think that there is also a definite number of abstract taxa of objects of human desires (Johansson 1995).<sup>2</sup> The point here is by no means to argue that I have found the right number of objects of desire; it is only to provide support for the claim that the search for such a number is as meaningful and theoretically interesting in relation to human desires as it is in relation to speech acts.

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2. Here I leave the question open as to whether there is also a connection between kinds of desired objects and kinds of desiring, and hence the possibility of providing a perspicuous classification of both.

I think that there are three fundamental or rock-bottom desires (as contrasted with mere wishes and with unconscious instincts): a desire to have desires in general, a desire to have cognitions in general, and a desire to feel affections in general. The following list of eight different kinds of objects of human desires, divided into two families, captures the remaining cases:



Since, to repeat, my intent here is only to make plausible that an ontology of human desires is possible, I will not explain and argue for all the proposed taxa, but confine myself to some brief comments. In particular, and in agreement with Searle (2001, 191–92), I think the view that all desires are desires for pleasure is false. I think there is a desire to be active (both bodily and intellectually) in general. A desire for pleasure is a desire on my part for pleasure on my part, and similarly for the other items in the left column—all of which are thus egoistic. A desire for another’s pleasure is a case of benevolence, and a desire for another’s displeasure is a case of malevolence. In general, benevolence is a desire for the satisfaction of another person’s egoistic desires, and malevolence is a desire for the frustration of another person’s egoistic desires.

As in all philosophical ontologies, we are here moving on a very abstract level, but there are nonetheless truths that can be found. Searle nowhere attempts to classify desires, but he has made some remarks about the structure of desires in general in introducing his views on “desire-independent reasons.” According to Searle, desires have a world-to-mind direction of fit, and they can be directed towards things not only in the present or the future, but also in the past. True descriptions of desires include that-clauses (“X desires that . . .”), desires can be parts of larger desires, and one can rationally and consistently have inconsistent desires (Searle 2001, 248–49). In relation to this I would like to make four specific claims; the first one is also made by Searle (2001, 157–58), and the other three are, as far as I can see, consistent with everything that he has written.

First, independently of whether the *object* of one of my desires is related to myself (ego  $\text{Æ}$  ego) or to someone else (ego  $\text{Æ}$  alter), the desire is

always a desire of my ego. This position, which one might call “trivial egoism” is thus logically prior to “real egoism.” Trivial egoism is therefore quite consistent with the existence of benevolence and altruism.

In order to see the distinction between egoistic and alteristic desires clearly, one needs something like Searle’s concept of an intentional state. An ordinary property of an ordinary thing is just a property of that thing, but an intentional state of a person is not just a feature of the person alone, it also has directedness towards something else. Egoistic desires have the structure *from ego towards* the same ego, whereas alteristic desires have the structure *from ego towards* alter. Thus when an alteristic desire is satisfied or frustrated in an individual ego, there is also and necessarily either satisfaction or frustration in an alter.

Second, egoistic desires are logically prior to alteristic ones (or: real egoism is logically prior to altruism). In a world with only egoistic desires many actions would still take place; but in a world with only alteristic desires, and no false beliefs to the contrary, no actions at all would occur. No person could then try to satisfy or frustrate another person’s desire.

Third, every ontology of desires that contains both egoistic and alteristic desires implies a simple classification of persons into (1) ordinary people (people that can have both egoistic, benevolent, and malevolent desires); (2) psychopaths (people that can have only egoistic desires); (3) angels (people that can have only benevolent desires); and (4) devils (people that can have only malevolent desires). Ordinary people are easily caught in tragic situations in which they have to face irresolvable conflicts between their egoistic and alteristic desires. Perhaps devils live beyond the domain of the tragic, but for psychopaths and angels, too, there are tragic-like situations. Suppose P is a psychopath who is put in jail for something he (or she) has done, and that he is told that his sentence will be reduced if he is able to make himself a somewhat more empathetic person. For purely egoistic reasons P wants to become a little less egoistic, but his nature makes it impossible for him to satisfy this egoistic desire. Think next of an angel, A, who has learned about Adam Smith’s theory of the invisible hand of the market. He (or she) wants to make other people happy by acting in an egoistic way in the market, but A’s nature makes it impossible for him to satisfy this alteristic desire. Be this as it may, in my opinion, the ontology of social reality needs only to take ordinary people into account.

Fourth, there are not only consistent and inconsistent desires, but also what we might call “superconsistent desires.” Two desires are consistent if both can be satisfied; two desires are inconsistent if they pull you, like Buridan’s ass, in two opposed directions; two desires are superconsistent if they are satisfied by the same action. For instance, if a friend who likes to cook invites you to dinner, then you can by attending the dinner satisfy

both your egoistic desire for food and your alteristic desire to be benevolent towards your friend.

Searle wants to understand how there can be an objective social reality, but he has nonetheless not tackled the issue of what constitutes “the cement of society” (Elster 1989), namely, human desires. I regard this as a flaw, though an excusable flaw. Probably, it is impossible for pioneers to take everything into account. But back to the question: What glues the individuals in a society together? Is it language? Is it desire-independent reasons? Is it egoistic calculations which bring the mutual benefit of social cohesion as a side effect? I think that all such one-factor explanations are false. For language, desire-independent reasons, and side effects of egoistic desires all play a role. But so also do benevolent desires, and so also does the existence of superconsistency between benevolence and egoism.

In *The Construction of Social Reality* (1995), Searle does not discuss egoism and altruism at all; in *Rationality in Action*, he discusses them (2001, 157–65), but only in order to contrast both egoistic and altruistic (benevolent) *desires* with altruistic *commitments* and the concomitant desire-independent reasons that speech acts can create. He regards benevolent desires as cases of “weak altruism” and altruistic commitments as cases of “strong altruism.” From a morally evaluative point of view, this might be an adequate use of the concepts “weak” and “strong,” but from a motivational point of view, I am sure it is the other way round, that is, “weak altruism” is strongly motivational and “strong altruism” is only weakly so. I make these points in order to stress the fact that, so far, Searle’s ontology of social reality does not contain any analyses of the role played by motivations in giving rise to social unity and social disunity, respectively.

De Soto has written, “I am not a diehard capitalist. I do not view capitalism as a credo. Much more important to me are freedom, compassion for the poor, respect for the social contract and equal opportunity. But for the moment, to achieve these goals, capitalism is the only game in town. It is the only system we know that provides us with the tools required to create massive surplus value” (de Soto 2001, 242). Here, one might ask whether de Soto deceives himself when he thinks that he is able to have such benevolent desires. I think he does not, but all those who think that human beings are completely egoistic have to deny this. What this points to is that the ontology of human desires one accepts makes a difference in how one views human motivation and the nature of social unity. In this connection it is worth noting that the founding father of market thinking, Adam Smith, was not at all of the opinion that all humans are completely egoistic. Already in part I, section I, chapter I, first paragraph of his *The Theory of Moral Sentiments*, published in 1759, he writes: “How selfish soever man may be supposed, there are evidently some principles in his

nature, which interests him in the fortune of others, . . . Of this kind is pity or compassion, the emotion which we feel for the misery of others, . . . [It] is by no means confined to the virtuous and humane, . . . The greatest ruffian, the most hardened violator of the laws of society, is not altogether without it” (Smith 1984).

He shared these views with his friend David Hume, who in 1751 writes, “We cannot without the greatest absurdity dispute that there is some benevolence, however small, infused into our bosom; some spark of friendship for human kind; some particle of the dove kneaded into our frame, along with the elements of the wolf and serpent” (Hume 1975, 271).

I have got the impression that Searle agrees with the views (and even sentiments) expressed by Hume, Smith, and de Soto in these passages. But nowhere in his writings on the ontology of social reality do we find any indication of this fact. Why? My guess is that it mirrors Searle’s neglect of desires in his social ontology. There is more to social reality than language and all the things X that are “counted as Y in C.” There are desires of various kinds too. And here can be seen once more how careful attention to the issues of social science can help inform and expand a philosophical account of the nature of social reality. Just as de Soto has been able to use the philosophy of John Searle to help him in his activities of social scientific research and reform, so also Searle’s philosophical ontology of the social can be filled out and rendered more accurate by careful attention to the issues faced by scientists and reformers such as de Soto.

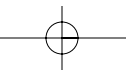
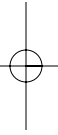
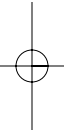
## **7. Words of Conclusion**

I am in perfect agreement with the opinion that in Searle’s writings on the ontology of social reality there is: “a certain highly promising theory, dealing with a hitherto neglected but in fact very interesting and extremely important problem area, and [that] this theory is not in a perfect shape at the moment” (Moural 2002, 78). Furthermore, I think there are a growing number of philosophers and social scientists with whom I share this opinion. I hope that most of these thinkers share also my view that philosophy and science are overlapping disciplines that can benefit from interaction.



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# Language and Institutions in Searle's *The Construction of Social Reality*

6

*Josef Moural*

In chapter 3 of his *The Construction of Social Reality* (*CSR*), John Searle endeavors to explain and justify his claim that language is essential to the constitution of institutional reality. Unlike several other components of his theory of institutions (collective intentionality, deontic power, constitutive rules), this claim of Searle's has not yet been made a topic of critical discussion. However, there are several difficulties connected with this part of Searle's theory. This paper is an attempt to show what they are and how they might be addressed from within Searle's own account.

First, I shall summarize Searle's main argument for the necessary role of a linguistic element in the establishment of institutional reality, provided at *CSR* 66–71. Then (section 2), I shall point out what seem to be the weak points of this argument. Finally (section 3), I shall discuss two further points raised by Searle, and attempt to articulate the best way to view the problems raised by Searle's discussion in chapter 3. The resulting view is more detailed and hopefully much clearer than Searle's position in the book. While the position I propose probably differs from Searle's position in one or two respects, I shall attempt to show that it can claim support—besides the immediate force of argument—also from Searle's hallmark doctrine of intrinsic versus derived intentionality.

## 1.

The claim about the constitutive role of linguistic elements in the ontology of institutional reality appears twice already in chapter 2 of *CSR* (37, 51), but detailed discussion of the relationship between language and institutional reality is reserved for chapter 3 (59–78). Let us first get clear about the content of Searle's claim and how he proceeds in justifying it.

According to Searle, institutional reality is built up of *status functions* recognized by a community of agents. Status functions are characterized as *agentive functions*, meaning that they modify the range of what agents can and cannot do. More specifically, they are agentive functions of a *non-causal type*. This means that they modify the range of possible action available to an agent not solely in virtue of the causal (physical, chemical, etc.) properties of the bearers of function, but rather in virtue of certain statuses that are imposed on such bearers insofar as they are consciously recognized within a community of agents as bearing the function in question. We can use the formula “X counts as Y” to express the relationship between a status function Y and a bearer X (where X can be either a physical thing or event, or an agentive function of lower order). Such a relationship, a status function Y imposed by a community of agents on a bearer X, is an elementary institutional fact.

The claims of Searle that we are concerned with are his claims that institutions are impossible without some form of language (CSR 59); that “the institution of language is logically prior to other institutions” (CSR 60) and that all other institutions “presuppose language” (CSR 60). More specifically, Searle says that language “has a constitutive role in institutional reality” (CSR 61) in the following sense: each institution requires linguistic representation of the facts within itself (CSR 60).

It is important to notice that, according to Searle, it is not necessarily a fully developed language with syntax, infinite generative capacity, and so forth that is involved in this claim. The minimal languagelike structure required to make possible the existence of institutions is something far more primitive than a natural language like English or French. Searle writes, “The feature of language essential for the constitution of institutional facts is the existence of symbolic devices, such as words, that by convention *mean* or *represent* or *symbolize* something beyond themselves” (CSR 60). The minimal structure required is simply a set of symbolic devices, specifically a set of entities that *represent something beyond themselves*. Thus, Searle’s basic claim “amounts to the claim that institutional facts contain some symbolic elements in this sense of ‘symbolic’: there are words, symbols, or other *conventional* devices that *mean* something or express something or represent or symbolize something beyond themselves, *in a way that is publicly understandable*” (CSR 60–61).

Such is the claim; next, we need to look at how Searle justifies it. Between the formulation of the claim (CSR 59–61) and the main argument (CSR 66–71), Searle inserts what might be called a *methodological digression* (CSR 61–66). In my opinion, the main line of exposition in this passage is misleading and invites criticism; however, I shall attempt to propose a view from which what Searle says both withstands such criticism and provides us with an insight that is helpful for understanding the rest of the

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chapter. Thus, my aim in the following five paragraphs is twofold: to help the student of Searle's book who might be baffled by the apparent circularity in the exposition, and to bring to light a message which seems to be involved in the text but not stated explicitly.

In the methodological digression, Searle begins with introducing two general distinctions: the first between language-dependent and language-independent *facts*, and the second between language-dependent and language-independent *thoughts* (CSR 61). We know already that what Searle wants to show is that *each institutional fact is necessarily language-dependent*. From this restatement of his claim, he proceeds as follows: to show that a fact is language-dependent, it is sufficient to show (1) that there are certain thoughts or mental representations partly constitutive of the fact, and (2) that these thoughts are language-dependent (CSR 62). According to Searle, it is immediately clear that condition (1) is met by institutional facts. Thus, what remains is to show the same about condition (2) (CSR 62–63).

How does one show a thought to be language-dependent? In general, one can do it in two different ways: either by arguing that the *complexity* of the thought is such that it is *empirically impossible* for us to think it without the help of some linguistic representation, or by arguing that the *content* of the thought is such that it would be *logically impossible* for the thought to be the thought it is if there were no linguistic representations involved. Since empirical impossibility is not strict enough, Searle seeks to show that the thoughts in question are language-dependent in the latter, stricter sense (CSR 64–65).<sup>1</sup>

However, it turns out that, in this stricter sense, “the thought is language dependent because the corresponding fact is language dependent” (CSR 65). That is, in order to show (2), we need to show that the *facts* which are the content of the thoughts in question are themselves language-dependent. But does this not mean that we have simply gotten back to where we started from? Namely, to the attempt to show that certain facts are language-dependent?

Now this procedure, as described by Searle, does not necessarily involve circularity. If we consider the proposed structure of inquiry purely formally, it is conceivable that, in attempting to justify the language-dependence of an institutional fact  $F_1$  in terms of the language-dependence of a thought  $T_1$  that is partly constitutive of it, we proceed to justifying the language-dependence of  $T_1$  by the language-dependence of a fact  $F_2$  that is

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1. However, later Searle briefly returns to the notion of empirical impossibility and—rather plausibly—claims that most of institutional reality is so complex that a capacity to deal with it requires linguistic representation anyway (CSR 77).

the content of  $T_1$ —and, in general,  $F_2$  need not be identical with  $F_1$ . Also, nothing said so far precludes the possibility that  $F_2$  (or some  $F_n$  of a higher order, if we think of the procedure as iterable) is itself not institutional—which should be desirable given that Searle’s goal is to show the language-dependence of all institutional facts (and we could hardly gain any advantage from employing a procedure that endlessly shifts our task from language-dependence of one institutional fact to another). However, since the only available way to show that a fact, institutional or not, is language-dependent is to show a thought (at least) partly constitutive of it to be language-dependent, and the only available way to show it about the thought is to show it about a fact that is its content, the only alternative to circularity is infinite regress (or to provide another, independent way of showing the language-dependence of either facts or thoughts).

However, if we look at how Searle proceeds in his actual argument, we see that his  $F_2$  are invariably institutional and equal to  $F_1$  (at least in the crucial moments of the argument): those thoughts constitutive of institutional facts that are relevant for Searle are the thoughts that have as their content the very institutional fact they are constitutive of.<sup>2</sup> Thus, there is no infinite regress here, but what about circularity? The circularity involved would have been harmful if we read the passage (*CSR* 61–66) as proposing a method, a linear path of inquiry—and what makes the passage quite misleading is the fact that its rhetorics suggests that much. Instead, I propose that we should view the passage as a logical analysis of mutual entailment: in order to show an institutional fact to be language-dependent, it is enough to show that the thought thinking that institutional fact is language-dependent; but in order to show a thought to be necessarily language-dependent, one needs to show that the fact thought by that thought is language-dependent. Consequently, showing either of the two would do the job, but one shall hardly show one without showing the other simultaneously.<sup>3</sup>

2. Which should be no surprise for the reader: from the beginning, Searle is emphasizing that institutions “exist only because we believe them to exist” (*CSR* 1), i.e., that what is constitutive of an institutional fact is a thought (actually, a recognition shared in the relevant community) which has as its content the very institutional fact. More precisely, “that representation is now, at least in part, a declaration: it creates the institutional status by representing it as existing. It does not represent some prelinguistic natural phenomenon” (*CSR* 74).

3. It may be a question worth pursuing whether there are other kinds of language-dependent thoughts than such that the content of the thought is institutional. Searle himself proposes an example when he says that “the fact that today is Tuesday the 26th of October is not an institutional fact because, though the day is institutionally identified as such, no new status-function is carried by the label” (*CSR* 65). But it is not clear why it is not an institutional fact, and it seems that Searle is using an unnecessarily restrictive conception of institutional facts here (compare the case of void powers such as being elected Miss Bielefeld, discussed in my “Searle’s Theory of Institutional Facts,” 284–85n13).

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After the methodological digression, we turn back to the original problem. Searle needs to show that *either institutional facts or thoughts about them are language-dependent*—and we know that the way to show one is to argue for the other (so much results from the digression, CSR 60–66). Thus, it is legitimate that Searle not only does not keep distinguishing which of the two seemingly alternative ways he is following, but also that he keeps shifting attention from the thoughts to the facts and back during the presentation of his main argument. Perhaps, given the nature of institutional reality, this is the right way to proceed, and, as far as I can see, the difficulties I have with Searle’s main argument do not stem from this methodological peculiarity.

The core of Searle’s main argument, presented at CSR 66–71, has two major steps: (1) the lowest-level shift from X to Y (i.e., the shift from the level of brute facts to the first level of institutional reality) can occur only if it is represented as existing (*representation requirement*); (2) there is no way to represent the Y element extralinguistically because there is nothing extralinguistic there that one can perceive or otherwise attend to in addition to the X element (*no availability of extralinguistic markers*). Thus, the conclusion (3) that one needs words or other symbolic markers to be involved in the representation, and this makes the creation of an institutional fact (that X counts as Y) language-dependent (in the broad, permissive sense of the word “language” discussed above). Let us look more closely at Searle’s presentation of the argument.

He presents it twice, first using an example from football (CSR 66–68), and then on a more general level (CSR 69–71). He begins with considerations regarding the fact (and the corresponding thought) that “a touchdown counts six points.” Searle claims that such a fact cannot be thought about without linguistic symbols, for points can exist only relative to a linguistic system for representing and counting points (notice the shift: arguing about a thought from the fact level). Why is this the case?

The answer, to put it simply, is that if you take away all the symbolic devices for representing points, there is nothing else there. . . . [T]here is no thought independent of words or other symbols to the effect that we have scored six points. The points might be represented by some symbolic devices other than actual words, for example, we might count points by assembling piles of stones, one stone for each point. But then the stones would be as much linguistic symbols as would any others. They would have the three essential features of linguistic symbols: they *symbolize* something beyond themselves, they do so by *convention*, and they are *public*. (CSR 66)

Notice the inverse shift (arguing about a fact from the thought level), and notice the broad notion of language being appealed to.

The same argument again, this time with some more detail on the crucial point of the *no availability of extralinguistic markers*:

Even if we don't have words for 'man', 'line', 'ball', etc., we can see that man cross that line carrying that ball, and thus we can think a thought without words, which thought we would report in the words 'The man crossed the line carrying the ball'. But we cannot in addition see the man score six points because there is nothing in addition to see. The expression 'six points' does not refer to some language-independent objects in the way that the expressions 'the man', 'the ball', 'the line' and 'The Evening Star' refer to language-independent objects. Points are not 'out there' in the way that planets, men, balls, and lines are out there. (CSR 68)

Here, too, the argument about thoughts is based on the ontology of the content of the thought, that is, of points.

And, still dealing with the football example, but now relating the argument to the more technical terminology in which the theory was stated, and adding point (1), *the representation requirement*:

At the lowest level, the shift from the X to the Y in the move that creates institutional facts is a move from brute level to an institutional level. That shift . . . can exist only if it is represented as existing. But there can be no prelinguistic way to represent the Y element because there is nothing there prelinguistically that one can perceive or otherwise attend to in addition to the X element. . . . Without a language, we can see the man cross a white line holding a ball. . . . But we cannot see the man score six points . . . without language, because points are not something that can be thought of or that can exist independently of words or other sorts of markers. (CSR 68)

And this, Searle claims, holds about institutional reality in general. Notice that here, at the crucial point, argumentation about the fact and about the thought coincide: "points are not something that *can be thought of* or that *can exist* . . ." (my italics).

On the general level, the argument is supplemented by a few additional considerations. Status functions "exist only by way of collective agreement, and there can be no prelinguistic way of formulating the content of the agreement, because there is no prelinguistic natural phenomenon there" (CSR 69). More precisely, "in the case of status-functions, there is no structural feature of the X element sufficient by itself to determine the Y function. Physically X and Y are exactly the same thing. The only difference is that we have imposed a status on the X element, and this new status needs *markers*, because, empirically speaking, there isn't anything else there" (CSR 69). Now could the X term itself be such a marker, the "conventional way to represent the status"? Notice well Searle's answer: "it



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could, *but to assign that role to the X term is precisely to assign it a symbolizing or linguistic status*" (CSR 69).

Searle summarizes his argument as follows:

Because the Y level of the shift from X to Y in the creation of institutional facts has no existence apart from its representation, we need some way of representing it. But there is no natural prelinguistic way to represent it, because the Y element has no natural prelinguistic features in addition to the X element that would provide the means of representation. So we have to have words or other symbolic means to perform the shift from the X to the Y status. (CSR 69–70)

Here, notice the two-step movement—first arguing about thoughts (“we need some way of representing . . .”) from the level of facts (the mode of existence of the Y level), then about facts (language-dependence of the shift) from the level of thoughts (language-dependence of the thought)—and the identity of  $F_1$  and  $F_2$  (the representations constitutive of the institutional facts have as their content the very institutional fact they constitute).

## 2.

So far we have examined Searle’s claim that institutional reality depends for its existence upon language, and how he explains and justifies this claim. Next, let us turn to certain difficulties that arise in connection with Searle’s argument. In my view, the main are the following three: first, Searle’s argument is in tension both with his claim that continuity exists between the linguistic and the nonlinguistic, admitting of no sharp line of demarcation (CSR 71), and with his argument that his account is not circular (CSR 72–76). Second, the markers can hardly be of any help in the initial shift from X to Y unless they are already endowed with the capacity to symbolize beyond themselves: but if they are, the initial shift has already been performed and the markers come too late. Third, the argument is vacuous or nearly vacuous because it operates with an extremely weak concept of what it means for something to be linguistic: it requires only that a thing have the capacity to symbolize beyond itself in a publicly understandable way, and is ready to confer it indiscriminately. Let us look at each of the difficulties in more detail.

*First*, we have seen that Searle’s argument presupposed a rather sharp distinction between the brute level and the symbolism-endowed (i.e., linguistic) level. Without such a sharp distinction, the argument does not work. Why? Because of the “no availability of extra-linguistic markers” premise. The conclusion that it is only in the realm of language (or, rather,

symbolism) where the required markers could be found can be drawn only if it is clear that (a) they are not available on the brute level, and (b) there is no other place to look for them but language (symbolism). In other words, it requires a sharp and comprehensive topography of the area in question, the more so given the modality of Searle's lemmas (he says "there *can be* no prelinguistic way to represent the Y element because there is nothing there prelinguistically," and "we *cannot* see the man score six points . . . without language, because points are not something that *can be thought of* or that *can exist* independently of words or other sorts of markers"—*CSR* 68, my italics). If the boundary between the brute level and the level of the symbolic is not sharp to the extent that we can safely exclude the possibility of some semibrute, semisymbolic entities, or of entities of some other (unknown) kind that could compete with symbolism in explaining how it is possible that football points exist, I do not see how it is possible for Searle to draw the desired conclusion.

But if Searle's main argument (not the main argument of the book, of course, just the main argument of Chapter 3, main regarding our topic of the relationship between institutional reality and language) requires that there is a fundamental gap between the brute and the symbolism-endowed, we need to get worried by another claim he makes. He says: "I do not think there is a sharp dividing line between . . . the linguistic and the prelinguistic" (*CSR* 71). I do not see how to reconcile this statement (if it is meant ontologically and not epistemically, which is what the context suggests) with the conditions that are required for the main argument to go through.

A similar clash occurs between the main argument and another part of Searle's exposition, this time not just a single isolated remark but a point with an indispensable role in the architecture of Searle's doctrine. I mean Searle's treatment of the problem of language itself as an institution: if all institutions presuppose language, and language is itself an institution, then *does it presuppose language too*, or not? And what does it mean if it does? This is obviously a serious problem that Searle has to deal with, and he addresses it in the five pages immediately following the main argument (*CSR* 72–76). Basically, the challenge is for Searle to show why what was impossible in the case of extralinguistic institutions, namely, that they be recognizable as existing without the help of some sort of linguistic markers, is possible in the case of language itself.

The stakes here are high, for there is nothing on the brute level of sound or visual tokens that can serve as a clue to the symbolic level, exactly like in the case of touchdowns and points: "If it is true, as it surely is, that there is nothing in the physical structure of the piece of paper that makes it a five dollar bill, . . . then it is also true that there is nothing in the acoustics of the sounds that come out of my mouth or the physics of the

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marks I make on paper that makes them into words" (CSR 72–73). I am afraid that Searle's solution comes here as a remarkable anticlimax. Here is what he says:

The solution to our puzzle is to see that language is precisely designed to be a self-identifying category of institutional facts. The child is brought up in a culture where she learns to treat the sounds that come out of her own and others' mouths as standing for, or meaning something, or representing something. And this is what I was driving at when I said that language does not require language in order to be language because it already is language. (CSR 73)

This may all be true, but the answer we were expecting, the answer to the question what makes language different, what allows us to recognize the symbolism in this case without appeal to other symbolism, while we assumed it be impossible in all the other cases; that answer is not here. All that we are told is that in fact this is what happens: children do learn the meanings that patterns of sound or shape have. It indeed does happen, but if it can happen in the case of language, what makes it impossible in the case of other institutions? If we cannot explain what makes this difference, the force of the main argument is seriously damaged.

The *second difficulty* is at least as grave as the first, and it does not concern a tense relationship between the main argument and some other part of Searle's theory, but rather the strength of the main argument itself. Remember, the situation discussed in the main argument is that of the initial shift from the brute level to the institutional, from the world consisting solely of physical objects to the imposition of the first status-function Y. The crucial point of the argument was: without linguistic markers, such a step could not be taken, for there is nothing in the physical object X alone that could serve as a clue to its symbolic dimension. If we take the symbolism away, there remains nothing there but the physics, and one just cannot find the way from pure physics to the existence of touchdowns, football points, or money without linguistic markers, without some conventional way of representing the status, of formulating the content of the collective agreement.

But, we need to ask, what are these markers? In particular, are they already endowed with the power to symbolize or not? If they are not, they can be hardly of any help, as they are just objects among others and the same argument applies to them: there is nothing in them serving as a clue to the symbolic dimension. But if they are already endowed with a power to symbolize, *they come too late to help us with the problem of the initial shift*, for that shift has already been performed when these markers were created as markers (when the status-function Y has been imposed on the physical X).

Alternatively, one could develop the second horn of the dilemma in the form of an *infinite regress* objection. How could the marker  $M_1$  have been created without the help of some other marker or markers? Clearly, if the main argument is valid, there had to be at least one other marker  $M_2$  around, otherwise there is no clue to the symbolic dimension of  $M_1$ . Obviously, the same question could be asked regarding  $M_2$  (were  $M_2$  already endowed with the power to symbolize?), leading us to another marker,  $M_3$ , and so on. This seems to be a serious difficulty for the main argument.

The *third difficulty* has to do with the permissively broad concept of language used by Searle. One could, of course, express a concern whether such terminology is appropriate, and whether it is not misleading to announce a topic like “the role of language in institutional reality” (CSR 57), when what is in fact discussed is the role of simple symbolism equivalent to marking football points by piles of stones (as in the example from CSR 66 quoted above, \*\*). But such concerns I am leaving aside, for I have a more substantial worry. My worry is that the all too permissive concept of language threatens to make the initial claim that institutional reality depends on language *vacuous* or nearly *vacuous*: if every X becomes automatically linguistic with the shift from X to Y, then there is not much information contained in the claim that a linguistic element is necessarily involved in the existence of every institutional fact.

Such potential panlinguisticism is not foreign to the text we are discussing. When discussing the indispensability of markers (as ways of representing statuses), Searle inserts a question posed by a fictive interlocutor, to which he immediately answers: “But why couldn’t the X term itself be the conventional way to represent the new status?” The answer is that it could, *but to assign that role to the X term is precisely to assign it a symbolizing or linguistic status*” (CSR 69). Similarly, Searle says that we must think of language as constitutive of genuine institutional fact, “because the move that imposes the Y function on the X object is a symbolizing move” (CSR 71). And here are two other passages that make the same point quite clearly: “The move from the brute to the institutional status is *eo ipso* a linguistic move, because the X term now symbolizes something beyond itself” (CSR 73); and “The move from X to Y is already linguistic in nature because once the function is imposed on the X element, it now symbolizes something else, the Y function” (CSR 74). I shall refer to this position as to the *eo ipso* view, and to the class of cases of which it is supposed to hold, the *eo ipso* cases.

Now if we adopt the *eo ipso* view, it seems inevitable that we should answer Searle’s question “what *exactly* is the role of language in the constitution of institutional facts?” (CSR 37) by saying: “None. For all that is really needed comes already with the imposition of status-function. It is true that such imposition necessarily involves symbolism, for the X element now means or symbolizes more than can be found in its physical, chemi-

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cal, and other similar features, and one can even call such symbolizing a linguistic element (although it may be questionable whether it is not terminologically extravagant)—but all that is just subsequent describing and labeling, which does not add anything to what is already there simply due to the imposition of status-function, due to the move from X to Y.”

At this point, it not only seems that the main claim of chapter 3 is vacuous, but one can also worry whether the *eo ipso* view is compatible with what I called the main argument (summarized in section 1 above). For, in the main argument, Searle intended to show that the shift from X to Y is impossible without help of symbolic markers, while here he appears to be saying that the shift from X to Y already contains all the symbolism required. However, on a closer look it turns out that this need not be a problem, at least if we boldly adopt the panlinguistic attitude. This, essentially, is the route that Searle takes. In the continuation of the passage about the child who learns a language quoted above (\*\*p. 6–7), he says:

“Why can’t all institutional facts have this self-identifying character of language? Why can’t the child just be brought up to regard this as so-and-so’s private property, or this physical object as money? The answer is, she can. But precisely to the extent that she does, she is treating the object as symbolizing something beyond itself; she is treating it as at least partly linguistic in character” (*CSR* 73).

In light of this passage, we can see how the *eo ipso* view and the main argument click together. It is because of the main argument’s point about the need of symbolic markers that we can be sure that in each shift from X to Y such a symbolic element is present. The appearance of incompatibility is only the result of the tendency to read the main argument as arguing for the *nonvacuity version of the claim*, that is, the version which would claim the linguistic element to be an autonomous, self-standing necessary constitutive component of institutional facts, and not only a descriptive feature with no separable constitutive role. When oriented on the nonvacuity version of the claim, we expect the symbolic markers necessary for the shift from X to Y to be somehow external to the shift and pre-existent in the treasury of the language. However, we see that we cannot stick to such a conception, for it would make impossible the institution of language. Thus, we have to admit that the symbolism required can be internal to the shift, can be simply a descriptive aspect of the imposition of status-function. From the perspective of the vacuity version, the threat of incompatibility disappears, and so does the second difficulty discussed above<sup>4</sup> (I discuss what remains of the first difficulty in section 3 below).

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4. If markers are not (always) external and pre-existent, the problem of infinite regress of the original shift (i.e., the second difficulty) does not occur.

“Now is it really a difficulty you are talking about here?” someone might ask at this point; “is it not rather the case that we have here a clear and flawless doctrine, only of a slightly different content (i.e., the vacuity version of the claim) than expected?” We shall return to this question in section 3 below, where I shall attempt to find the best way to treat the topics discussed in chapter 3 of Searle’s book. But, preliminarily, I should say that it indeed seems to be a difficulty for the position presented in the book, for Searle obviously was concerned to argue for the nonvacuous claim. “Throughout this book I have tried to emphasize that in institutional facts language is not only descriptive but constitutive of reality,” he says quite clearly (*CSR* 120; see also *CSR* 59, 60, 64), and where he comes closest to explicitly endorsing the vacuity version, he says “I am not comfortable with it” (*CSR* 74).

### 3.

In this section, I introduce and discuss two more potential solutions to our problem, one Searle’s, the other half Searle’s and half mine (or perhaps Searle’s without qualification, but not made clear enough in the book). These two ideas will show us the way to remove the difficulties faced so far by Searle’s account.

First, by distinguishing between the vacuity and the nonvacuity version of the claim, we certainly did not exclude the possibility of a mixed approach, which would ascribe the *eo ipso* symbolism to one portion of institutional reality and the external markers symbolism to the other. Now such a *mixed approach* appears to be Searle’s considered position, stated most clearly in the following passage:

So we need words, such as ‘money’, ‘property’, etc., or we need word-like symbols, such as those just considered [royal crowns, wedding rings, uniforms, etc.—J.M.], or in the limiting case we treat the X elements themselves as *conventional representations* of the Y function. To the extent we can do that, they must be either words or symbols themselves or enough like words to be *both* bearers of the Y function and representations of the move from X to Y. (*CSR* 75)

The classification seems to be clear here: the required representation is either an external marker, or the *eo ipso* symbolism included in the move from X to Y. External markers can be (i) words or (ii) wordlike symbols; *eo ipso* symbolism can be involved when X is (iii.a) a word, (iii.b) a word-like symbol or (iii.c) anything else.<sup>5</sup>

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5. Another passage speaking in favor of the mixed approach: “a thought they cannot

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Of course, to the extent that a language-dependency claim is made about institutional reality in general, and not *per partes* about its various regions, the content of the claim should collapse to the lowest common denominator, that is, to the vacuity version—but this is basically an issue of formulation, not of substance. However, there remains a substantial problem, namely, what to do with the threat of incompatibility between the main argument (*CSR* 66–71; see section 1 above) and the existence of the *eo ipso* cases, regardless of how marginal they may be. Remember, the conclusion of the main argument can be drawn only if *eo ipso* cases are impossible: thus, unless there is a substantial explanation of why *eo ipso* symbolization is allowed for one class of cases and not allowed for another, the mixed approach inherits at least the first of the difficulties discussed in the previous section.

I believe that it is only in the following brief remark where Searle provides us with a hint regarding the solution to the difficulties we are facing. He says: “The account also has this consequence: the capacity to attach a sense, a symbolic function, to an object . . . is the precondition not only of language but of all institutional reality. The preinstitutional capacity to symbolize is the condition of possibility of the creation of all human institutions” (*CSR* 75). Searle does not elaborate on this point at all in the book, but we can—and we can use several other texts by Searle to support our attempt.

First, who or what is *the bearer* of the *capacity to symbolize* in the passage just quoted? Does Searle mean the capacity of things to receive imposed symbolism, the capacity of X to be assigned a status-function Y? I believe he does not, and my reasons for believing that have to do as much with relevance as with truth. First, even if nearly everything that Searle says in the short passage applies also to things as potential bearers of symbolic function, their capacity in this respect simply is not interesting enough, and nothing (or nearly nothing) gets explained by invoking it. Second, Searle speaks not only of a *capacity to symbolize*, but also of a *capacity to attach a symbolic function*, and this is a capacity that things do not have. Who or what does? It is us, humans, who are the bearers of this capacity, and Searle pointed out this “remarkable capacity that humans and some other animals have to impose functions on objects” already early in chapter 1 (*CSR* 13–14).

Thus, the basic explanation on which all that we discussed so far appears to depend is the following: it is *intentionality* that is responsible for the creation of symbolic markers and institutional reality. In each such

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think without *words or other symbols, even if the only symbol in question is the object itself*” (*CSR* 76; my italics).

case, the ascription of the particular function Y ascribes to the X in question something that is not to be found in the X when we disregard everything symbolic; in that precise sense, each such move—by making X to count as Y—makes X to symbolize something beyond itself, and can be said to be symbolic or linguistic in a very broad sense. Then, in many of the following moves, the already created symbolism-loaded objects can be used by intentionality in creation of further symbolism-loaded objects.

This view is not only in perfect agreement with Searle's well-known doctrine of *derived intentionality*,<sup>6</sup> it is even required by that doctrine. To see this it is sufficient to repeat our earlier question, from where does the symbolism of the symbolic markers come? And here the answer is clear: their intentionality, their capacity to point to something beyond themselves, is only borrowed or derived from the intrinsic intentionality of the mind (and is thus observer-relative). Our question has been already asked and (regarding the main issues) solved by Searle in his 1983 book *Intentionality*. "How does the mind impose Intentionality on entities that are not intrinsically Intentional, on entities such as sounds or marks that are, construed in one way, just physical phenomena in the world like any others?" (27).

With this explanation at hand, we can see why Searle did not make language one of the three or four basic elements—imposition of function, collective intentionality, constitutive rules, and perhaps the Background (CSR 13)—required for the construction of institutional reality. We see that collective intentionality on the one hand and assignment of status-function plus constitutive rules on the other<sup>7</sup> are already a strong enough explanatory basis, and that the *constitutive role of language is ultimately reducible to the constitutive role of intentionality combined with the assignment of function*. And we see that the difficulties we were facing before are now disappearing.

For now we can see that the difficulties were largely the result of exaggerating the role played by symbolic markers. Having assumed that the markers themselves were enough to perform the shift from the brute to the institutional level, we encountered difficulties insofar as it appeared that the markers would inevitably come too late to assist with the primary shift, and with the explanation of why what was shown in general to be

6. See Searle 1980, 451–52; Searle 1983, 27–28 and 176–79; and Searle 2002, 116.

7. I have suggested elsewhere that the structural relationship between *assignment of status-function* and *constitutive rules* in the architecture of Searle's theory is not clear, and that it seems that they do largely or entirely the same job (once there is a status-function assigned, there is no separate work remaining to be done by the constitutive rule) and thus are likely to be just two descriptive aspects of one and the same thing (which I proposed to call *acceptance unit*). See Moural 2001, 90, and Moural 2002, 274–75 and 280.



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impossible (i.e. to find a clue to the symbolic dimension in a purely brute, symbolism-void entity) now should be possible for language. The necessity to account for the creation of language itself as one of the institutions led, insofar as we tried to stick to the unrealistic claim ascribing the over-loaded role to the markers, to keeping the *litera* of the claim but emptying its content: the only way to save the claim was to say that the emergence of the markers is (or at least can be) epiphenomenal on the ascription of status-function (the *eo ipso* doctrine). These difficulties, we can see now, resulted from neglecting the true agent of the actions in question, i.e. the intrinsic intentionality.

To sum up the view resulting from our considerations: the *vacuous linguistic element* (i.e. the fact that, once assigned a new status-function, the X in question—*qua* Y—necessarily means something beyond itself) is undoubtedly a pervasive descriptive feature of institutional reality. Besides, there are a number of good reasons to believe that there is a *non-vacuous constitutive role* for linguistic elements to be found in a large portion of institutional reality: one reason for this is the sheer *complexity* of most institutions (*CSR* 77), another is the *deontic powers* connected with them (*CSR* 70), yet another is the *epistemic* role the markers are likely to play (*CSR* 76–77). But we do not gain anything by attempting to overstretch the extent to which such markers play a non-vacuous role. And when we attempt to do this, the theory loses plausibility and perhaps even coherence, for it is clear that there cannot be any already existing linguistic markers assisting in the creation of the first linguistic markers. In particular, it may be a good thing to abandon what I call the main argument (*CSR* 66–71), because it clashes with the *eo ipso* view required in the case of the creation of linguistic markers themselves. And the clash is now resolved: once we recognize the role of intentionality as the preinstitutional capacity to attach symbolic function, we see that what appeared impossible in the main argument (i.e., to assign symbolic function without pre-existing symbolic markers) is really possible, for intentionality already is such a pointing-out-beyond-itself, which we understand is necessary in order to perform the semantic shift beyond the brute level.

In Moural 2002, I attempted to draft a program of future work that should be done on Searle's theory of institutions (which, by the way, I consider one of the most promising and most exciting philosophical theories of the past few decades). Among the open problems I mention there are: (1) the worrying fact that there seem to be “two different sets of claims” connected with the linguistic element, “one grandiose . . . , and one extremely modest” and possibly bordering on self-annihilation (Moural 2002, 281); and (2) the problem of how successful Searle has been in dealing with his *unified ontological* task (i.e., the task to integrate institutions into a more basic physical and biological ontology—*CSR* xi) (Moural

2002, 279). I hope it is much clearer now what we should think about the double set of claims. Regarding the unified ontology task, I think it is clear now that the crucial point is to show how *intentionality* is possible “in a world that consists entirely of physical particles in fields of force” (CSR xi). Once we manage that, Searle has shown us very plausibly how to deal with the rest (linguistic markers, institutions etc.).<sup>8</sup>

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# The Mystery of Human Capital as Engine of Growth, or Why the U.S. became the Economic Superpower in the Twentieth Century

*Isaac Ehrlich*

## Prologue

Common to the bulk of the “new” economic growth and development literature is the idea that the process by which less-developed countries break out of a poverty trap and achieve steady, self-sustaining growth in real per-capita income is predicated on persistent production and accumulation of “human capital.” This powerful concept is wrapped up in three layers of mystery. First, unlike physical capital, human capital is not a tangible asset. How, then, can we account for it empirically? Second, what explains its continuous formation over time? Third, how is such formation transformed into growth in real output and personal income?

One of the objectives of this essay is to unwrap this apparent mystery through an exposition of a general-equilibrium paradigm of economic development where human capital, or knowledge, is the engine of growth, its accumulation is enabled by parental and public investments in children’s education, and underlying “exogenous” institutional and policy variables are ultimately responsible for *both* human capital formation and long-term growth.

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The paradigm is developed in the context of a competitive market economy in which human capital, measured *imperfectly* by quantitative indicators of schooling and training, is competitively rewarded and efficiently allocated to productive activities. The model also recognizes, however, the role of externalities such as market imperfections that affect adversely the accessibility and financing costs of schooling for those with borrowing constraints, or informal knowledge-spillover effects emanating from workers and entrepreneurs with superior education and skill, which enhance the productivity of others with whom they interact. The way these externalities are internalized may vary across different economies by the political and legal framework governing the economy, and as a consequence of accommodating economic and educational public policies, especially insofar as higher education is concerned. Such factors ultimately account for differential long-term growth patterns in different countries.

A more specific objective of the presentation is to illustrate the power of the “human capital hypothesis” to explain observed differences in long-term growth dynamics across specific countries. The case in point is the emergence of the U.S. as the world economic superpower, overtaking the U.K., and Europe in general. The U.S. was a relatively poor country over much of the nineteenth century. In the last few decades of that century, and especially during the twentieth century, however, the U.S. has *overtaken* the U.K. and other major European countries, and then developed considerable advantage over these countries in terms of not just gross domestic product, but per-capita GDP as well. What may be less known is that over the same period the U.S. has developed a considerable gap over Europe in the schooling attainments of its labor force, especially at the higher education level. The gap remained significant through the entire twentieth century, although it narrowed in the latter part of it, and is continuing to narrow in this decade. Largely accounting for this gap was the massive high school movement of 1915–1940, but an independent gap emerged as early as the 1860s with the U.S. foray into tertiary education beginning with the first Morrill Act of 1862, and continuing especially with the massive higher education movement following World War II. A basic argument of this paper is that the U.S. lead in knowledge formation, imperfectly measured by higher educational attainments, has been a major, and perhaps *the* major instrument through which the U.S. overtook Europe as the economic superpower in the twentieth century.

To illustrate the case empirically, it is worth noting that by popular measures of real income used in international comparisons (GDP, adjusted by Purchasing Power Parity), the U.S. maintains a considerably larger level of per-capita income relative to practically all top twenty-five countries in the world, including even small tax-heaven countries (see appendix A, table A). In the early 1800s, however, the U.S. had levels of GDP and GDP per

capita considerably below that of the U.K. and it was not until 1872 for GDP and 1905 for GDP per capita when the U.S. has overtaken the U.K. Figures 1 and 2 (see appendix B) illustrate the comparisons poignantly. Abstracting from year-to-year and cyclical fluctuations, both the U.S. and U.K. graphs relating the logarithm of GDP or GDP per capita to chronological time appear over the long haul to resemble the shape of an upward-sloping straight line. The slope of each line represents the long-term annual growth rate of GDP or GDP per capita. The fundamental difference is that the slopes are higher for the U.S. relative to the U.K. In other words, the U.S. has overtaken the U.K. because its long-term growth rates have been higher: Over the 131-year period 1871–2003 (starting at the point of overtaking) the U.S. versus U.K. GDP growth rates have been 3.39% versus 1.91% per annum while the corresponding per-capita GDP growth rates were 1.87% versus 1.42%.<sup>1</sup> In recent decades, these gaps have narrowed. For example, over the period 1961–2003, the comparative growth rates of GDP in the U.S. versus the U.K. were 3.37% versus 2.43%, while those for per-capita GDP were 2.25% versus 2.11%, respectively.<sup>2</sup> My basic thesis is that differences in long-term per-capita income growth stem primarily not from differences in physical stocks, including land or other natural resources, but from differences in the rates of growth of human capital. Both human capital formation and its impact on growth, however, are ultimately attributable to underlying institutional and policy factors which *reward* knowledge formation within an economy. In what follows I examine whether this hypothesis has a leg to stand on.

## 1. The “Mystery” of Growth: The Human Capital Hypothesis

What accounts for differences in wealth across nations has been a key puzzle of economic science since Adam Smith. Logically, the question involves

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1. These statistics are taken from Maddison 2003. All figures are converted to 1990 U.S. dollars using the Geary Khamis Purchasing-Power-Parity (PPP) method. Similar graphs apply to other major European countries as well. For example the growth rates of GDP and GDP per capita (in parentheses) over the period 1850–2003—starting when the U.S. overtook other major European countries in per-capita GDP—were: 3.52 (1.83) for the U.S.; 1.98 (1.46) for the U.K.; 2.06 (1.72) for France; 2.31 (1.71) for Germany; 2.48 (1.75) for Italy; 2.18 (1.82) for Spain.

2. The shorter-term trends have been uneven for other major European countries. Over the period 1961–2003 the per-capita GDP growth rate in France and Italy were 0.21% and 0.40% higher than in the U.S., respectively, while in Germany it was .14% lower. However, over 1976–2003, e.g., the U.S.’s per-capita GDP growth was 0.28% higher than France’s, 0.47% higher than Germany’s, and .06% higher than Italy’s.

both static and dynamic elements: why are some nations doing better than others economically at a point in time, and why some nations become more successful than others over time. In the terminology of the current literature on economic growth and development, this two-part question relates to determinants of the long-term *rate of growth*, as distinct from the *level*, of per-capita real income or GDP, taking the latter to represent a scalar measure of personal economic welfare.

A significant advance in the modern economic treatment of the problem came about with the neoclassical growth model, which identifies key factors contributing to a steady-state *level* of per-capita income and its associated capital-labor ratio ( $K/L$ ), under any exogenously given rate of population growth and level of production technology. The model thus attributes persistent growth in per-capita income over time, which is a more relevant measure of private economic welfare than aggregate income, strictly to exogenous technological shocks. This inference can be conveniently illustrated via the following “neoclassical” aggregate production function:

$Y = B(T)F(L, K)$ , where  $Y$  is the economy’s aggregate output,  $F$  is a constant-returns-to-scale production function summarizing the impact of conventional labor ( $L$ ) and physical capital ( $K$ ) inputs on production, and  $B(T)$  represents the process by which “technology” ( $T$ ) augments the impact of these inputs. Under an exogenously given technology, the neoclassical growth model suggests that the steady-state level of *per-capita* real income ( $y$ ) is given by:

$$(1) \quad y^* \equiv B(T)f(k^*),$$

here  $k^* \equiv (K/L)^*$  is the “golden rule,” or equilibrium capital to labor ratio.

Growth in the equilibrium per-capita income level  $y^*$  can thus occur by this analysis through exogenous technological advances. The role of technology,  $B(T)$ , can be interpreted more broadly to include any and all factors that enhance the utilization of the labor and physical capital resources available to the economy at a point in time. In principle, therefore, the economic and regulatory policies that facilitate the operational efficiency of the market economy within which economic resources are utilized are also subsumed by this factor—a point that will be further underscored in later sections. Like technology, these factors are assumed to be exogenously given to the economy. They affect the *level* of output per capita at a point in time.

In the last two hundred years or so, however, the world has witnessed a relatively new phenomenon in economic history: persistent and seemingly self-sustaining growth in per-capita real income over the long haul in most of the so-called developed economies following the technological shock produced by the industrial revolution. Periodic and occasionally

large business-cycle disturbances notwithstanding, this phenomenon is still continuing, although at a different pace in different countries. Furthermore, over the last century or so, the world has also experienced episodes of economic takeoffs by less developed countries from relatively stagnant, low income levels into regimes of self-sustaining growth (e.g., the Asian Tigers), as well as episodes in which a relatively poor economy has overtaken a much wealthier one (e.g., the U.S. versus Europe). If “exogenous” factors, such as accidental technological discoveries, are the key to this mystery, what accounts for the smooth and continuous, but also variable, productivity growth in different countries, especially when technological discoveries originating in one country can be rapidly imitated and adopted by any other country?

The answer offered by much of the recently developed “endogenous growth” literature (see Lucas 1988, and the articles in Ehrlich 1990) rests on identifying “technology” as “human capital,” and modeling continuous and self-sustaining technological advances as the outcome of persistent investment in human capital treated as a decision variable, subject to individual and social choice, within a dynamic, general equilibrium framework. The concept of human capital as an intangible asset is perhaps best defined as a stock of embodied and disembodied knowledge, comprising education, information, health, entrepreneurship, and productive and innovative skills, that is formed through investments in schooling, job training, and health, as well as through research and development projects, and informal knowledge transfers (see Ehrlich and Murphy 2007). By this definition human capital has two inherent dimensions: “embodied” and “disembodied.” The first is knowledge embodied in workers, or skill, which augments the productivity of labor and physical capital inputs at a point in time. The second is creative knowledge that flows from the minds of scholars, scientists, inventors, and entrepreneurs and increases their capacity to accumulate new knowledge. This “disembodied” knowledge is manifested in papers, books, patents, and algorithms, and winds up as *technological advances*—product and process innovations—at the firm and industry levels. It is thus more likely to be acquired and produced in tertiary institutions of teaching and research. While these types of human capital are distinct, they are also complementary, as creative knowledge feeds on previously accumulated embodied knowledge and facilitates the acquisition of new knowledge.

In this view, technology as popularly understood—inventions, innovations, scientific discoveries—does not “fall from heaven”: it stems from decisions made by families, firms, and governments to invest in schooling, job training, and research and development, making human capital the relevant “engine,” or facilitator, of growth. The fuel that feeds this engine are the rewards or *rates of return* offered by efficient markets and government policies to investments in knowledge formation, or human capital. Skill

and creative knowledge can accumulate continuously in a given economy only if the underlying reward system in that economy supports a sufficient investment in skills and creative knowledge beyond a critical level.

But how does one measure human capital empirically? The empirical literature associated with this concept identifies it typically as a function of years of schooling and job experience. These measures must be supplemented, however, by corresponding measures of educational quality. Also missing are supplementary education and research efforts at the firm level, which become more important at advanced stages of development, and informal knowledge transfers. Indeed, the hypothesis that investment in schooling serves as an engine of long-term growth is yet to be verified through systematic econometric studies (but see section 6.C for some empirical insights). Nevertheless, I here venture to apply this hypothesis using as a case study the comparative long-term real income growth and educational attainment paths of the U.S. versus the U.K. and other major European countries over the last century. My dual hypotheses are: first, the economic overtaking of Europe by the U.S. beginning in the late nineteenth century, and its continuing dominance through the twentieth century, owe largely to the faster and more widespread schooling attainments, especially at the upper-secondary and the tertiary levels; and second, these differential schooling attainments, whether domestically produced or imported, are ultimately attributable to the higher reward the U.S. economy has offered to human capital attainments owing to accommodating political and institutional factors. To flesh out these arguments I begin by surveying some historical evidence on the evolution of different schooling attainments in the U.S. relative to Europe over the twentieth century.

## 2. Evidence on Educational Attainments: Does the Thesis Have a Leg to Stand On?

The following is a summary of illustrative data on comparative educational attainments and educational spending by selected categories involving the U.S. and other European or OECD countries, as reported in authoritative publications. Since year-to-year reports do not always involve the same categories, occasionally alternative years of data have been selected.

### 2.1. *Data on Schooling Attainments in the U.S. versus OECD Countries over the Last Century*

*Table 1: Average years of formal educational experience of the population aged 15–64 in 1913 and 1989 (Maddison's data). Highlights of table 1 (see*



appendix A) include Maddison's finding (1991) that in 1913 average schooling years in the U.S. (6.93) was behind Germany (6.94) and the U.K. (7.28). Japan had the lowest attainment (5.10). Even at that point, however, the U.S. already had the highest average higher education attainments in years in 1913 (0.2), followed by Netherlands (0.11), and France (0.10). In 1989, in contrast, Maddison's data indicate that the U.S. became the leader in schooling attainments at all levels. Average schooling years in the U.S. shot up to 13.39, ahead of Japan (11.66), France (11.61), and the U.K. (11.28). Germany slipped to last place at 9.58. The average number of higher-education years attained in the U.S. was 1.67, ahead of France (1.32), with other countries substantially lower. Note that Japan, which was at the last place in average schooling attainments in 1913, rose to second place in 1989.<sup>3</sup> Unfortunately, no comparable data were available for the same population groups and countries in more recent years, but the following tables allow for such international comparisons using alternative educational attainment measures.

## 2.2. *Recent Evidence from OECD's Education at a Glance, 1998 and 2003*

### 2.2.1. SCHOOLING ATTAINMENTS

*Table 2: Percentage of the population that has attained at least tertiary education Type-A by age group 1998 and 2003.* Table 2 (see appendix A) shows that in 1998, the U.S.'s percentage of the population 25–64 years of age educated in tertiary type-A programs, defined as regular four-year colleges or universities and advanced research programs, reaches 26.6%, followed by Norway's 23.7%. In this year, the U.S. figure is decisively above Europe's five major economies: U.K., Germany, France, Italy, and Spain (E-5), while the average for all OECD countries is scarcely above half of the U.S. A striking pattern of the educational gap is that it is higher among older age cohorts. In the age group 55–64, for example, the corresponding U.S. percentage is 22%, relative to just 9% for the OECD average. By 2003 Norway catches up with the U.S. in the age group 25–64 at 29%, but the average for all OECD countries is still substantially below the U.S. (16%). In the age groups 45–54 and 55–64, however, the U.S. maintains a decisive advantage of a 2 to 1 ratio or over in 2003 as well.

3. Early comparative educational data are difficult to collect. Some economic historians believe, however, that the U.S. relative advantage in education was showing up even before 1913, which would even more strongly support the basic thesis of this paper.

Tertiary type-B programs, in contrast, which are more popular in some OECD countries (e.g., Canada, Japan, New Zealand, Sweden) relate to vocational, rather than academic institutions. But even in total tertiary educational attainments, the U.S. is second only to Canada in the age group 25–64 and is leading in the age group 55–64 in 2003. (These data are not included in table 2, but the source for both is the same.)

*Table 3: Distribution of the population that has attained at least upper secondary education, by age group 1998 and 2003.* Highlights of table 3 (see appendix A) include that in 1998 and 2003, the U.S. is leading in the age group 25–64 (86%, 88%), relative to the OECD means (61%, 66%) but much more so in the age group 55–64 (80%, 85%), where the second highest are Germany and Japan (76%, 78%). The gap narrows at younger age groups. In the age group 25–34 in 2003, the U.S. is in eighth place behind, Korea, Norway, Japan, the Czech and Slovak Republics, Sweden, Finland, and Canada, but above all the E-5, including Germany. These data indicate that a number of OECD countries have caught up with the U.S. in terms of secondary schooling in more recent years. But the U.S. again shows overwhelming leadership in terms of the proportion of the population that has attained at least tertiary education.

*Table 4: Expected years of tertiary education for all 17-year-olds (1998).* This table (see appendix A) demonstrates more vividly that while the U.S. is still in a dominant position in terms of the expected number of years of tertiary type-A education: 2.7 years for both part-time and full-time workers, Finland (2.9) and Norway (2.7) have already caught up with the U.S., but France at 1.9 and the U.K. at 1.7 have not done so.

The attainments data tell a dynamic story: the U.S. advantage is highest in the older age categories. The gap is narrowing at the younger ages as well as over time, which indicates that Europe is closing the educational gap. But the U.S. still holds a commanding lead in the category of those who hold *at least* tertiary type-A education, especially at older age cohorts.

### 2.2.2. EXPENDITURES ON EDUCATION

Comparative schooling attainments, as illustrated by tables 1–4, are but one dimension of an effective measure of human capital. As important is the quality of the education experience. A possible measure of quality typically used by economists is educational *spending*, to which I turn next.

*Table 5: Expenditure on educational institutions as a percentage of GDP for all levels of education by source of funds (1990, 1995, and 2002)* (see appen-

dix A). At 7.2% of GDP in 2002, the U.S. ranks among the top countries in terms of total expenditure from both public and private sources for education institutions, being surpassed only by Iceland (7.4%), with Denmark and Korea (both 7.1%) following the U.S. But these numbers are not fully revealing because they do not account for the differences in the magnitude and composition of student populations across countries. More relevant are data on total spending per student, and these are much higher in the U.S. relative to other OECD countries (see below).

*Table 6: Annual expenditures on educational institutions per student (U.S. dollars converted using PPP) by levels of education based on full-time equivalents (2002) (see appendix A).* The U.S. expenditure per student on all levels of secondary education in 2002 was \$9098, while the average among OECD countries was \$6992, but at this point the U.S. already ranks behind Switzerland (\$11,900), and Norway (\$10,154) (Luxembourg at \$15,195, is not a comparable country). In the case of tertiary educational expenditures (both type A and B), however, the U.S. (\$20,545) is second only to Switzerland (\$23,714), and only Sweden (\$15,715) and Denmark (\$15,183) have spending levels above \$15,000.

*Table 7: Expenditure per student (private and public) relative to GDP per capita by level of education based on full-time equivalents (2002) (see appendix A).* The U.S. ratio here (25) is just about equal to the average in OECD countries in the case of all secondary expenditures (26), but at 57, it is still substantially above the average in OECD countries (43) in the case of all tertiary expenditures. To the extent that education can be considered a consumption good, this ranking indicates only that higher education in the U.S. is now a necessity rather than a luxury good (with income elasticity of demand falling short of unity). But these ratios may largely reflect differences in the weight of other types of spending on, say, private consumption or public defense, across different countries.

### **3. How the U.S. Schooling Advantage Emerged: Major Sources and Trends**

- a. *The secondary schooling advantage.* Claudia Goldin (see, e.g., 2001) argues that what has been mainly responsible for the U.S. advance over Europe is the massive “high school movement of 1910–1940.” Her thesis is that, although advances in higher education have been important, the mass secondary education system, which first emerged in the U.S., set the stage for the subsequent transition to the mass higher education movement. In 1910, school

enrollment rates for five- to nineteen-year-olds were fairly similar among the world's economic leaders (the ratio of enrollments relative to the U.S. set at 1 was: .93 in France, .96 in Germany, and .82 in the U.K.). But by 1930, the U.S. was three to four decades ahead of Britain and France, and the high school gap remained large until the 1950s. The median eighteen-year-old person was already a high school graduate in the early 1940s. This had a knock-on effect on the massive development of higher education institutions after World War II: when President Franklin Roosevelt signed the GI Bill in 1944, the average GI could attend college because (s)he had already graduated from high school.

- b. *The Morrill Acts and the Land Grant institutions of higher learning.* What is being overlooked by the previous explanation, however, is that the U.S. already held the lead in tertiary enrollment in 1913, as Maddison's data show. What may have been responsible for this historical development are the Morrill Acts (Land Grant Creation) of 1862 and 1890, and related accommodating factors which made higher education in the U.S. accessible to larger segments of the population relative to Europe. John Morrill was a Congressman from Vermont who managed to convince Congress and President Lincoln to launch a system of public higher education, to be financed through land grants from the federal government to the states. Under the terms of the original Morrill Act, later supplemented by the Hatch Act of 1887, the second Morrill Act of 1890, and the Smith-Lever Act of 1914, public lands, or funds in lieu of public lands, were granted to the states for the establishment and support of land-grant colleges and universities, as well as research stations that focused on agricultural and mechanical-art studies and research. I am not aware of any systematic analysis of the role the Morrill Acts had in the evolution of the higher education system in the U.S., but some important facts allude to their significance. There were sixty-eight land-grant public institutions and universities located in the fifty states and Puerto Rico in 1961. Although at that point in time—following the explosion in tertiary institutions after World War II—these institutions, varying greatly in size from the University of California to Delaware State College, accounted for just less than 5% of all four-year institutions of higher learning, they still accounted for 48% of total organized research expenditures, 40% of the doctorates conferred, 33% of the current-fund income for educational and general purposes, and 28% of the value of plant assets in the U.S.<sup>4</sup>

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4. See Statistics of Land-Grant Colleges and Universities [LGCU], Year ended June

- c. *The GI Bill of 1944.* The public education system, bolstered by the Land Grant movement, received a huge impetus by the Servicemen's Readjustment Act, popularly known as the GI Bill, signed by President Roosevelt in June 1944. The act mandated the federal government to subsidize tuition, fees, books, and educational materials for veterans meeting educational admission requirements, and to contribute to the living expenses they would incur while attending college or other approved institutions of their free choosing. The GI Bill created a massive higher education movement. Within the following seven years, approximately eight million veterans received educational benefits. Of that number, approximately 2.3 million attended colleges and universities. The high school movement of 1910–1940 played a critical role in facilitating this development since almost half of the soldiers returning home from World War II had a high school diploma and were thus eligible to enroll in colleges and universities. The U.S. lead in higher education was enhanced not just by the GI Bill, but also by federal Pell grants and the legislation of tuition assistance supports in many states. Again, Europe was lagging behind the U.S. in this regard over much of the second half of the twentieth century. The British Education Act of 1955, for example, just guaranteed all youth a publicly funded elementary and secondary schooling.
- d. *Immigration and the brain drain.* Another key factor which accounts for a good part of the U.S. schooling advantage is immigration of human capital into the U.S. In an open economy human capital is not necessarily just homegrown—it can be imported through immigration of skilled and highly educated labor. It is beyond the scope of this essay to assess systematically the brain drain into the U.S., but there is general agreement for the proposition that the U.S. became a magnet for skilled labor and scientists, first from Europe and later from Asia as well, following the economic advances of the U.S. in the twentieth century, especially after World War II. Dramatic support for this conjecture is provided in a

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1961, U.S. Department of Health Education and Welfare, Office of Education. In June 2005, the LGCU national association had 214 members. This includes seventy-six land-grant universities (36% of the membership), of which eighteen are the historically black public institutions created by the Second Morrill Act of 1890, and twenty-seven public higher education systems (12% of the membership). In addition, tribal colleges became land-grant institutions in 1994 and 33 are represented in the National Association of State Universities and Land-Grant Colleges) through the membership of the American Indian Higher Education Consortium.

2005 study by the Committee on Science, Engineering, and Public Policy, showing that the share of all the science and engineering doctorates awarded to international students rose from 23% in 1966 to 39% in 2000, the share of temporary residence among science and engineering post-doctoral scholars increased from 37% in 1982 to 59% in 2002, and more than one-third of U.S. Nobel Laureates to date are foreign born.

A number of *caveats* need to be recognized, however, for a more complete assessment of the U.S. schooling advantage:

- i. The U.S. advantage at the tertiary level applies unequivocally to type-A institutions (regular four-year colleges/universities), but not as much to tertiary type-B, which are more vocational in nature. The latter has remained more popular in Europe. Also, the numbers do not include post formal training and apprenticeships, which are more prevalent in Europe.
- ii. However, schooling attainments, measured as the number of years of schooling or the percentage of the population with tertiary education, have institutional upper limits, for instance, a PhD degree, thus becoming a less effective measure of knowledge formation in highly developed economies. It is thus critical to take into account another dimension of educational attainments, which is more open-ended—schooling quality as captured by level of spending per student. In this regard, the educational gap between the US and the major European countries remains significant, as illustrated by Tables 5–7. Furthermore, investments in knowledge at the firm level via general on-the-job training and specific research and development programs are becoming a more important means of knowledge formation in the more developed economies. The U.S. may still hold a sizeable advantage over Europe in this supplementary human capital measure as well.
- iii. Both schooling lengths and expenditure levels are in essence “inputs” into effective human capital formation. The picture is far more mixed concerning “output” or quality measures, such as math test scores. Evidence indicates that the distribution of U.S. combined mathematics literacy scores of fifteen-year-old students is, in fact, below that of the average of OECD countries and in the mid-range of the E-5 countries (see appendix A, table 8). In contrast, at the tertiary level, U.S. academic institutions are generally ranked higher than Europe’s and attract more international students and faculty.

#### 4. Whence the Divergence? Contributing Factors

- (a) *Educational templates.* Goldin (2001) and Goldin and Katz (1999) emphasize the implicit choice between *general* training (formal schooling) and *specific* training (apprenticeship, on-the-job training options). General training is more expensive, but it produces more transferable and flexible skills across geographical areas, occupations and industries. The focus on general training in the U.S. is attributable to the U.S. developing into a larger open-trade area relative to European countries. Its labor force in the early twentieth century was more mobile and responsive to technological changes in manufacturing, telecommunications, large-scale farming, and retailing.
- (b) *Economic development.* The growth of the industrial and transportation sectors of the economy and the expanding size of the U.S. domestic market raised the rate of return to education, secondary and higher education specifically. The intellectual high school movements which started in New England spread quickly to the rich agricultural areas in central and western states, where rates of return to schooling were as high for blue-collar workers and farmers as for white-collar workers. The high school movement gained momentum also because of the decentralized educational system in the U.S. owing to the fiscal independence of local school boards.
- (c) *Feedback wealth effects.* By the early twentieth century, the U.S. already had the highest income per capita, enabling families to more easily finance the higher education of offspring.
- (d) *Educational policies.* The U.S. educational system has been more democratic, secular, and gender neutral. In contrast, the educational systems in Germany, France, and other European countries were more rigid and elitist over much of the twentieth century. Differences in institutional restrictions are manifested especially in the context of tertiary education. In the U.S., publicly subsidized higher education started with the Morrill Acts, becoming massive in 1944, while in Europe this process began later—in some countries not until the 1960s and 70s. In France, for example, the number of college students started increasing considerably only during the 1980s because of the knock-on effect of expanding secondary education: a political decision was made to increase to 80% the percentage of age cohorts that would reach the level of the *baccalauriat*, and admissions to the first year of university studies

was guaranteed to anyone with a high school diploma, regardless of type. Although European tertiary institutions have become virtually tuition-free in recent decades, *access* to these colleges and universities remained much more restricted until recently. The U.S., in contrast, has practiced virtually universal admission to higher education, albeit with differences between community colleges and public and private colleges and universities. As noted in section 2, however, that the gap in higher education enrollments between the U.S. and Europe is fast closing.<sup>5</sup>

- (e) *The political-economic systems.* Last, but not least, the U.S. has had a more democratic political system; e.g., suffrage was extended to all (white) U.S. males early in the nineteenth century, but much later in almost all European countries. It has also had a freer and more decentralized economy, where individuals, families, and firms can make resource allocation decisions in largely free markets, bolstered by the rule of law and protection of property rights, including intellectual property. The U.S. has also had less regulated labor markets, and greater openness to external trade and immigration relative to Europe. These factors helped produce a relatively high rate of return to human capital investments for the domestic population, and a larger premium on completed education for skilled immigrants.

The preceding analysis traces the gap in educational attainments favoring the U.S. in the twentieth century to the interplay of two main forces: first, the feedback effects on private demand for education generated by the new industrial economy, economic growth, and personal wealth; second, the impact of the more open economy and society in the U.S. on the returns to human capital formation, whether domestically produced or imported, and thereby on economic growth.

By items (a)–(c) above, economic affluence leads to greater demand for education as consumption, or to greater ability to finance private educational investments by overcoming inherent imperfections in the capital market. Items (d)–(e) above trace the growth in educational attainments to institutional, political, and economic policies that lower the costs, or raise the potential returns to investment in especially higher education, thus enabling individuals and firms to capture more fully any external effects generated by education. These factors also encourage immigration of workers with superior education or entrepreneurial ability. Put differ-

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5. For a survey of European school systems, see section B (Structures and Schools) of *Eurodice 2000*.



ently, the democratic capitalism exercised in the U.S. has contributed to a higher rate of return to individual investment in human capital generally, and tertiary education in particular.

While the two groups of factors represent apparently opposite directions of causality regarding the association between human capital formation and economic growth, they are, in fact, complementary. Greater investment in human capital as a proportion of total production capacity raises productivity growth, while the demand for human capital investments is partly a by-product of economic growth, and this needs to be accounted for in regression analyses aiming to explain productivity growth as a function of educational spending. But this would be a partial-equilibrium view of economic development. The endogenous growth, general equilibrium model discussed below sees both human capital formation and productivity growth as endogenous outcomes of underlying legal and political factors. Moreover, prudent political and economic policies are also affected by the schooling level of the electorate. In this view, the critical causal factors can be traced especially to those summarized in item (e).

## 5. Linking Human Capital Formation with Economic Growth

### 5.1. *The Endogenous Growth Hypothesis: Human Capital as the Engine of Growth*

The literature on endogenous growth attempts to go beyond the neoclassical model of economic growth in two important ways: (a) explaining persistent growth as a result of factors endogenous to the economy, rather than exogenous, unpredictable technological inventions; (b) identifying “technology” as human capital, or *knowledge*. By this view, knowledge breeds greater knowledge. Some new knowledge translates into higher productivity of existing resources (embodied human capital), and some is manifested through innovations, patents, manuscripts, and specialized capital goods that account for what is commonly perceived of as technological innovations (“disembodied human capital”). Human capital is ultimately the source of both types of “technology,” and can therefore be considered the engine of growth (see Lucas 1988, Becker et al. 1990, and Ehrlich and Lui 1991).

The reason persistent growth is enabled by human capital formation is that knowledge is *the only instrument of production that is not subject to diminishing returns*, as John Maurice Clark (1923) argued. The idea can be formalized in a simple way by specifying a law of human capital accumulation as follows:

$$(2) H_{t+1} = A(H^c + H_t)h_t$$

Here  $H_t$  and  $H_{t+1}$  represent the human capital stocks of a representative agent in generations  $t$  and  $t+1$ ,  $A$  represents the technology of learning and human capital transfer,  $(H^c + H_t)$  denotes production capacity ( $H^c$  representing fixed personal or family endowments and  $H_t$  acquired knowledge at  $t$ ), which is transformed to per-capita real income, or output  $y = (H^c + H_t)$ , at an implicit constant competitive rental rate (normalized at 1); and  $h_t$  represents the fraction of production capacity spent by members of generation  $t$  on the human capital formation of members of generation  $t+1$ . While the level of human capital attained by the next generation,  $H_{t+1}$ , could in principle be subject to diminishing returns in the rate of investment by the current generation, captured by  $h_t$ , it is specified as a linear function of the human capital attained by the current generation,  $H_t$ . The implicit argument is that attained knowledge and skill by any given generation enhances both the creation of new knowledge and the productivity of intergenerational knowledge transfer to the overlapping future generation, thus escaping diminishing returns.

Human capital can thus grow perpetually from one generation to the other essentially because the level of productive knowledge attained by a current generation serves as an input into the generation of knowledge in the succeeding generation. But whether the latter exceeds the former (or  $H_{t+1} > H_t$ ) and to what extent, critically depends on whether investment in human capital exceeds a threshold level: by equation (2) if investment,  $h_t$ , is not sufficiently high, the knowledge attained by generation  $t + 1$  will be stuck at the level of generation  $t$ ,  $H_t$ , producing a stagnant equilibrium level of output. In a decentralized market economy and a democratic political system, investment in human capital is affected directly by individuals and families, as well as indirectly by the level of public spending they demand from their local and federal government.

Of course, the production of human capital is a *necessary* but not a *sufficient* condition for expansion in productive capacity. Implicit in this analysis is the assumption that accumulated human capital contributes to expansion in desired output ( $Y$ ) through the aggregate production function introduced in section 1 and the accommodating role of efficient markets, which assure the allocation of skill and creative knowledge to their most productive uses. The endogenous growth paradigm indicates that in a steady state of continuous growth, physical capital accumulation, including natural resources and productive land, would adjust to the pace of human capital accumulation, making the latter the economy's engine of growth. At a given population level, continuous human capital formation will lead to continuous expansion in real output per capita ( $y$ ). Human capital ( $H$ ) thus replaces the concept of "technology" ( $T$ ) in equation (1).

The model outlined in the preceding discussion is a closed economy model. In an open economy, expansion of output is also conditional on the ability of the economy to *retain* the human capital it produces. The U.S. was not the first to take off: the industrial revolution began in Europe. But the emergence of the U.S. as an economic superpower can be attributed to the ability of the U.S. market to provide a high reward for human capital investments, and thus to both retain domestically produced human capital and attract human capital produced abroad.

### *5.2. The Special Role of Higher Education in Economic Growth*

The previous analysis also rests on the simplifying assumption that workers are homogenous. In reality, people are heterogeneous in terms of both innate ability and family endowments they possess. A more complete view of endogenous growth and development, based on human capital as engine of growth, must recognize differences among individuals and families in terms of their capacity to both acquire and implement knowledge. This is the framework used in my current joint work on income growth and income inequality (Ehrlich and Kim 2007) which is used to explain the dynamic pattern of both income growth and income distribution over different stages of economic development.

The story is simple: human capital, as measured by average schooling attainments, has a direct effect on the skill and productivity of the existing labor force, but also an indirect effect on the emergence of new ideas, that is, technological innovations and productivity growth. Those who are in a position to acquire more human capital, especially higher education, because of personal ability or family endowments allowing them to more economically finance higher education, are likely to be the “first movers” when it comes to create new knowledge, or implement advances in knowledge triggered by technological shocks. Both schools and the labor market also allow for the *socialization of knowledge*, whereby the achievements of workers with superior knowledge can spill over to, and be shared by, other workers. These “spillover effects” tie population groups of different human capital attainments together over the development process as well as in a regime of persistent growth, and ultimately produce stable income distributions. The existence of spillover effects and imperfections in the capital market also justify government’s subsidization of education, and especially higher education, in order to maximize social income and welfare.

### 5.3. *The Role of Underlying Factors*

The endogenous growth models described above are *general equilibrium* models. In such models, both human capital accumulation and income growth are “endogenous” choice variables: they attain self-sustaining growth as a consequence of individual choices about optimal investments individuals make in themselves and their offspring, motivated by a desire to maximize the return they obtain on these investments. Individual welfare maximization in a decentralized market system thus leads to continuous, self-sustaining growth for the average person in the economy—a dynamic restatement of Adam Smith’s basic proposition.

But this also means that human capital accumulation and income growth are two sides of the same coin: while the production functions (1) and (2) represent a causal relation flowing from per-capita human capital formation ( $H$ ) to per-capita income ( $y$ ), this is a secondary causality. The primary one relates to the causal effects of underlying “parameters” that influence both variables; most importantly, factors enhancing the *incentives* individuals and families have to invest in their own, and their offspring’s, knowledge, as well as the ability of the domestic economy to effectively utilize the human capital it generates or imports in domestic production.

Basic parameters affecting both output and knowledge accumulation are knowledge production and transfer technologies— $A$  and  $B(T)$  in equations 2 and 1—and population longevity (see Ehrlich and Lui 1991), which enable those investing in learning and training to recoup the benefits of their investments over a longer lifetime horizon. Equally important, however, are “institutional” factors, such as the “rule of law”, a legal system which protects intellectual and property rights, and a free-enterprise system where wages and rates of return on investment are determined by competitive market forces rather than bureaucratic intervention. They also include accommodating public educational policies that help overcome capital market constraints in education financing and internalize spillover effects generated by basic science. These accommodating factors, including government regulations and tax policies, can greatly affect output growth by the way they enhance or discourage the incentives to invest in human capital. For example, under a heavily regulated system, let alone a command economy, the bureaucracy rather than free markets determines the allocation and remuneration of resources, including education. The Soviet Union invested heavily in basic sciences used largely to promote military might, not necessarily economic might. Its *command economy* system also fostered investment in “political capital” promising bureaucratic power to apparatchiks, rather than in market-driven productive human capital (see Ehrlich and Lui 1999.) A free market system is better geared to reward human capital of the productive type through the

market mechanism, and is thus more likely to produce self-generating growth.

Free trade and an open economy create greater opportunities for human capital accumulation, but also greater challenges. Greater opportunities, because investment in “disembodied knowledge” such as new production processes or new products is subject to scale economies, which make their returns higher in a larger market open to free trade. Greater challenges, because opportunities to migrate from one region or country to another mean that investment in human capital made in one place may actually wind up benefiting another. Public investment in human capital in Peru or in Ireland before 1986, for example, did not bring about an economic takeoff and self-sustaining growth partly because graduates of institutions of higher learning sought employment in the U.S. market rather than in their own countries. But this does not refute the thesis that investment in human capital is the key to economic growth. It simply reflects the fact that investment that is not backed up by a market system that assures an adequate reward to knowledge cannot be expected to yield its full economic benefits.

A final underlying factor is the role of externalities inherent in both the production and transfer of human capital. Private human capital, unlike physical capital, cannot serve as collateral in financial markets, which limits borrowing opportunities. This justifies a public role in the financing of education at all levels, but especially higher education, where investment is substantial, which enhances accessibility to such educational opportunities according to talent rather than social class and borrowing constraints. Moreover, since higher education can generate spillover effects on the productivity of less educated workers that are not fully internalized through a private reward system, subsidizing it becomes an especially important role of government. That the U.S. was a leader in opening up massive high school and higher-education systems has been a significant factor explaining its emergence as an economic superpower.

## **6. Evidence Linking Education and Productivity Growth**

### *6.1. Evidence from Growth Accounting*

Estimates of the role of schooling in explaining per-worker income variations or growth rely on a “growth accounting methodology,” following the works of Denison (1974) and Solow (1957). The technique ascribes changes in the aggregate economy (GDP per capita) to variations in aggregate measures of capital utilization and labor employment, with the labor employment index weighted by measures of the education attainments of

workers. Claudia Goldin and others estimate that over the twentieth century (actually since 1915) the expansion in the educational index has accounted for close to a quarter of the 1.62 percent per year increase in U.S. labor productivity. Hall and Jones (1999) estimate that in 1988, educational attainments account for over 20 percent of the international variation in labor productivity across different countries.

Studies using the growth accounting methodology invariably find a substantial unexplained residual variation in productivity, known as the “Solow residual.” It is generally attributed to “technological growth.” However, much of this residual variation may be ascribed to the *indirect* role of education in inducing technological advancements, as technology is a derivative of special knowledge, or specific human capital. Indeed, this is the crux of the “endogenous growth” literature that identifies human capital as the engine of growth.

## 6.2. Evidence from Rates of Return to Education

That education is the critical factor explaining differences in earnings across individuals at a point in time has been well established by human capital theory and related empirical work. The human-capital-earnings-generating function formulated by Jacob Mincer links the logarithm of individual earnings to the number of years of schooling and a quadratic specification of the number of years of job-market experience. This specification allows the measurement of the “rate of return to human capital” as the regression coefficient associated with the number of years of schooling. Table 9 (see appendix A), based on a study by Heckman, Lochner, and Todd (2003), indicates that the real rate of return to schooling thus measured has been stable at upward of 10% in six decennial years, but has approached 13% in 1990. More important, by estimating separate regressions for white and black males, this study shows that over the period 1940–1990, rates of return to blacks, initially lower than those of whites, have more than caught up with the latter in 1990, indicating that the U.S. labor markets have become more competitive over time, and better able to reward human capital regardless of race.

The Mincerian linear regression model does not allow for separate estimation of rates of returns by alternative levels of schooling. By relaxing various linearity restrictions implicit in the Mincer model, however, Heckman, Lochner, and Todd (2003) have also estimated rates of return for primary, secondary, and tertiary levels of schooling as well. Their results indicate that the rates of return are considerably higher for those actually completing high school and college education relative to other

levels of schooling.<sup>6</sup> Other studies indicate that that the rate of return to especially college education shoots upward at times of rapid technological innovation, essentially because people with higher skills adapt more quickly to changes in technology.

These studies focus on returns to education captured in market earnings. New work in economics indicates that this may greatly understate the full individual returns to education, which are derived from various non-market activities as well, such as improved health, longevity, and implicit individual assessments of their own life-saving values. Ehrlich and Yin (2005), for example, estimate that both age-specific life expectancies and implicit private values of life-saving are substantially higher for those with tertiary, relative to high-school education.

### 6.3. *Linking Investment in Schooling and Per-Capita Income Growth*

Empirical studies linking educational attainments and economic growth have not produced uniform conclusions, partly because of disagreements about the quality of available schooling data. Barro and Lee's (1993) study, for example, indicates some positive but weak correlation between the overall schooling data they assembled and growth rates. Following Ehrlich and Kim 2007, we here attempt to offer a different perspective on the link between education and growth by stressing the correspondence between *investments* in education, rather than the *level* of educational attainments, and long-term growth rates of per-capita income. By our theoretical analysis, the steady state rates of investment in human capital, which are endogenous outcomes of underlying demographic, institutional and public policy variables, are the critical determinant of corresponding long-term growth rates of both per-worker human capital stocks and per-capita real output in a growth-equilibrium regime. While reported data on educational outlays are incomplete, investment levels can be imputed from time-series evidence on relatively long-term rates of growth of schooling attainments in different countries. We thus expect a systematic link between equilibrium values of average growth rates of schooling

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6. International comparisons using Mincer's model or related techniques are hampered by the absence of comparable data. Existing evidence suggests, however, that estimated rates of return in the U.S. tend to be high relative to those in other highly developed countries (See, e.g., Psacharopoulos and Patrinos 2002). Less developed countries may show unusually high rates of return to schooling during a takeoff period from stagnation to continuous, self-sustaining growth regimes.

attainments per worker (H) and per-capita GDP (GDPPC) over relatively lengthy periods of time in countries experiencing persistent growth. To test this hypothesis, we first estimate expected growth rates of per-capita GDP,  $[1 + g(\text{GDPPC})^*]$ , and schooling attainments,  $[1 + g(\text{H})^*]$ , which are predicted from underlying country-specific factors through a regression model described below, and then compute their association using the following log-linear regression specification:

$$(3) \text{Log}[1 + g(\text{GDPPC})^*] = a + b \text{log}[1 + g(\text{H})^*]$$

Specifically, we use Barro and Lee (2003) data on average schooling years attained by the population aged 15–65, and Summers and Heston estimates of real GDPPC as proxies for our endogenous variables, along with data on explanatory variables listed below, to construct a panel of fifty-seven developing and developed countries over an intermediate-length period of thirty-one years (1960–1991). We first run fixed-effects regressions relating each of our two endogenous variables to a set of underlying country-specific factors. These include demographic variables (population longevity measures), public policy variables (the share of government spending in GDP and a measure of the social security tax rate), as well as chronological time and the interaction terms of these explanatory variables with time. (For an explanation of the role of these explanatory variables see Ehrlich and Kim 2007) The fixed-effects specification also accounts for the role of idiosyncratic institutional factors that are unchanging over the sample period. This method allows us to generate *multiple* predicted values of  $g(\text{GDPPC})^*$  and  $g(\text{H})^*$ , in each country over our sample period. We can then estimate equation (3) using an OLS regression model. Variant 1 of the model imposes a common intercept term ( $\cdot$ ) representing the same technology linking human capital formation to output growth in all countries, whereas variant 2 allows for variation in the latter, using a fixed-effects regression specification.<sup>7</sup>

7. The analysis involves the following steps. In step 1 we run fixed-effects regressions of  $\text{log}(\text{GDPPC})$  or  $\text{log}(\text{H})$  as a dependent variable on a set of regressors as follows:  $t$ ,  $t^* \text{log}(\text{Pi1})$ ,  $t^* \text{log}(\text{Pi2})$ ,  $t^* \text{log}(G)$ ,  $t^* \text{log}(\text{PEN})$ ,  $\text{log}(\text{Pi1})$ ,  $\text{log}(\text{Pi2})$ ,  $\text{log}(G)$ ,  $\text{log}(\text{PEN})$ , where  $t$  is chronological time in years,  $\text{PEN}$  is a measure of the social security tax rate,  $\text{Pi1}$  and  $\text{Pi2}$  are probabilities of survival of children to adulthood and of adults to old age, respectively, and  $G$  is the share of government spending in GDP. (For detail see Ehrlich and Kim 2007.) In step 2 we compute multiple predicted country-specific growth rates of GDP and H over the entire sample period,  $g(\text{GDPPC})^*$  and  $g(\text{H})^*$ , based on the estimated regression coefficients involving  $t$  and the interaction terms of the basic explanatory variables with  $t$  from step 1. This produces a large scatter of observations on  $1+g(\text{GDPPC})^*$  and  $1+g(\text{H})^*$  allowing a meaningful estimation of equation (3). In step 3 we then estimate variants 1 and 2 of equation (3) via OLS and fixed-effects regressions. Since the countries in our panel are in varying development



The idea behind this experiment follows the basic thesis underlying our endogenous growth model. If human capital is the engine of growth, the equilibrium rates of growth of the two endogenous variables of the model—human capital attainments  $g(H)$  and real income  $g(GDPPC)$ —should be outcomes of the economy's institutional and demographic factors, including the degree of government intervention in private economic activity. If these two variables are predicted separately from these underlying country-specific “parameters,” they should be closely related within countries. The results are presented in figure 3 (appendix B) and table 10 (appendix A). Figure 3 shows the noisy scatter of estimated expected growth rates of per-capita GDP and average schooling attainments within countries. The line going through this scatter represents the estimated regression line of variant 1 of equation (3). Table 10 shows also the estimated results of variant (2) of equation (3), which cannot be depicted graphically. The results in table 10 indicate the existence of a statistically significant correlation between the predicted *growth rates* of per-capita schooling attainments and real income within countries in our panel. These results are experimental and preliminary. More complete measures of human capital formation and productivity growth over longer periods, and more elaborate sensitivity analyses, would be required to confirm the findings.

## Epilogue: Looking Back and Looking Ahead

Although the evidence assembled in this paper concerning the long-term growth dynamics of per-capita GDP and schooling attainments is largely “circumstantial,” it appear to be remarkably consistent with the view that human capital formation, even though imperfectly measured by schooling, has been the “secret weapon” through which the U.S. has been able to achieve its robust long-term rate of persistent, self-sustaining growth in productivity and per-capital income. Moreover, it supports the hypothesis that the documented educational gap between the U.S. and Europe in terms of average high school, and especially higher education attainments, is a major factor explaining why the U.S. has overtaken Europe as an economic superpower in the twentieth century. Can the U.S. maintain its lead in the twenty-first century?

Table 11 (see appendix A) summarizes the evidence on schooling attainments shown in tables 2 and 3 for the 5 major European countries

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stages, in additional regressions which we skip here for simplicity, we also allow the intercept terms in variants 1 and 2 to drift downward over time, which our model predicts to occur over the development process. These regressions produce very similar results to those reported in table 10, and have even higher explanatory power.

(E-5: Germany, U.K., France, Italy, Spain) expressed as percentages of the U.S.'s attainments over the period 1998–2003, which may serve as a rough indicator of the trends over the last few decades as well. Even over this short period we see evidence of closing educational gaps, primarily for upper high-school attainments, where the simple average level of schooling attainment for the age group 25–64 in the E-5 rose from 64.9% to 68.2% of that of the U.S. The gaps are closing even faster at the tertiary type-A level, where the corresponding simple average level of schooling attainments rose from 46.7% to 51.7%. Of all E-5 countries, the U.K. has converged most closely to the U.S.'s schooling attainments at the tertiary level, rising from 55.6% in 1998 to 65.5% in 2003.

However, as argued earlier, schooling attainments are subject to institutional upper limits (say, Ph.D. education), thus becoming a less effective indicator of human capital formation at more advanced development levels, where spending on educational quality and knowledge generated within firms may be more important supplementary measures of effective human capital. The US may still maintain a significant lead over much of Europe in these measures. Indeed, corresponding trends in long-term GDP and per-capita GDP (GDPPC) growth rates present a more mixed picture. Figure 4 shows how *percentage differences in long-term real GDPPC growth rates* between the U.S., U.K., and the E-5 (based on the Maddison 2003 data) have evolved over the last 150 years, as we gradually shift the starting reference period from 1850–2003 (the longest time period) to 1991–2003 (the shortest and recent time period). The long-term percentage differences indicate a consistent U.S. advantage, although they also exhibit quite a bit of noise and sensitivity to influential intermediate-term sub-periods. For example, over the Great Depression, the U.S. absolute GDPPC gap over the E-5 was declining significantly along with the U.S.'s long-term growth rate advantage before rising again during recovery. Over World War II and its aftermath, in contrast, the U.S. absolute gap over the E-5 was first rising because of the collapse of the E-5 economies, but was then falling because of the exceptionally high GDPPC growth rates in the E-5 over the following 2–3 decades of European recovery. More recently, however, the U.S. GDPPC growth rate advantage over the E-5 has trended back toward its 1850–2003 level.

One exception seems to be the U.K., where the U.S.'s long-term GDPPC growth-rate gap has been falling more steadily since the early 1930s, and again from the early 1960s when the U.K. has also made significant progress in relative educational attainments. In Germany, in contrast, the U.S.'s GDPPC growth-rate advantage has intensified since 1967, while its educational advantage over Germany has been increasing in more recent years. Thus even this, more recent evidence points to a positive cor-

relation between relative growth rates of tertiary schooling attainments and per-capita GDP, at least in these two countries.<sup>8</sup>

Clearly, there are other forces in play which explain the evolution of comparative growth rates of the U.S. and the E-5 over the twentieth century, such as changes in labor market, welfare, free-trade, and immigration policies, but the U.S. advantage in human capital formation, as judged by schooling attainments especially at the tertiary level, seems to provide a powerful explanation for its long-term growth rate advantage over Europe.

Is the U.S. losing this advantage? The closing schooling gaps might indicate that Europe could catch up with, and even surpass this indicator of U.S.'s human capital formation and ensuing per-capita income growth. However, as figure 5 shows, the *absolute* historic gap between the U.S. and the E-5 in per-capita GDP levels is still far from closing, and it will continue to grow in absolute terms even if the respective growth rates converge. More important, future developments depend on the comparative trends in the underlying causal factors which produced the U.S. long-term advantage in the first place.

Looking back, it is ultimately the relative efficiency of the free-market and open-economy system in the U.S. and the relatively higher *reward* it provided to skill and creative knowledge, which induced a higher rate of growth and efficient utilization of various components of human capital, whether domestically produced or imported. The democratic political system in the U.S. has also augmented the process of human capital formation through prudent government subsidization of education generally, and higher education in particular, much ahead of similar efforts by Europe. These accommodating factors have been a major determinant of the ability of the U.S. to attract, and put to effective use, human capital from other countries as well.

Looking ahead, therefore, one may conclude that continued support of an efficient economic environment that assures a competitive reward to investment in human capital and encourages its persistent formation and utilization could sustain the U.S. lead for years to come. The U.S. still enjoys a significant advantage in terms of the quality of its higher education system and innovative activities relative to Europe and other countries. At the same time, there are strong indications of the failure of the public elementary system in the U.S. to produce competitive educational outcomes relative to other countries. Recognition of current shortcomings

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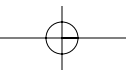
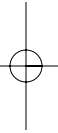
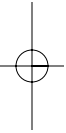
8. Spain constitutes another example: while the U.S.'s long-term growth rate of GDPPC 1850–2003 slightly exceeds that of Spain, from 1877 Spain is reported to have had a higher growth rate, which expanded during World War II. Spain's advantage is still holding in recent years as well, but it also shows the highest percentage increase in higher-education attainments among the E-5, according to table 12.

in the public education system in the U.S., along with the challenge to compete with educational systems in other countries, may improve human capital formation in the U.S. at all levels. Whether or not the U.S. lead is maintained is ultimately a secondary issue. World welfare would be best served if *all* countries adopt competitive economic and educational policies yielding continuous human capital formation, per-capita income growth, and equitable income distributions.

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## Appendix A: Tables

**Table A** Comparison of real GDP per capita for the top 25 countries  
(U.S. dollars converted using purchasing power parity)

Country	Per Capita GDP	Estimate Year	Country	Per Capita GDP	Estimate Year
Luxembourg	58900	2004	Austria	31300	2004
Jersey	40000	2003	Belgium	30600	2004
United States	40100	2004	United Kingdom	29600	2004
Norway	40000	2004	Netherlands	29500	2004
Bermuda	36000	2003	Japan	29400	2004
San Marino	34600	2001	Finland	29000	2004
Hong Kong	34200	2004	Aruba	28000	2002
Switzerland	33800	2004	Germany	28700	2004
Cayman Islands	32300	2004	France	28700	2004
Denmark	32200	2004	Sweden	28400	2004
Ireland	31900	2004	Monaco	27000	2000
Iceland	31900	2004	Singapore	27800	2004
Canada	31500	2004			

Sources: Central Intelligence Agency, *The World Factbook* 2005,  
<http://www.cia.gov/cia/publications/factbook>, file name:  
 factbook2005/factbook/fields/2004.html; World Facts and Figures for 2005,  
[http://www.worldfactsandfigures.com/gdp\\_country\\_desc.php](http://www.worldfactsandfigures.com/gdp_country_desc.php)

**Table 1** Average years of formal educational experience of the population aged 15–64 in 1913 and 1989

1913				
Country	Total (Rank)	Primary (Rank)	Secondary (Rank)	Higher (Rank)
France	6.18 (4)	4.31 (5)	1.77 (4)	0.10 (3)
Germany	6.94 (2)	3.50 (6)	3.35 (1)	0.09 (4)
Japan	5.10 (6)	4.50 (4)	0.56 (6)	0.04 (6)
Netherlands	6.05 (5)	5.30 (1)	0.64 (5)	0.11 (2)
United Kingdom	7.28 (1)	5.30 (1)	1.90 (2)	0.08 (5)
United States	6.93 (3)	4.90 (3)	1.83 (3)	0.20 (1)
1989				
Country	Total (Rank)	Primary (Rank)	Secondary (Rank)	Higher (Rank)
France	11.61 (3)	5.00 (5)	5.29 (2)	1.32 (2)
Germany	9.58 (6)	4.00 (6)	5.20 (3)	0.38 (6)
Japan	11.66 (2)	6.00 (1)	4.95 (4)	0.71 (3)
Netherlands	10.51 (5)	6.00 (1)	3.82 (6)	0.69 (4)
United Kingdom	11.28 (4)	6.00 (1)	4.75 (5)	0.53 (5)
United States	13.39 (1)	6.00 (1)	5.72 (1)	1.67 (1)

*Source:* Data from Maddison 1991, 64.



**Table 2** Percentage of the population that has attained at least tertiary education Type-A by age group (1998 and 2003)

Country	1998					2003				
	25-64	25-34	35-44	45-54	55-64	25-64	25-34	35-44	45-54	55-64
Australia	17	19	18	16	10	20	25	21	20	14
Austria	6	7	8	5	4	7	8	8	7	5
Belgium	12	16	13	10	6	13	18	14	11	8
Canada	19	23	18	18	13	22	28	22	20	18
Czech Republic	10	10	12	10	8	12	12	14	11	10
Finland	13	14	15	13	8	16	23	17	14	12
France	11	15	10	10	6	14	22	13	11	10
Germany	14	14	16	15	10	14	14	15	15	12
Greece	11	15	14	10	6	13	17	15	12	7
Hungary	13	14	14	14	10	15	17	16	15	14
Iceland	16	19	18	15	9	20	23	22	19	12
Ireland	11	16	11	7	5	16	23	16	13	9
Italy	9	9	11	9	5	10	12	11	10	7
Japan	18	23	23	15	9	21	26	25	20	12
Korea	17	23	19	11	8	22	30	26	14	9
Luxembourg	N/A	N/A	N/A	N/A	N/A	6	7	7	6	4
Mexico	12	15	14	10	5	14	16	15	12	7
Netherlands	24	27	26	23	17	22	25	23	21	17
New Zealand	13	16	13	12	7	16	21	17	15	10
Norway	24	27	25	22	17	29	37	30	25	20
Poland	11	12	10	11	10	14	20	13	11	11
Portugal	7	8	7	5	4	8	13	9	6	3
Slovak Republic	N/A	N/A	N/A	N/A	N/A	11	13	11	12	8
Spain	14	21	16	11	6	18	26	19	14	9
Sweden	13	10	14	15	11	18	24	17	17	16
Switzerland	14	16	15	13	11	18	20	19	16	15
Turkey	6	7	7	6	3	10	11	8	9	7
United Kingdom	15	17	17	15	11	19	24	19	18	14
United States	27	27	26	29	22	29	30	29	30	27
Country Mean	14	16	15	13	9	16	20	17	15	12

*Note:* Denmark is omitted in this table because the reported annual data for tertiary type-A attainments in Denmark are incompatible between 1998 and 2003. But the overall country mean includes Denmark.

*Sources:* OECD, Education at a Glance 2000, 36, table A2.2b; OECD, Education at a Glance 2005, Indicator A1: Educational attainment of the adult population, <http://www.oecd.org/dataoecd/22/35/35282639.xls> (table A.1.3a).

**Table 3** Distribution of the population that has attained at least upper secondary education, by age group (1998 and 2003)

Country	1998					2003				
	25-64	25-34	35-44	45-54	55-64	25-64	25-34	35-44	45-54	55-64
Australia	56	64	58	52	44	62	75	64	58	47
Austria	73	84	78	68	56	79	85	83	75	69
Belgium	57	73	61	51	34	62	78	68	55	43
Canada	80	87	83	77	65	84	90	86	83	71
Czech Republic	85	92	88	84	74	86	92	90	84	77
Denmark	78	85	80	78	67	81	86	82	80	74
Finland	68	84	78	62	41	76	89	85	73	55
France	61	75	63	56	41	65	80	69	59	48
Germany	84	88	87	84	76	83	85	86	84	78
Greece	44	66	52	36	22	51	72	60	44	28
Hungary	63	77	73	65	31	74	83	81	75	53
Iceland	55	61	58	55	40	59	64	62	58	48
Ireland	51	67	56	41	31	62	78	67	52	38
Italy	41	55	50	35	19	44	60	50	39	24
Japan	80	93	91	77	57	84	94	94	82	65
Korea	65	92	70	45	27	73	97	83	55	32
Luxembourg	N/A	N/A	N/A	N/A	N/A	59	68	61	54	50
Mexico	21	26	23	16	9	21	25	24	18	12
Netherlands	64	74	68	59	50	66	76	71	62	53
New Zealand	73	79	77	69	58	78	84	81	76	64
Norway	83	93	88	78	65	87	95	92	85	76
Poland	54	62	59	53	37	48	57	49	46	40
Portugal	20	29	20	14	12	23	37	22	16	10
Slovak Republic	N/A	N/A	N/A	N/A	N/A	87	94	91	84	70
Spain	33	53	38	23	12	43	60	48	33	19
Sweden	76	87	80	73	60	82	91	88	80	69
Switzerland	81	88	83	80	71	70	76	72	68	61
Turkey	18	24	19	13	7	26	33	25	21	16
United Kingdom	60	63	62	58	53	65	71	65	64	57
United States	86	88	88	87	80	88	87	88	89	85
Country Mean	61	72	65	57	44	66	75	70	62	51

Sources: OECD, Education at a Glance 2000, 35, table A2.2; OECD, Education at a Glance 2005, Indicator A1: Educational attainment of the adult population, <http://www.oecd.org/dataoecd/22/35/35282639.xls> (table A.1.2a).

**Table 4** Expected years of tertiary education for all 17-year-olds (1998)

Country	Full and Part Time	Rank	Full Time Only	Rank
Australia	2.3	5	1.4	16
Austria	1.8	14	1.8	8
Belgium	1.3	21	1.2	20
Canada	1.9	10	1.4	16
Czech Republic	0.9	24	0.8	24
Denmark	1.3	21	1.3	19
Finland	2.9	1	2.9	1
France	1.9	11	1.9	5
Germany	1.7	15	1.7	11
Greece	1.7	15	1.7	11
Hungary	1.6	19	0.9	23
Iceland	1.6	19	1.6	14
Ireland	N/A	~	N/A	~
Italy	2.2	7	2.2	4
Japan	N/A	~	N/A	~
Korea	1.9	11	1.9	5
Luxembourg	N/A	~	N/A	~
Mexico	0.8	25	0.8	24
Netherlands	2.2	7	1.9	5
New Zealand	2.1	9	1.5	15
Norway	2.7	2	2.4	2
Poland	1.9	11	1.0	22
Portugal	1.7	15	1.7	11
Spain	2.5	4	2.3	3
Sweden	2.3	5	1.8	8
Switzerland	1.1	23	1.1	21
Turkey	0.8	26	0.8	24
United Kingdom	1.7	15	1.4	16
United States	2.7	2	1.8	8
OECD Average	1.8		1.6	

Source: OECD, Education at a Glance 2000, 158, table C3.2.

**Table 5** Expenditure on educational institutions as a percentage of GDP for all levels of education by source of funds (1990, 1995, and 2002)

Country	2002			1995			1990		
	Public	Private	Total	Public	Private	Total	Public	Private	Total
Australia	4.4	1.5	6.0	4.5	1.2	5.7	4.2	0.8	5.0
Austria	5.4	0.3	5.7	5.9	0.3	6.1	N/A	N/A	N/A
Belgium	6.1	0.3	6.4	N/A	N/A	N/A	N/A	N/A	N/A
Canada	N/A	N/A	N/A	6.2	0.8	7.0	N/A	N/A	N/A
Czech Republic	4.2	0.2	4.4	4.7	0.7	5.4	N/A	N/A	N/A
Denmark	6.8	0.3	7.1	6.1	0.2	6.3	N/A	N/A	N/A
Finland	5.9	0.1	6.0	6.2	x	6.3	N/A	N/A	N/A
France	5.7	0.4	6.1	5.9	0.4	6.3	5.1	0.5	5.7
Germany	4.4	0.9	5.3	4.5	0.9	5.4	N/A	N/A	N/A
Greece	3.9	0.2	4.1	3.1	n	3.2	N/A	N/A	N/A
Hungary	5.0	0.6	5.6	4.9	0.6	5.5	N/A	N/A	N/A
Iceland	6.8	0.6	7.4	N/A	N/A	N/A	N/A	N/A	N/A
Ireland	4.1	0.3	4.4	4.7	0.5	5.3	N/A	N/A	N/A
Italy	4.6	0.3	4.9	4.7	N/A	N/A	N/A	N/A	N/A
Japan	3.5	1.2	4.7	3.5	1.1	4.7	N/A	N/A	N/A
Korea	4.2	2.9	7.1	N/A	N/A	N/A	N/A	N/A	N/A
Luxembourg	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Mexico	5.1	1.1	6.3	4.6	1.0	5.6	N/A	N/A	N/A
Netherlands	4.6	0.5	5.1	4.5	0.4	4.9	N/A	N/A	N/A
New Zealand	5.6	1.2	6.8	4.8	N/A	N/A	N/A	N/A	N/A
Norway	6.7	0.3	6.9	6.8	0.4	7.1	8.1	N/A	N/A
Poland	5.5	0.7	6.1	5.7	N/A	N/A	N/A	N/A	N/A
Portugal	5.7	0.1	5.8	5.3	n	5.3	N/A	N/A	N/A
Slovak Republic	4.0	0.2	4.2	4.6	0.1	4.7	4.8	0.3	5.1
Spain	4.3	0.5	4.9	4.5	0.9	5.4	4.4	0.7	5.1
Sweden	6.7	0.2	6.9	6.1	0.1	6.2	5.1	N/A	5.1
Switzerland	5.7	0.5	6.2	5.4	N/A	N/A	N/A	N/A	N/A
Turkey	3.4	0.4	3.8	2.3	N/A	2.3	2.8	N/A	2.8
United Kingdom	5.0	0.9	5.9	4.8	0.7	5.5	4.2	0.1	4.3
United States	5.3	1.9	7.2	5.0	2.2	7.2	4.9	2.2	7.1
Country mean	5.1	0.7	5.8	~	~	~	~	~	~
OECD total	4.9	1.2	6.1	~	~	~	~	~	~

Source: OECD, Education at a Glance 2005, Indicator B2: Expenditure on educational institutions relative to Gross Domestic Product, <http://www.oecd.org/dataoecd/2/11/35286380.xls> (table B2.1a)

**Table 6** Annual expenditures on educational institutions per student (US dollars converted using PPP) by levels of education based on full-time equivalents (2002)

Country	Primary	All secondary	Tertiary-type A	All tertiary
Australia	5169	7375	13410	12416
Austria	7015	8887	12701	12448
Belgium	5665	8272	N/A	12019
Canada	N/A	N/A	N/A	N/A
Czech Republic	2077	3628	6671	6236
Denmark	7727	8003	N/A	15183
Finland	5087	7121	11833	11768
France	5033	8472	9132	9276
Germany	4537	7025	11860	10999
Greece	3803	4058	5646	4731
Hungary	3016	3184	8187	8205
Iceland	7171	7229	8232	8251
Ireland	4180	5725	N/A	9809
Italy	7231	7568	8649	8636
Japan	6117	6952	11984	11716
Korea	3553	5882	7630	6047
Luxembourg	10611	15195	N/A	N/A
Mexico	1467	1768	N/A	6074
Netherlands	5558	6823	13163	13101
New Zealand	4536	5698	N/A	N/A
Norway	7508	10154	N/A	13739
Poland	2585	N/A	N/A	4834
Portugal	4940	6921	N/A	6960
Slovak Republic	1471	2193	4756	4756
Spain	4592	6010	8074	8020
Sweden	7143	7400	N/A	15715
Switzerland	7776	11900	25524	23714
Turkey	N/A	N/A	N/A	N/A
United Kingdom	5150	6505	N/A	11822
United States	8049	9098	N/A	20545
Country Mean	5313	7002	~	10655
OECD Mean	5273	6992	~	13343

Source: OECD, Education at Glance 2005, Indicator B1: Educational expenditure per student, <http://www.oecd.org/dataoecd/2/12/35286348.xls> (table B1.1).

**Table 7** Expenditure per student (public and private) relative to GDP per capita by level of education based on full-time equivalents (2002)

Country	All secondary education	All tertiary education
Australia	27	45
Austria	30	41
Belgium	29	42
Canada	N/A	N/A
Czech Republic	22	38
Denmark	27	51
Finland	26	42
France	31	34
Germany	26	41
Greece	21	25
Hungary	22	57
Iceland	25	29
Ireland	18	30
Italy	29	33
Japan	26	43
Korea	32	33
Luxembourg	29	N/A
Mexico	19	65
Netherlands	23	44
New Zealand	26	N/A
Norway	28	37
Poland	N/A	43
Portugal	37	37
Slovak Republic	17	38
Spain	26	35
Sweden	26	56
Switzerland	37	73
Turkey	N/A	N/A
United Kingdom	23	41
United States	25	57
Country Mean	26	43

Source: OECD, Education at Glance 2005, Indicator B1: Educational expenditure per student, <http://www.oecd.org/dataoecd/2/12/35286348.xls> (table B1.2).

**Table 8** Average combined mathematics literacy scores of 15-year-old students by percentiles (2003)

Country	5th	10th	25th	75th	90th	95th	90th–0th difference
Australia	364	399	460	592	645	676	246
Austria	353	384	439	571	626	658	242
Belgium	334	381	456	611	664	693	284
Canada	386	419	474	593	644	673	225
Czech Republic	358	392	449	584	641	672	249
Denmark	361	396	453	578	632	662	236
Finland	406	438	488	603	652	680	214
France	352	389	449	575	628	656	239
Germany	324	363	432	578	632	662	269
Greece	288	324	382	508	566	598	242
Hungary	335	370	426	556	611	644	241
Iceland	362	396	454	578	629	658	233
Ireland	360	393	445	562	614	641	221
Italy	307	342	400	530	589	623	247
Japan	361	402	467	605	660	690	258
Korea	388	423	479	606	659	690	236
Luxembourg	338	373	430	557	611	641	239
Mexico	247	276	327	444	497	527	221
Netherlands	385	415	471	608	657	684	241
New Zealand	359	394	455	593	650	682	256
Norway	343	376	433	560	614	645	238
Poland	343	376	428	553	607	640	231
Portugal	321	352	406	526	580	610	228
Slovak Republic	342	379	436	565	619	648	241
Spain	335	369	426	546	597	626	229
Sweden	353	387	446	576	631	662	243
Switzerland	359	396	461	595	652	684	256
Turkey	270	300	351	485	560	614	260
United States	323	357	418	550	607	638	251
OECD Average	332	369	432	570	628	660	259

*Source:* U.S. Department of Education, Institute for Education Sciences, National Center for Education Statistics, "International Comparisons of Mathematics Literacy," <http://nces.ed.gov/programs/coe/2006/section2/table.asp?tableID=464>.

**Table 9** Estimated coefficients from Mincer log-earnings regressions for males

		Whites		Blacks	
		Coefficient	Std. Error	Coefficient	Std. Error
1940	Intercept	4.4771	0.0096	4.6711	0.0298
	Education	0.1250	0.0007	0.0871	0.0022
	Experience	0.0904	0.0005	0.0646	0.0018
	Experience-Squared	-0.0013	0.0000	-0.0009	0.0000
1950	Intercept	5.3120	0.0132	5.0716	0.0409
	Education	0.1058	0.0009	0.0998	0.0030
	Experience	0.1074	0.0006	0.0933	0.0023
	Experience-Squared	-0.0017	0.0000	-0.0014	0.0000
1960	Intercept	5.6478	0.0066	5.4107	0.0220
	Education	0.1152	0.0005	0.1034	0.0016
	Experience	0.1156	0.0003	0.1035	0.0011
	Experience-Squared	-0.0018	0.0000	-0.0016	0.0000
1970	Intercept	5.9113	0.0045	5.8938	0.0155
	Education	0.1179	0.0003	0.1100	0.0012
	Experience	0.1323	0.0002	0.1074	0.0007
	Experience-Squared	-0.0022	0.0000	-0.0016	0.0000
1980	Intercept	6.8913	0.0030	6.4448	0.0120
	Education	0.1023	0.0002	0.1176	0.0009
	Experience	0.1255	0.0001	0.1075	0.0005
	Experience-Squared	-0.0022	0.0000	-0.0016	0.0000
1990	Intercept	6.8912	0.0034	6.3474	0.0144
	Education	0.1292	0.0002	0.1524	0.0011
	Experience	0.1301	0.0001	0.1109	0.0006
	Experience-Squared	-0.0023	0.0000	-0.0017	0.0000

Source: Heckman, Lochner, and Todd 2003.



**Table 10** Correlating Predicted Growth Rates in Per Capita GDP and Average School Years of the Adult Population (based on Ehrlich and Kim 2007)

	Intercept (·)	Slope(·)	t-value (·)	Adjusted R <sup>2</sup>
Variant 1 *	0.00567	1.67458	21.23	0.3036
Variant 2 **	**	1.25854	11.40	0.3682

Number of observations = 1,032.

\*OLS regression estimates of equation (3)

\*\*OLS fixed-effects regression estimates of equation (3) allowing for country-specific intercepts, not reported in this table.

*Econometric procedure:* see text and footnote 6.

**Table 11** Relative percentage differences in educational attainments (U.S. = 100) by level and age group (1998 and 2003)**Attaining at least tertiary education Type-A:**

Country	1998				2003					
	25-64	25-34	35-44	45-54	55-64	25-64	25-34	35-44	45-54	55-64
US	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
France	40.7	55.6	38.5	34.5	27.3	48.3	73.3	44.8	36.7	37.0
Germany	51.9	51.9	61.5	51.7	45.5	48.3	46.7	51.7	50.0	44.4
Italy	33.3	33.3	42.3	31.0	22.7	34.5	40.0	37.9	33.3	25.9
Spain	51.9	77.8	61.5	37.9	27.3	62.1	86.7	65.5	46.7	33.3
United Kingdom	55.6	63.0	65.4	51.7	50.0	65.5	80.0	65.5	60.0	51.9
E4*	44.4	54.6	51.0	38.8	30.7	48.3	61.7	50.0	41.7	35.2
E5**	46.7	56.3	53.8	41.4	34.5	51.7	65.3	53.1	45.3	38.5
E11***	52.2	57.9	59.4	47.0	43.8	56.4	68.8	58.3	50.0	45.8

**Attaining at least upper secondary education:**

Country	1998				2003					
	25-64	25-34	35-44	45-54	55-64	25-64	25-34	35-44	45-54	55-64
United States	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
France	70.9	85.2	71.6	64.4	51.3	73.9	92.0	78.4	66.3	56.5
Germany	97.7	100.0	98.9	96.6	95.0	94.3	97.7	97.7	94.4	91.8
Italy	47.7	62.5	56.8	40.2	23.8	50.0	69.0	56.8	43.8	28.2
Spain	38.4	60.2	43.2	26.4	15.0	48.9	69.0	54.5	37.1	22.4
United Kingdom	69.8	71.6	70.5	66.7	66.3	73.9	81.6	73.9	71.9	67.1
E4*	63.7	77.0	67.6	56.9	46.3	66.8	81.9	71.9	60.4	49.7
E5**	64.9	75.9	68.2	58.9	50.3	68.2	81.8	72.3	62.7	53.2
E12****	80.0	89.9	83.1	74.9	65.9	81.4	93.1	86.3	77.2	69.3

\* E4: Simple average of the normalized data for France, Germany, Italy, and Spain

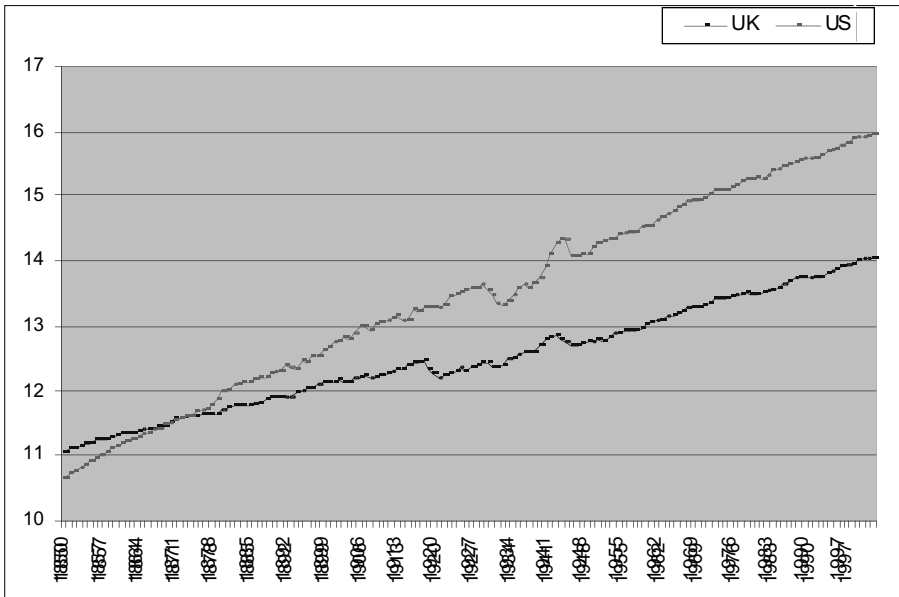
\*\* E5: Simple average of the normalized data for France, Germany, Italy, Spain and United Kingdom

\*\*\* E11: Simple average of the normalized data for Austria, Belgium, Finland, France, Germany, Italy, Netherland, Norway, Sweden, Switzerland, and the United Kingdom

\*\*\*\* E12: Simple average of the normalized data for E11 countries and Denmark

## Appendix B: Figures

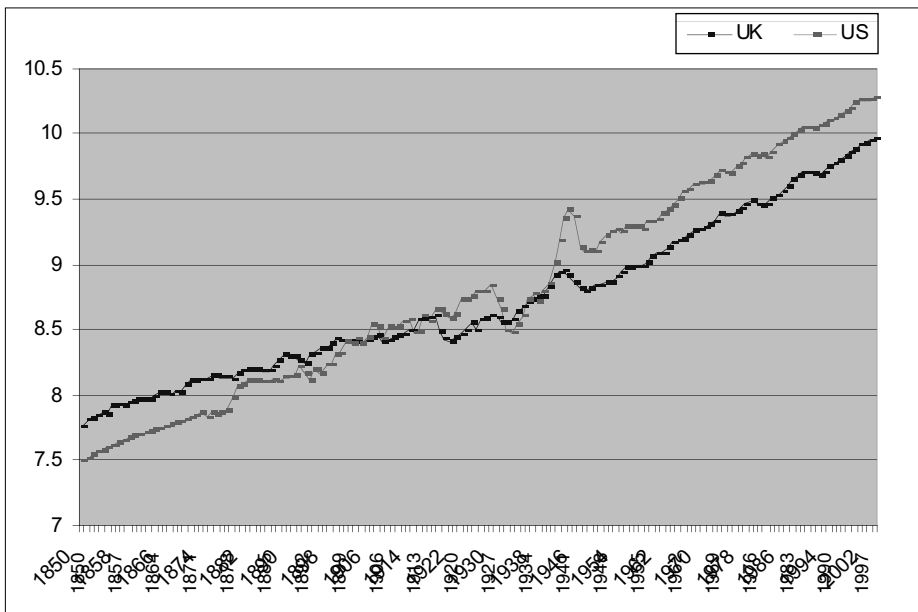
**Figure 1** Comparison of U.S. and U.K. Real GDP in Log Terms (1850–2003)



*Note:* GDP data are converted to 1990 U.S. dollars using the Geary-Khamis Purchasing-Power-Parity (PPP) method. Data for 1851–1859 and 1861–1869 are imputed.

*Source:* Data from Maddison 2003.

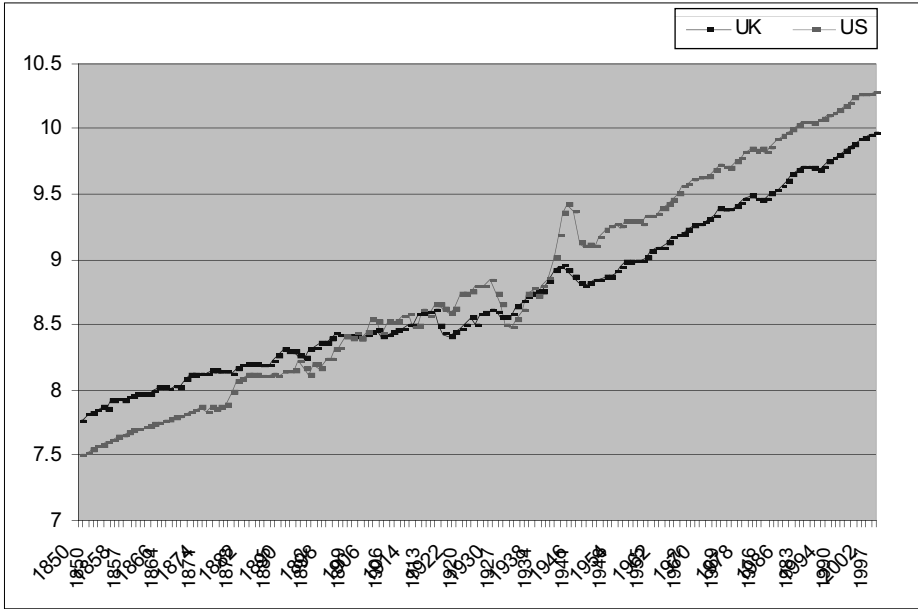
**Figure 2** Comparison of U.S. and U.K. Real GDP per capita in log terms (1850–2003)



*Note:* Per-capita GDP data are converted to 1990 U.S. dollars using the Geary-Khamis Purchasing-Power-Parity (PPP) method. Data for 1851–1859 and 1861–1869 are imputed

*Source:* Data from Maddison 2003.

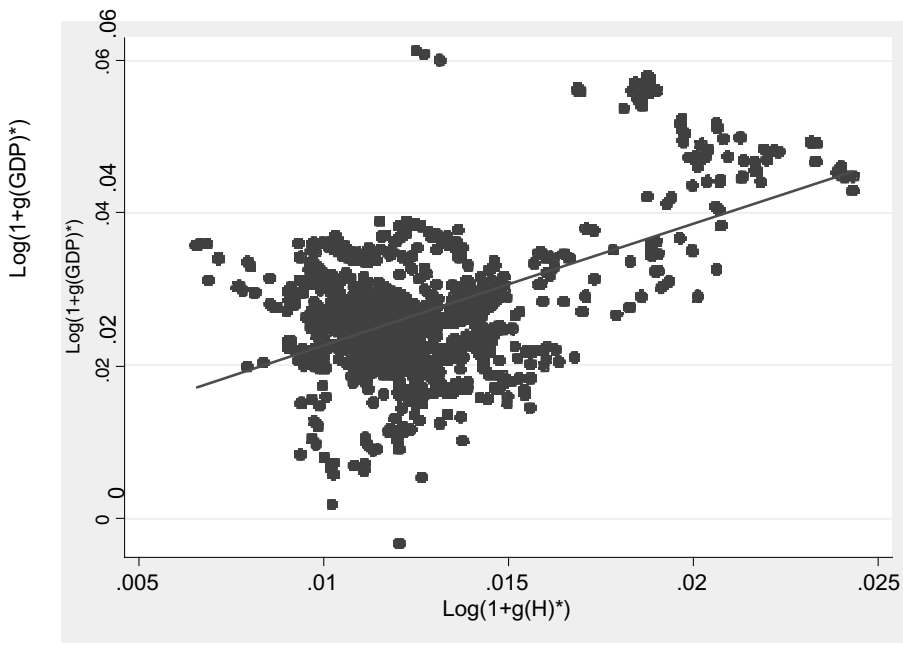
**Figure 2** Comparison of U.S. and U.K. Real GDP per capita in log terms (1850–2003)



Note: Per-capita GDP data are converted to 1990 U.S. dollars using the Geary-Khamis Purchasing-Power-Parity (PPP) method. Data for 1851–1859 and 1861–1869 are impute

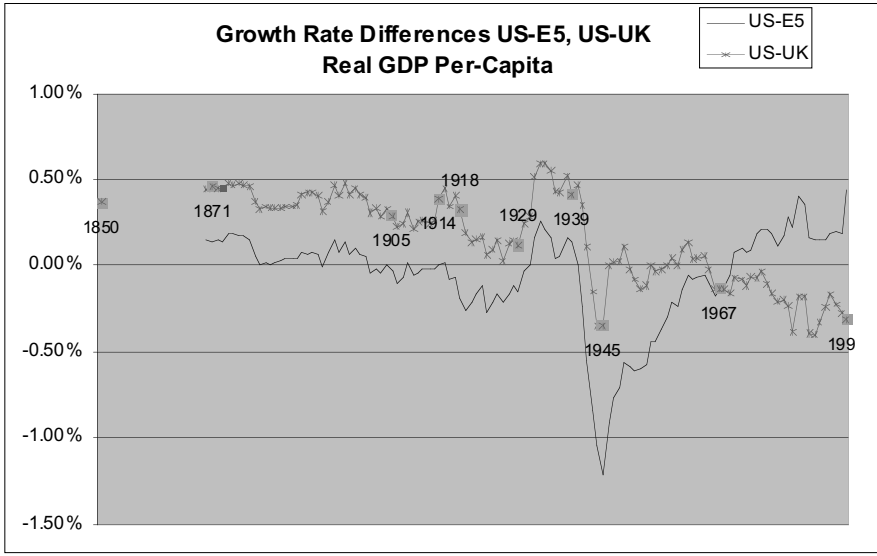
Source: Data from Maddison 2003.

**Figure 3** Correlating predicted growth rates in per-capita GDP and average school years of the adult population (based on Ehrlich and Kim 2007)



*Note:* The regression line in this scatter is based on Variant 1 of Equation 3.

**Figure 4** Deviations in long-term per-capita GDP growth rates per annum over the period 1850–2003 between the U.S. and E-5, and U.S. and U.K.

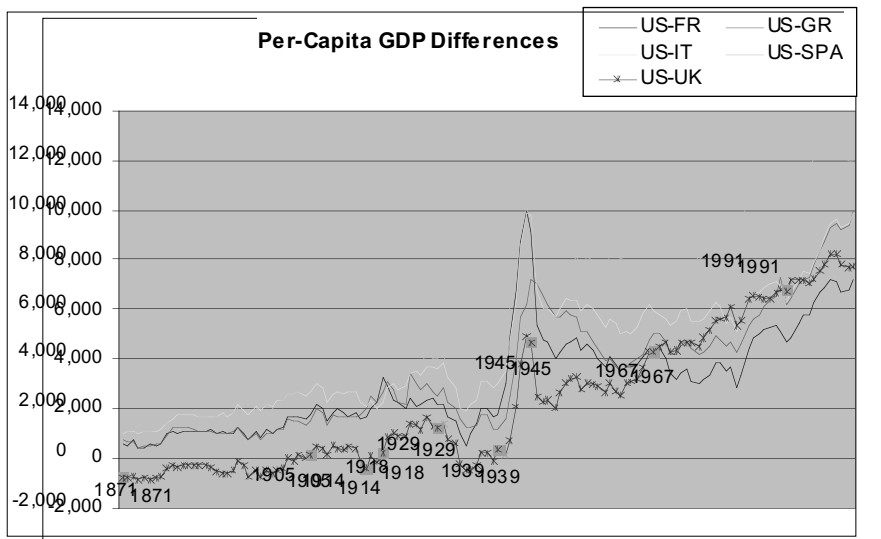


*Note:* Chart shows Percentage differences measured at progressively later starting dates from 1850-2003 up to 1991-2003. GDP data are in real (PPP) 1990 Geary-Khamis dollars.

\* E5 includes: France, Germany, Italy, Spain, and United Kingdom

*Source:* Data from Maddison 2003.

**Figure 5** Annual per-capita GDP differences between the U.S. and major European countries 1871–2003 (1990 Geary Khamis \$)



Source: Data from Maddison 2003.



# Allocation and Misallocation of Human Capital: Some Lessons from Japan and Russia

8

*Serguey Braguinsky*

## Human Capital as the Engine of Growth

In October 1945, Masaru Ibuka and a couple of his friends rented a utility room in the war-devastated Tokyo that did not even have glass in its window and started up a radio repair shop. On May 7, 1946, a new company called “Tokyo Tsushin Kogyo” was officially registered, with shareholders’ capital of 190,000 yen. The new firm had no capital equipment and whatever tools its employees used they had themselves made by hand. It was constantly running out of money to cover operating expenses.

Fifty years after, in 1996, the shareholders’ capital of the company stood at 1,459,332,000,000 yen, or about \$15 billion, with a comparable figure representing the market value of its plants, capital equipment, and other capital assets. Its total market capitalization approached \$30 billion; the company employed 151,000 people and had 998 subsidiaries worldwide, including in the United States. Long before that in 1957, the company officially changed its name to Sony.

This episode is just one illustration of a well-established empirical fact that the twentieth century was the century of human capital (e.g., Goldin 2001). Theoretical literature on “endogenous growth” (see Ehrlich 1990, for a review of this literature) convincingly demonstrates that human capital is indeed the most important “engine of growth.”

But what exactly do we mean by “human capital” in the context of growth and development? Education is the most commonly used proxy, although even in this case, it is not immediately clear what level and what type of education is most important. For example, according to Professor

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I am grateful to Isaac Ehrlich, Salavat Gabdrakhmanov and two anonymous referees for useful comments. All remaining errors are mine. —S. B.

Ehrlich (in this volume), one of the major reasons why the United States became an economic superpower was its superior higher (tertiary) education that produced more human capital of the highest quality and of general applicability than did the Old World educational system. Several African countries have failed to improve their economic performance despite large-scale investment in educational projects, most of which were in the primary education area (Easterly 2001).

An even more general definition of human capital as related to economic growth also has to include reputation, trust, and productive “relational capital” (Boot et al. 1993, Fudenberg and Kreps 1987, Greif 1993, Bezemer et al. 2003). But, again, reputation, trust, and especially relational capital are not always conducive to capitalistic development. As pointed out by Tanzi (1995), corruption can in fact be also defined as a form of “relational capital” (absence of an “arm’s length relationship”), and most empirical studies find a negative relationship between corruption and growth (e.g., Mauro 1995). Murphy, Shleifer, and Vishny (1991) and Ehrlich and Lui (1999) show that when relational capital takes the form of unproductive political capital or rent-seeking connections, allocation of talent is adversely affected and economic growth definitely suffers. Since both productive human capital and destructive rent-seeking capital are produced by investing in nontangible human assets (although of a different nature), we can interpret these models as pointing to the need to distinguish human capital that is the engine of growth from human capital that is actually “bad” for economic development.

We are thus led to the conclusion that a closer look is required into how different types of human capital affect the process of development and, most importantly, how different incentive mechanisms affect the creation and allocation of these different types of human capital. Without aiming at full generality, in this paper I will discuss how some types of reputational and relational capital can help allocate human capital to its most productive usage, thereby jumpstarting economic development, while other types of such capital result in misallocation of human capital and actually derail growth. This theoretical discussion will be illustrated by examples taken from Japan (a case in which the allocation of human capital has generally benefited economic progress) and Russia (a case in which human capital has been and largely still is misallocated).

## **Allocating Real Resources to Human Capital: The Case of Japan**

Professor de Soto (in this volume; see also de Soto 2000) stresses that formal property rights to physical assets, especially real estate and housing that

can be pledged as collateral for borrowing, are important, if capitalism is to work. The idea is that in order to make possible a capitalistic enterprise, individuals must have access to productive resources, and the only way they can gain such access is by borrowing from capital markets. This basic idea is indeed extremely important. While human capital is the “engine of growth,” access to real resources needed to implement “innovations” is the fuel without which an engine cannot run. Ever since Schumpeter published his “Theory of Economic Development” back in 1912 (see Schumpeter 1934), this link between capital markets and growth had been the focus of attention in development literature, with the general conclusion (already postulated by Schumpeter) that better developed financial markets can foster economic progress (see also Goldsmith 1969 and Shaw 1973). More recently, this literature has been further developed in a string of papers emphasizing the importance of the legal system in protecting outside investors and maintaining corporate governance (see, for example, La Porta et al. 1998).

There is thus little doubt that well-developed capital markets and a properly functioning legal system that offer reliable protection to outside investors can play a very important role in economic development by enabling resources to be allocated to innovators possessing large amounts of human capital, or, more generally, to the most efficient users of such resources. This statement, however, does little to shed light on how such a system can be generated in the first place. As the discussion of a Russian example below will show, a legal system registering and protecting property rights will not be enforceable unless economic incentives work in the right direction to begin with and there is already some degree of reputational and relational capital of the right kind accumulated in the economy. Indeed, as pointed out by Arrow (1974), even “a criminal law cannot be enforced if it is sufficiently disobeyed. . . . Ultimately . . . authority is viable to the extent that it is the focus of convergent expectations. An individual obeys authority because he expects that others will obey it” (7, 72). A legal system, indeed any kind of a social contract, is no more and no less than “an implicit self-policing agreement between members of society to coordinate on a particular equilibrium in the game of life” (Binmore 1994, 35).

The same is true of capital markets: their growth and development presupposes the existence of conditions that make it possible for capitalistic development to start in the first place. Financial market development, improvements in the legal system, and economic development usually go hand in hand; equally it can be argued that the development of capitalism is the precondition for those institutions to arise rather than the other way round.

As the example of Japan’s transition to capitalism shows, the prior existence of a legal system and capital markets indeed does not appear always

to be necessary for initiating capitalistic growth, provided that the right kind of human capital is available. Some express skepticism about the view that human capital can be enough to jumpstart capitalistic growth, because borrowing against the collateral of such capital is supposedly impossible. Indeed, barring slavery, property rights to human beings are inalienable from them and cannot be pledged as collateral. The argument becomes much less convincing, however, if the definition of human capital is expanded to include reputational and relational capital.

Let us look more closely at the example of Sony. At the start the company founders had absolutely no tangible assets to offer as collateral. In order to gain access to real resources, Ibuka and other engineers who ran the firm made use of their access to reputational and relational capital. It initially came in the form of Ibuka's relationship with his father-in-law, Maeda, who was a prominent intellectual and minister of education in the first postwar Japanese government. Maeda agreed to assume the post of president of the company for the initial few years to back his son-in-law's startup firm with his reputation and his contacts. This turned out to be crucial for Sony's business success, as it was Maeda and the other reputable members of the board of directors that he enlisted who introduced the company's management to several wealthy families with assets to invest. Those families subscribed to new issues of Sony's shares, which around 1950 enabled the firm to embark on its first truly big project, the production of the first Japanese-made tape recorder. Some members of those wealthy families also became very closely involved in the day-to-day operations of the firm, helping it to find more clients to buy tape recorders.

It should be specially noted that at no stage was a formal registration system or provision of tangible collateral involved. Sony's financing came from what in modern terminology is called "relationship banking," a system in which a company secures investors' money to finance innovative ideas with a commitment from a reputable individual who maintains hands-on status with respect to the management and at the same time serves as a mediator between management and investors.

The founding of Sony is an example that is quite characteristic of the success story of Japanese capitalism in general. While the post-Second World War "Japanese miracle" is relatively well known (although also subject to many misconceptions, including gross overstatements of the role played by the government), the first Japanese miracle of the late nineteenth century is studied much less frequently, even though it shares some important features with the postwar example of Sony. Mitchell (1995) argues that the same kind of relational capital manifested in extended families and business networks played a very big role in the development of capitalism in Hong Kong.

Japan was the first Asian country to industrialize on its own, and the first modern industry to emerge in Japan in the late 1880s was cotton spinning. The remarkable establishment of this industry was the first step in “the Japanese miracle”: “the astonishing ascendance of Osaka over Lancashire stands as the first completely successful instance of Asian assimilation of modern Western manufacturing techniques” (Saxonhouse 1974, 150). For example, Japanese firms introduced new ring spinning frame technology faster than any country in the world: in 1910, 98.5 percent of Japanese spinning frames were rings as compared to 82.4 percent in the United States, 51.6 percent in Russia, and only 16.6 percent in the U.K. In the mid-1880s Japan still imported over 80 percent of its domestic consumption of cotton yarns. Then, between 1888 and 1900, domestic production of cotton yarn increased more than twenty times over. Exports began in 1890, and the value of exports exceeded that of imports in 1897. By the early 1930s the three largest cotton-spinning firms in the world were all Japanese.

Contrary to a perception still pervading much of the literature, early Japanese capitalism possessed neither a good institutional system nor a strong benevolent government to make this remarkable success happen. In particular, its driving force was private entrepreneurial initiative, not government intervention (which remained limited until the 1930s). Early modern Japanese manufacturing firms did not borrow money from financial intermediaries using real estate or some other tangible assets as collateral either. Instead, they relied on the same kind of reputational and relational capital as Sony did more than half a century later, successfully selling equity to finance investment in capital equipment.

It is interesting to note that some of the earliest and most successful corporations in early Japanese industrialization had been set up even before the country passed its first law governing the formation of joint-stock companies. Despite the absence of guarantees provided by the law, wealthy people with a good reputation in the business community did not hesitate to purchase company shares when they knew and personally monitored the company’s management and the engineering personnel. In the absence of a proper legal system, local authorities had an unlimited free hand in imposing various restrictions and rules of their own, thereby causing a lot of delays and obstacles in starting up new businesses (Kinugawa 1990). But in sharp contrast to what happened and still happens in Russia and other developing countries (cases documented by de Soto are particularly telling in this respect), reputational and political capital of the owners helped early Japanese corporations to overcome bureaucratic red tape relatively easily. To put it simply, local bureaucrats were no match for the powerful business elite whenever such an elite appeared to have put its reputation and relationships to work for the success of the productive

enterprises they owned rather than resort to rent seeking. The “hands-on” style of management by reputable owners (which also meant that corrupt bureaucrats and criminals had to keep their hands off) then encouraged small investors to also purchase shares, creating the basis for business expansion. For example, the first successful modern enterprise in nineteenth-century Japan, the Osaka Cotton Spinning Company, paid out over 20 percent in annual dividends to its shareholders, regardless of the number of shares, thereby greatly contributing to the creation of a healthy stock market. It also seems that whenever their own wealth was not enough, people with good reputation in the business community used their reputations and monitoring ability as a form of collateral for bank borrowing, receiving personal loans that they used to buy more shares.

One important aspect of employing reputational and relational capital as collateral for bringing in the resources needed to implement an innovation is their relation to the distribution of wealth and the ability to be personally involved and familiar with the business concerned. This link was first noted by Demsetz (1988, chap. 14) but it still remains largely unexplored in the literature.

The essence of Demsetz’s argument is that when large-scale business concerns are efficient, a certain but not excessive degree of wealth inequality is required to ensure effective control. Completely equal distribution of wealth inevitably means that ownership of a large firm is dispersed among many small investors, impairing efficient control over the firm’s management. Too high a concentration of wealth, however, also produces problems of its own. With only a few people owning the bulk of the economy’s wealth, a single owner has to spread his limited resources across too many firms, again leading to a loss of efficiency. Hence, some, but not too much, wealth inequality is required for the economy to have just the right number of owners owning substantial stakes in individual firms, but not in too many, and controlling their management effectively.

Although Demsetz makes his argument in the framework of the principal-agent problem, his reasoning can be readily extended to the mechanism of allocating resources to innovative entrepreneurial activity. If reputational and relational capital serve as collateral for borrowing that matches real resources with productive human capital, then lenders, almost by definition, have to be directly involved with the entrepreneurs they are lending to and must be able to monitor how resources are being used. Hence, the number of lenders and the number of potential innovators should be roughly of the same order of magnitude. With no deep pockets, the task of allocating resources to innovators becomes formidable, at least without well-functioning capital markets. This is something that cannot be expected in an economy just about to start moving toward capitalism. But

with only a few “oligarchs” who have each amassed a huge amount of wealth, most potential innovations would go unrealized, as there are clear limits to the scope of relational capital that any individual lender can establish between himself and his borrowers.

To sum up, our conjecture about the success of capitalism in Japan is that in the second half of the nineteenth century (and perhaps once again after World War II) the country had just the right amount of reasonably wealthy people with good reputation. Their wealth, and most importantly, the quality of their reputation (human capital) not only made the start of economic growth possible but also provided the crucial initial impetus for the creation of a modern legal system and capital markets.

The presence of this factor itself can perhaps be traced back to the legacy of the Tokugawa era (the feudal regime that had governed the country since the early seventeenth century). Tokugawa Japan was neither a fully national state nor a completely decentralized feudalism but rather a combination of both (Passin 1965, 15). There was enough centralism to maintain law and order and to guarantee peace (coming after almost a century of fierce feudal warfare that had devastated the country). At the same time, provinces were largely autonomous and local nobility competed for wealth, tangible as well as human. One consequence of this competition was the creation of a broad educational system that later helped Japan to secure enough human assets to be transformed into human capital during industrialization and the post-Second World War reconstruction. Another consequence was that although Japan was largely premodern in the 1870s, the previous system had generated a sufficiently large supply of chunks of material wealth and also reputational and monitoring capacity manifested in local noble families. The fact that those families were rich but not overly rich and had to compete by finding productive ways of employing their wealth, rather than by being engaged in rent seeking and redistribution, played an important role in the success of capitalistic development. Although, as already mentioned, Japan did not have a functioning modern legal system when it first started its transition to capitalism, an informal trust and monitoring system proved to be a good enough substitute for such a system, which later developed endogenously as part of the overall development of Japanese capitalism.

Overall, the Japanese example convincingly demonstrates not only that human capital is the engine of sustainable endogenous growth but also that when complemented by the appropriate type of social capital (trust and reputation), it can be a sufficient condition to trigger the growth process. As the example of the former Soviet Union and Russia shows, however, human capital may very easily be completely misallocated if the existing system of trust and relational capital is of the wrong kind.

## **Human Capital Caught in a Rent-Seeking Environment: The Case of the Former Soviet Union and Russia**

The example of the Soviet Union shows that even high-level human assets may contribute virtually nothing to economic growth and welfare if the environment enabling them to be matched to real resources and proper incentives are lacking.

The Russian empire's record on education was not particularly impressive. Although the education of a very small elite was perhaps not inferior to any other European nation, the rate of illiteracy among the ordinary population was extremely high, and tertiary education was also very limited. But the Soviet authorities took mass education seriously, so that after the collapse of communism, Russia inherited a quite respectable level of human capital (assets) from the former Soviet Union. In 1994 the fraction of population in the age group of 25–64 with at least a college degree stood at 17.2 percent, more than 3 percentage points higher than the average for 28 OECD countries cited in Ehrlich's chapter in this volume. Comparing this figure with the data in Ehrlich's table T.2, we can actually see that Russia ranked behind only the United States, the Netherlands, Norway, Canada, and Japan. And if some have lingering suspicions that only a small elite enjoyed excellent education while the rest of the population was deprived of it (as it was the case under the Czars), it is enough to point out that the literacy rate in Russia is higher than in the United States and that the fraction of the population in the 25–34 age group that had attained at least upper secondary education was 93.5 percent, the highest among all countries, when compared to table T.3 in Ehrlich's chapter.

Despite this presence of human capital, capitalism in Russia after the start of the transition to a market economy has not produced any serious economic development. On the contrary, ever since the country opened up its borders, Russia has been losing its human capital to emigration at the rate of hundreds of thousands of people per year, as reported by the Russian press. Moscow State University, the flagship of Soviet and Russian higher education is reported to have lost over 20 percent of its best scholars. And those who stay behind often take up occupations that are at best remotely related to the optimum employment of their human assets. For example, trained engineers might be selling homegrown potatoes in a farmer's market. Clearly, something prevents the occurrence of the same kind of growth based on human capital and the use of reputational and relational aspects of it as a collateral as happened in Japan.

For the answer, we probably have to look into the history of totalitarian communist regimes, in which a system of hierarchical promotion produced a derived demand for reputational and relational capital that was oriented toward building political connections and rent seeking rather than



seeking productive employment. Not only had this ruled out any kind of independent innovative entrepreneurship, it also created a lock-in that remains in place long after the previous regime collapsed.

Under the Soviet system, the share of one's claims to the ownership of assets was determined by one's place in the hierarchy. Economic incentives could not be ignored completely, however. After brief experimentation with "wartime communism," in 1921 Lenin declared the "New Economic Policy," which although later reversed with regards to the private sector in industrial production, trade, and agriculture, remained in place in the sector of individual consumption right until the end of the Soviet Union. Limited as its use was, economic motivation complemented the system of incentives provided by the hierarchical structure of the society and caused the evolution of the centrally planned economy that eventually led to its collapse and to the start of the transition to a market economy (see Braguinsky and Yavlinsky 2000 for a more detailed discussion).

The basic limitation on the role played by money in the system of economic incentives in the former Soviet Union lay in the fact that money by itself gave its owner almost no additional claims to real assets, and could even be a source of trouble if not supported by appropriate hierarchical connections. Those trying to increase their ownership claims on collective assets could thus serve their goal either by aiming at promotion in the hierarchical system or by establishing a relationship with someone already high enough in that system. Since money was necessary to increase private consumption, a natural symbiosis developed between communist party mandarins and those economic agents who managed to accumulate large money funds. "Connections" (*svyazi*), the Russian term for relational capital, was the single most important form of asset that economic agents needed both for personal consumption and for a career in the hierarchy, and this relational capital was often lubricated by outright bribery as well as by other forms of money transfer. Economic incentives in the form of the increasing role played by wealth expressed in money penetrated the socialist system and corrupted it from the within; once this process had reached a certain scale, the system itself was doomed.

As a result, at the end of its history, the former Soviet Union faced a situation that was not much different from Japan's at the start of its transition to capitalism (Miwa and Ramseyer 2000). Although asset ownership under the communist system was highly centralized, as the planned economy disintegrated, the de facto control over those assets largely was transferred to appointed managers, forming local elite groups. After the communist system was gone, these wealthy local groups could in principle have entrusted the assets they owned to the high-level human capital of Soviet engineers and the generally well-educated labor force and relied on these factors for the productive use of assets. But this did not happen.

Instead, the reputational and relational capital that enabled control to be exercised over assets turned out to be the biggest obstacle to capitalistic development.

Part of the problem may be due to the fact that Russia is a country rich in natural resources, the exploitation of which naturally gives rise to competition based not on productive innovation but on political capital and rent seeking. The exporting of mineral resources, control of the country's power plants, and the flow of money from the government budget indeed appear to be the most important sources of the reproduction of wealth for new Russian capitalists (Braguinsky and Yavlinsky, 2000). For example, as of the late 1990s, the only two firms that had an annual volume of sales over 10 billion US dollars, comparable to large transnational corporations in market economies, were monopoly holding companies in electric energy production (UES Russia) (22.8 billion dollars' worth of annual sales) and extraction of natural gas (Gazprom) (22.5 billion dollars' worth of annual sales). Twenty-three companies had an annual volume of sales worth 1–10 billion US dollars; twelve of those were represented by holding companies in the oil industry, another seven were the largest steel factories.<sup>1</sup>

Thus, instead of becoming centers for promoting new businesses and new industries, as happened in Japan, most of the largest financial-industrial groups in Russia have been formed on the basis of windfall wealth, and most firms belonging to these groups had been acquired by the owners during privatization with a view to using their connections to make the best out of any chance of grabbing formerly state-owned property for free. Political connections and influence with the government (federal and local) have played and continue to play the most important role, while the questions of strategic management have stayed (and continue to stay) in the background. The biggest tycoons, or "oligarchs," whose positions in the ruling class continue to depend crucially on the personal "working relations" they had developed with influential leaders of the federal and regional governments, hastened "not to miss the leaving train" without thinking too much about where the train was headed. As Boris Berezovsky, one of the most notorious Russian oligarchs, put it back in 1996, "the best business in Russia is in politics." It was impossible to organize an efficient system of monitoring and control under such conditions, and most of the oligarchs have shown little interest in organizing such a system because their fabulous new wealth was larger than they could effectively control anyway, and because they were too busy fighting each other for the pro-

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1. Since this paper was completed, Russian economy has experienced some moderate growth due mainly to very favorable trend in world prices of oil, gas and other primary resources. This has only made the dominance of companies in the resource-extracting/metallurgy sector even more pronounced.

tection of their existing turf and taking chunks out of others' turf whenever they sensed a chance.

With major oligarchs and members of the government competing with each other for political control of the economy and acting more like predators than like prudent investors with respect to the businesses they came to own, individual firms and local groups of firms have found that the only way to protect their ownership claims is to rely on a system of political protection. But promises to exchange protection for political support are likely to be credible only among individuals who have good reputations for honoring such agreements. The resulting equilibrium of the social game is one in which political support is valid only for a limited elite, cemented by the system of insider trust and shutting out all outsiders. Productive capital can be owned only by the members of such an elite oligarchy with political connections.

Given this system of oligarchic property rights, the task of getting oligarchic groups and the government catering to them to actively enforce outsiders' claims against their own members becomes a formidable issue (Braguinsky and Myerson 2007a). The essential feature of the oligarchies is that they protect their members' assets but not the assets of outsiders. Of course, any individual oligarch would benefit if he could credibly commit himself to honor debt obligations to outside investors. But once the loans or outside investments have been received, the oligarch's incentives will be reversed, and he will prefer to use his political power to protect himself against his outside creditors. Any other member of the local oligarchy who then supported these outside creditors could be accused of violating the internal protection norms of the oligarchy and would be expelled from it. These oligarchic norms would also naturally support the use of their economic power against outside creditors. For example, consider what might happen if one oligarch were asked by another to help in defrauding outside creditors, say by participating in illicit, unreported transactions that hide assets and conceal profits. Given the critical importance of keeping good relationships with others in the local oligarchy, it could be much safer to grant such illicit assistance than to deny it, as the internal law of the oligarchy may have effective priority over any formal statutory laws. As a result, a special culture is established in which business executives who honestly report their transactions are ostracized and keeping transactions secret is the norm. Vested interests of corrupt officials covering such illicit transactions complete the vicious circle.

A similar logic applies not only to borrowing and lending but also to buying and selling assets. Tons of reports in the Russian press tell stories of investors spending large amounts of money thinking that they were purchasing valuable assets, only to find out that they had been cheated and received no ownership rights for their money (Braguinsky and Myerson,

2007b). Thus, neither collateralizing nor selling relational connections based on insider trust appears to be possible, and economic agents outside of oligarchies remain completely deprived of ownership and investment opportunities regardless of the level of human capital they possess. Clearly, privatization of formerly state-owned assets and the establishment of a formal legal system designed to create a registry of private property rights would not work in such an environment, given this limitation of the social capital governing the actual relations of ownership. Nontransferability of the relational capital that protects the oligarchs' wealth and ownership rights continues to prevent investment and the onset of capitalistic growth.

Once such an environment becomes firmly entrenched, attempts at policy reform to protect the property rights and asset claims of outsiders could be viewed as a threat to the whole system of oligarchic privileges and are likely to meet with strong opposition and remain only on paper. A political equilibrium in which nobody holds valuable investments outside the sphere of control of his oligarchic group is a sustained problem preventing economic development in Russia and many other undeveloped countries. Clearly, neither human nor physical assets can be used as collateral for productive employment of capital, and resolving the problem requires moving to a totally different equilibrium of the social game.

### **Some Questions for Future Research**

In this chapter I discussed two episodes from recent history where reputational and relational capital that was largely accumulated under a premodern socioeconomic system played diametrically opposite roles in the subsequent development of capitalism. In one case, that of Japan, it was deployed as collateral that enabled real resources to be matched with the appropriate human capital and to jumpstart capitalistic growth. This growth then led to further institutional improvements, such as the development of an effective legal system and capital markets. In the other case, that of the former Soviet Union, the relational capital was used to grab existing assets for free, leading to continuous political fighting over the control of those assets, an economic decline, and the effective blocking of institutional reforms. Human capital accumulated in the former Soviet Union remains largely alienated from the real resources that it needs to put the economy on the trajectory for growth.

There were similarities between the situation faced by Japan in the late nineteenth century and the situation faced by the former Soviet Union and other countries in transition to a market economy in the late twentieth century. Nevertheless, the paths of development appear to be very

different. There is no doubt that historical lock-in and differences in natural wealth played an important role in this divergence. However, a closer look at economic incentives governing the process of building relations and reputations, as well as the ways in which this type of human capital was subsequently employed, can shed additional light on the complex question of why capitalism triumphed in one case and failed in the other. More research is needed in order to answer this question in general terms.

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# On the Essential Nature of Human Capital

## 9

*Gloria Zúñiga y Postigo*

Throughout the history of economic thought, the term *capital* has been the subject of misunderstandings. In 1871, Carl Menger advanced a definition in an attempt to correct previous misconceptions. Menger explained that capital is constituted by those economic goods that are available in the present and whose services together are capable of being applied to the production of new economic goods in the future.<sup>1</sup> It is not surprising that confusions emerged in the formative stages of economic science or that they continued even into the classical economic period, but it is troubling that the meaning of the term *capital* should still be misunderstood today.<sup>2</sup> The culprits today, however, are not the economists. Today's misunderstandings are mostly on the part of nonexperts, or laypersons. But this does not lessen the concern, since all ordinary citizens of a nation participate to a greater or lesser extent in the acquisition and productive use of capital.

In contrast, consider the concept of *human capital*, a concept famously introduced by Nobel laureate Gary Becker in the 1970s that has since been the subject of many investigations. Economists, however, have no clear definition of this term. Despite the lack of a clear definition, economists claim that human capital is a significant factor in a nation's growth. What they really mean is this: *education* is a significant factor in a nation's growth. Arguably, this claim is motivated by an intuition that seems to be

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1. This received definition of capital *simpliciter* was advanced by Carl Menger—the founder of the Austrian School of economics—in an appendix to his 1871 *Principles of Economics*.

2. Menger addressed some of the mischaracterizations of the meaning of the term *capital* by his predecessors in appendix E of his *Principles* (1871). Here we find that even the illustrious economist J. B. Say encountered difficulties with the meaning of the term *capital*.

corroborated by practical wisdom. The intuition is that the more one invests in education, the greater the opportunities for employment. It is important to note that this understanding of human capital seems to presuppose that the ends of human capital are similar to the ends of capital simpliciter: new production. Hence, investigations into the phenomenon of human capital have been dedicated mostly to the role of education in human capital formation and human capital formation has been typically measured in a nation's economic growth.<sup>3</sup> Although economists recognize that education is only one constituent of human capital, the reason for this narrow focus is that education lends itself to measurement and, thereby, to empirical and econometric analysis.

We have no reason to doubt that important findings may be on the horizon with this approach of the reducing human capital to education for practical purposes. Yet it is quite troublesome to find empirical investigations about human capital that lack a theory of human capital. Without a formal framework, what is to police excesses with empirical data? Lacking at least a working hypothesis of what human capital is, how could mistakes be identified? Moreover we must ask, what is the relation of education to the other constituents of human capital? Inasmuch as we have learned to recognize that moral knowledge is positively correlated to capital development—since honesty and trust are fundamental ingredients of healthy markets—perhaps we need to recognize the significance of all the constituents of human capital, even those that are difficult if not impossible to measure. To follow this direction of inquiry, however, would be to situate the examination of human capital beyond the grasp of the mathematical methods of mainstream economics. The question is, then, what could be the new province of such an inquiry? If it is true that any subject about which we lack definite knowledge falls squarely in the province of philosophy, then it would seem that, from this latter perspective at least, human capital is a subject for philosophical examination.

On this basis, I shall endeavor here to approach the task of unraveling the nature of human capital. But instead of trying to examine what it is, I shall attempt to examine what it would mean for human capital *not to exist* in persons. My impetus for this unusual approach was triggered by the term *dead capital* coined by Hernando de Soto in his book *The Mystery of Capital*. Dead capital exists whenever a parcel of land cannot be applied productively. And by the term *dead* de Soto does not suggest that by necessity the parcel of land was previously capable of being applied productively and then it became incapable. We can restate de Soto's notion of dead capital more formally as follows: There are objects of which it is true

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3. See, for example, Barro 2001, Barro 1997, and Hanushek and Kimko 2000.



that there are no such objects.<sup>4</sup> In other words, there are parcels of land *qua* capital of which it is true that no capital obtains. The consideration of a social object such as *dead capital* resurrects the heretofore-puzzling philosophical matter of the real existence of nonexistent objects raised by Alexius Meinong.<sup>5</sup> De Soto seems to have succeeded in showing that there are things in the world that make true the proposition that “there is dead capital.” The correlate of this proposition is not, strictly speaking, the physical land in question but the state of affairs in which a particular plot of land lacks a title or any other evidentiary document of property rights that belongs to a formal system of law and, based on this lack, the relation of this plot land to the realm of capital is nonexistent.

We assume that the physical nature of a given portion of land gives it the potential to serve as a constituent object of capital. This potentiality is not just apprehensible but, more importantly, it is apprehended by at least one person who is willing to carry out the transformation of the land that will allow it to serve the production of a complex consumption good, for example, through supporting the construction of a building, a factory, a resort. Nonetheless, if the potentiality of any parcel of land whose character as a constituent of capital (that is, as a means of production) is thwarted by its legal status—or, more precisely, by its lack of legal identity as property belonging to one or more persons—then this parcel acquires the character of dead capital. There is indeed no other way to describe more precisely an object that could be productive, an object that is apprehensible as a means for production, but whose productivity is hampered or destroyed entirely by a certain institutional state of affairs. This is the economic tragedy that we find in much of the developing world and de Soto blames the institutional state of affairs in which titles for landed property are either not formalized or, if they exist, they are not part of a uniform system of legal representation of landed property.

The problem is not that landed property that falls out of a uniform legal system is merely capital *in potentia* waiting for its realization, similar to an acorn prior to realizing its potential as an oak tree. And the problem is not that landed property that falls out of a uniform legal system merely lacks the *immediate potential* to become a capital good in the same way that an acorn lacks the immediate potential to become a wooden chair. Ultimately, the acorn can realize a mediate product—the oak tree—that can lead to the production of a wooden chair. But we are hampered when

4. This is the idea of real non-existence stated by Alexius Meinong in “Über Gegenstandstheorie,” originally published in 1904.

5. According to Alexius Meinong, “There are objects of which it is true that there are no such objects” because the object “stands beyond being and non-being” (1960, 83).

we attempt to use landed property without a legally protected title to realize any product, mediate or immediate. And if the institutional setting destroys any possibility of its realization as capital, then the land in question is nothing other than dead capital. This insight by de Soto is quite powerful because it points to the essence of landed property in such an institutional state of affairs.

It might appear odd to say that the predication *dead capital* refers to a nonexistent object. One could easily quibble, for example, that a case of dead capital in de Soto's sense is just something that could have been capital under other circumstances. Hence, one could argue that it is not the case that capital in no way exists.<sup>6</sup> Here, however, we prefer a realist account of meaning. In other words, the real object correlative to the belief is not only the physical parcel of land, but the character of capital of the physical parcel of land. On this robust view of meaning, capital is a type of social object that is instantiated upon the basis of a physical object, such as landed property, and thus becomes particularized. Accordingly, a belief could only correspond to a token of capital and not to the type capital itself. But a parcel of land as a token of capital exists only when believed to be a token of capital. The character of a parcel of land as capital is thus not intrinsic to the parcel of land, but carried into the situation by cognitive acts on the parts of human beings. In other words, the character of capital of a parcel of land is intended by relevant human beings with the belief that it is capital. In this sense, then, whenever a parcel of land is not apprehended as capital, capital does not exist. The nature of capital, as a social object, is indeed transcategorical in the sense that it is constituted by beliefs on the basis of concrete real objects.

When de Soto observes that landed property without a formal title constitutes dead capital, then he seems to be asserting something along the lines of: there is a nonexistent social object of the type *nonbeing of capital*, which inheres in particular real existing parcels of land in such a way as to have certain specific consequences, so that the nonbeing of capital can be shown to have real existence.

Now, let us return to our concern with *human capital*. If it is legitimate to conceive of the idea of dead capital (*simpliciter*) in this way, then is it similarly legitimate to admit of dead *human capital*? Could zombies, for example, exemplify dead human capital? It would be useful to address these questions if we are to arrive at a description of the essential nature of human capital in its proper, productive sense. After all, if we have not arrived at a definition of human capital by means of the more conventional method of examining what it *is*, perhaps we will encounter fewer obstacles by examining what it is not.

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6. And one would find support for this in Bertrand Russell (1905).

## 1. Why Zombies?

Zombies have not been merely the subjects of Hollywood films. The most celebrated use of zombies in philosophical inquiry is found in David Chalmers's investigation of consciousness. A zombie provides an interesting case for our purposes, since he is a living dead person. He is living insofar as he is, following Chalmers's discussion, physically identical to a human being except that he lacks conscious experience. An important characteristic of the Chalmers zombie is that he is not a corpse: a corpse is merely the body of a dead person. A corpse has no life.

The Chalmers-type zombie is also psychologically identical to a conscious being by virtue of his being able to process psychological phenomena. He will thus be able to report the character of his perceptions, tastes, and other stimuli, and he will be able to control his attention and behavior. The crucial difference between the Chalmers zombie and a conscious being is that the zombie lacks any conscious experiences. In other words, he is not able to *experience* perceptions, tastes, mental states even if he is able to make assertions which seem to report their character. The Chalmers zombie functions and responds like a living person, but he does not feel anything because he lacks consciousness.

We must keep in mind that zombies, for Chalmers, are a matter of logical possibility and not of physical probability.<sup>7</sup> Their conceivability, he holds, entails their logical possibility. Chalmers's zombie is unlike the zombie of Hollywood films in that the latter typically suffers from functional impairments such as, for example, he is typically depicted as ambulating with arms stretched out in front of him since he may not otherwise be able to avoid obstacles in his path. The Hollywood zombie also reveals in his behavior a capacity for enjoyment, albeit one that is limited to, for example, enjoyment in eating or killing people (see Block 1995). In large part for this reason, the Hollywood zombie is not useful for our examination. Consequently, our attempt to investigate the matter of dead human capital will consider only the Chalmers-type zombie but for aims altogether different than his. But this will come later on. First, we must consider in detail the theoretical framework in economics from which our assumptions begin.

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7. A proposition is logically possible if and only if there is some coherent *way for the world to be*, under which the proposition would be true. But this *way for the world to be* need not be the way the world *actually is*; it need only be logically coherent. So, for example, the false proposition *there are real zombies in the world* is *also* logically possible, so long as we are able to conceive of some logically coherent world in which there are real zombies. And we indeed seem to be able to conceive of zombies by evidence from the many films about zombies that have been produced.

## 2. Capital 101

What is capital exactly? Menger describes it as the sum total of economic goods that are available in the present and whose services together are capable of being applied to the production of new economic goods in the future. Bricks, cement, and steel, for example, are economic goods that together can be applied to the construction of a building.

But there are many misconceptions in ordinary use of what the term *capital* means. Consider, for example, the use of the term *capital* in ordinary language to signify a sum of money, as in the expression “capital in the bank.” But the most common yet least recognized mistake is the conflation of capital goods with income-producing items of wealth, such as rental housing. What is not recognized is that no new production is obtained by merely housing new, different, or a larger number of tenants. According to de Soto’s *Mystery of Capital*, this error is especially poignant in developing nations. “The poor,” de Soto writes, “have accumulated trillions of dollars of real estate during the past forty years,” but they lack the legal means to apply such assets toward new production because developing nations often lack formal mechanisms for recording property rights”(47–48). All that the landed poor can do beyond occupying the land they have acquired and building improvements is to make it available for rent. Rental income is not, however, capital. More specifically, while it is true that the landed poor can gain income from renting real estate, this does not amount to their applying the land toward the production of a new economic good.

To think that land produces capital through rent is again to confuse capital with sums of money gained. This is a mistake with grave economic consequences. The chief concern of de Soto is that, without formalized property rights, the landed poor in developing countries will be unable to direct their real estate assets to actual capital production. Without capital production, there will be no development in the sense with which we are familiar in the industrialized world.

Our misconceptions about the true meaning of capital lead to a certain complacency that serves to entrench the precarious economic *status quo* of developing nations. As de Soto tells us, capital “is not the accumulated stock of assets but the *potential* [an asset] holds for deploying new production.”<sup>8</sup> This potential is apprehended by an entrepreneur in relation to a particular future end. A parcel of land by a beach, for example, constitutes part of the capital necessary for erecting a new hotel. The ideal exists

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8. de Soto 2000, 42; brackets mine. Following Adam Smith, he holds the realist view that “for accumulated assets to become capital and put additional production in motion, they must be *fixed and realized in some particular subject.*”

tence of the hotel in the mind of the entrepreneur is what gives the parcel of land its character as capital. Similarly, an entrepreneur may apprehend a sand deposit as having the potential to deploy the production of computer chips. The ideal existence of the future production is what gives sand its character as a constituent object of capital.

But capital is not an ideal object as de Soto seems to assert.<sup>9</sup> According to the contributions to economic theory of Böhm-Bawerk and other old-world Austrian economists, only the future product is the ideal object.<sup>10</sup> On this account, capital is constituted by real objects in the world. The capital for the construction of a building is constituted by bricks, cement, cranes, and so on. These real objects are unified by the mind that conceives them together as the means for producing something new in the future.<sup>11</sup> Capital can be thought of as a social object in the sense that it is constituted by both beliefs about some future end (the ideal object) and by the real objects that will realize that future end. As such, it is important to recognize that a ton of bricks and mixed cement do not constitute capital independently of the production plans of an entrepreneur-builder and the relevant circumstances of time and place for the realization of these plans: the bricks and cement must be in the right place and at the right time, and subject to the right sorts of control. Above all, capital as a social object does not exist independently of the human social world.

Nonetheless, capital has meaning only by means of its concrete real form of particular capital goods—e.g., this crane, those two tons of bricks, and so on—because the price and actual function and performance of the concrete things that, together, are conceived as capital are of fundamental significance in relation to the production aimed at realizing the entrepreneur's ideal future product. The entrepreneur-builder cannot build his building with an *idea* alone, but only with the aid of capital goods—with crane and bricks. The *idea of the building*, or of whatever is the finished product, is indeed an ideal object driving the entrepreneurial effort. But its realization relies on actual capital goods, which have concrete, material form, and the investment decision turns on the perceived causal relations among these actual capital goods, on their prices, function, performance,

9. He writes, "The moment you focus your attention on the title of a house, for example, and not on the house itself, you have automatically stepped from the material world into the conceptual universe where capital lives" (2000, 50).

10. Eugen Böhm-Bawerk explains that our present actions are motivated by the idea of the future feelings. Hence, "we set up goods or renditions of services in readiness for utilization in the future" (1959, II:261).

11. According to Eugen Böhm-Bawerk, capital is "a complex of goods which came into existence as the result of a previous process of production, and which are destined, not for individual consumption, but for the acquisition of further goods" (1959, I:5).

availability, and so forth, and the realization of the final product as conceived by the decider. As Böhm-Bawerk tells us, the value of capital depends on the marginal utility that the final product for which they will be used is capable of delivering (1959, II:168).

Now, a real object such as land can exist as a capital good only if it is legally identified as property in a way that gives an owner the rights to employ it in an economically productive way. According to de Soto, “property has given minds the mechanisms with which to extract additional work from commodities” (2000, 217).<sup>12</sup> In the absence these mechanisms, of exercisable property rights, obstacles to capital growth in developing nations are created, to which de Soto offers a solution in the establishment of uniform systems of titles and property registries.

### 3. Enter Dead Capital

Let us now consider a real case reported by de Soto in which public housing neglected by the relevant government officials was used as a source of income by entrepreneurially minded tenants who created additional space to sublet without official approval.<sup>13</sup> This is a phenomenon that is not uncommon in developing countries where the incentives for this sort of exploitation of public property are often large. The problem is that the addition to the public housing is not such that it can be properly considered public property but it cannot be formally owned by the tenants who built it either. This means that, although the addition can produce income for the entrepreneurial tenants, albeit extralegally, it cannot be sold or mortgaged in order to deploy new production. The additions in question are then dead capital because the potentiality to serve as capital has no possibility of being actualized in the given institutional context.

It is quite seductive to find justice in this situation because we tend to approve of poor tenants who strive to better their lot in creative ways. We rejoice when clever tenants benefit from inefficiency or neglect on the part of public authorities. This reaction, however, must be tempered by sound economic analysis, which tells a different story: the small gains by a few will never offset the economic consequences of not directing resources (land, land improvements, human creativity, and vision) to their most efficient uses. The point de Soto makes is clear: dead capital is not only an obstacle to development and growth; it is also immoral since it results from a legal

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12. Carl Menger describes a commodity as “products that the producers or middlemen hold in readiness for sale.” See Menger 1871, 238.

13. See de Soto’s chapter in this volume.

framework that accepts no role in protecting private property. Only when dead capital is understood in this way does it become clear that de Soto is not merely attempting to standardize titles of landed property in developing countries that lack a formal property registry system. What he suggests, fundamentally, is the establishment (or restoration) of the rule of law, but he recognizes that this is a task impossible to accomplish through any one simple institutional change. To change a legal system from a state of affairs in which landed property is not protected into one that enjoys a formal property registry system is a step in the direction of restoring the rule of law, but other steps are needed—including education in the proper use of such a system and of its associated habits and artifacts. But eliminating dead capital via formal property registry systems is still, in de Soto's eyes, "the only game in town" when it comes to directing an economy in the direction of capital formation. Perhaps it is also the only safe, peaceful, and painless way to moving society towards a more widespread and thoroughgoing embrace of the rule of law in developing nations.

#### **4. The Mystery of Human Capital**

[tx]The chief mystery of contemporary macroeconomics is not the role of human capital in relation to development. Rather, it is the answer to this more fundamental question: What is the exact constitution of human capital? Economists provide different answers<sup>14</sup> But the most common characterization of human capital sees it as the stock of a person's income-producing skills. What we must recognize is that this characterization com-

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14. In the *Concise Encyclopedia of Economics* (Liberty Fund, 1999-2002, "Human Capital" entry), Gary Becker writes that "schooling, a computer training course, expenditures of medical care, and lectures on the virtues of punctuality and honesty also are capital. That is because they raise earnings, improve health, or add to a person's good habits over much of his lifetime. Therefore, economists regard expenditures on education, training, medical care, and so on as investments in *human* capital. They are called human capital because people cannot be separated from their knowledge, skills, health, or values in the way they can be separated from their financial and physical assets." (See <http://www.econlib.org/library/Enc/HumanCapital.html>) But there are other accounts of human capital. In human development theory, whose most notable contributor is Amartya Sen, there are distinctions drawn among social capital (social trust), instructional capital (sharable knowledge), and the individual's capital (leadership and creativity). These are seen as three distinct human capacities in economic activity. The problem is that in the human development context, the term *human capital* is often employed in ambiguous combinations of these distinctions. Nonetheless, such distinctions allow for interactions with welfare, education, and healthcare systems to be modeled even past retirement. By comparison, according to strict neoclassical analysis, human capital would be zero at retirement because labor, employment, or goods are no longer involved.

mits the same error as that which is made today by laypersons in regard to capital *simpliciter*. In other words, a person's skills for hire do not constitute a capital good, any more than rental housing constitutes a capital good, for capital production is not tantamount to an asset's capability to produce income. Rather, capital production is the deployment of an asset toward a new and greater end that employs, as de Soto explains, "the most economically and socially useful qualities *about* the asset" (2000, 49). Similarly, then, human capital production would arguably employ a person's assets in a way which draws on their most economically and socially useful qualities.

We shall recall that despite the lack of a clear understanding of the term *human capital*, the existence of human capital is widely presupposed in development economics, especially by economists who argue that a nation's growth in real production is primarily the result of the productivity of human capital.<sup>15</sup> Economist Isaac Ehrlich, for example, maintains that the economic growth attained by the United States since the late nineteenth century is primarily due to gains in university education. Although Ehrlich does not reduce human capital to education, he limits his analysis of human capital to education because it is a measurable factor. This is indeed in the direction of the neoclassical mainstream in economics.

In Gary Becker's seminal work on human capital (1975), his analysis is devoted mostly to education. Nonetheless, he mentions that, in addition to measurable investments in human capital such as education, there are also unmeasurable investments, such as migration and even perhaps the mere change in one's living environment, that affect not only future monetary income but also future psychic income. Here, Becker seems to suggest a broader understanding of human capital, as not merely the stock of skills that affect one's job-related productivity and associated income generation. Unfortunately, Becker's acknowledgement of psychic income seems to have been passed over in the literature and thus it remains undeveloped. We shall attempt to remedy this oversight here. One possible understanding of Becker's notion of psychic income can be seen by the light cast by the Aristotelian aesthetic of the good life. When a person chooses to act virtuously, he does so "for the sake of the noble" (NE 1120a 23-24). The noble can also be understood as beauty. In this sense, a well-done task in one's work and a good deed share an aesthetic common ground: they contribute to our sense of personal fulfillment, of living well. They add to our psychic income. After all, despite the immeasurability of personal fulfillment, an examination of a nation's capital development must reckon with the significance of shorter-hour days, early retirement, a

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15. See, for example, Ehrlich and Lutter 1989.



decreasing supply of unskilled labor, and other characteristics of the Western developed world as factors that improve quality of life. The examination of human capital is then much more complex than that of capital *simpliciter*. Moreover, the current treatment of human capital in economics that focuses on education and its effect on growth conflicts with knowledge we gain in ordinary experience: monetary income and psychic income are not positively correlated necessarily. This means, then, that education does not necessarily enhance human capital even if it contributes to growth. We could speculate, for example, that activities such as prostitution reduce psychic income in the long run. But if a prostitute's monetary income from prostitution is in the six-digit range, would this offset the loss of psychic income? Clearly, the latter is not measurable. But if only that which is measurable is considered, the analysis of human capital will overlook important considerations.

We could suppose a world in which feelings of pleasure are scientifically measurable. Anything that positively affects the feeling of happiness has an effect on this measurable psychic income. A drug addict's happiness could then be considered a manifestation of a high psychic income, even if this state has an inverse relation to his monetary income due to the addict's inability to maintain a job. In order to avoid the objection that this is unsustainable in the long run, we could suppose that the drug addict has a benefactor who pays for all of his drug expenses without limit. We can further suppose safely that the addict's drug use increases as his tolerance for the drug increases and as a result he affirms that he has never been happier. Can we say that his human capital has increased to a level never achieved before? The chief point here is that even if we were to be able to measure feelings of pleasure, or other forms of psychic income, a clear understanding of human capital still requires the careful consideration of all that may constitute human capital, and of the relations between these constituents, in order to correctly assess the state of a person's human capital.

A corollary that cannot be ignored is that the aggregate analysis of human capital may not be a suitable means for examining the effects of human capital on a nation's growth in real production. An analysis of all dimensions of each and every individual's human capital in a nation is not feasible. It already seems clear, however, that studies of the effects of education on a nation's growth should not too readily be identified as studies of human capital in the broad sense.

## **5. An Application of the Thesis of Aussersein**

De Soto's remarks on dead capital points to a new avenue for arriving at a description of human capital, an avenue laid out by the philosopher Alexius

Meinong.<sup>16</sup> In the Meinongian ontology everything is an object. Objects that have a location in space and time, such as a tiger or a loaf of bread, but also my present headache, are said to enjoy present real existence. Entities that are not localized in space and time, such as the number 3.1416 or Sherlock Holmes, are said to subsist. For Meinong, to exist and to subsist are the only two modes of existence. But he also recognizes that we entertain thoughts about entities with nonexistence, and he claims that in order to provide a realist account of judgment and assumption, these, too, must be conceived as directed at some referent. They enjoy not existence but *Aussersein*—they are beyond being and nonbeing.

Let us employ an illustration that applies this aspect of the Meinongian ontology to the sphere of the social world that de Soto addresses: landed property. Suppose that there are two prospective buyers contemplating the purchase of a plot of land. *Prima facie*, it would seem that their contemplations are directed at a real existing object—the land. Suppose further that one believes that the plot of land is dead capital, while the other believes that the purchase of this plot of land is a good capital investment. These two judgments reveal that the actual object of these judgments is not the plot of land. Rather, it is the possibility of the character of capital adhering in the plot of land. Incidentally, if the buyer who believes that the land is dead capital, then this means that the possibility of capital obtaining in the plot of land has no being. Now, we must keep in mind that, for Meinong, all objects towards which judgments are directed have *Aussersein*. The most interesting ones are, however, those with negative judgments. For example, suppose we find ourselves driving on a freeway and suddenly traffic reaches a standstill. We could easily form the assumption that there is an accident ahead. But we are quickly informed that there is no accident ahead as the cause of the standstill. We would then form a negative judgment with respect to our previous assumption by negating the state of affairs in which there is an accident ahead. Or, consider another example. Suppose we make the following judgment about the candidate that one is interviewing for a job: “he does not meet the requirements for the job.” This is a negative judgment with respect to the assumption for scheduling an interview in the first place was that the candidate was qualified. What is even more interesting in this Meinongian ontology is that all of the objects—the accident that does not exist in the relevant state of affairs, the qualifications that did not realize in the candidate interviewed—enjoy some constitution (*Sosein*) that make them eligible subjects of true propositional statements such as the negative judgments mentioned.

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16. For further historical and philosophical reference, see Chisholm 1982 and Smith 1994.

In this light, we can see that de Soto can make propositional statements, such as “This is dead capital.” The object presented before him is a plot of land, but the object of the judgment about is the capital that does not obtain in the plot of land. This is of importance to a realist account because the truth of this judgment can be settled objectively, which means independently of perceptions or points of view. Above all, this is what we understand when we hear expressions such as that which Democratic candidate Lloyd Bentsen uttered in rebuttal to Republican candidate Dan Quayle in what is perhaps the most notorious vice-presidential debate in the United States: “Senator, you are no Jack Kennedy.” No one mistook the object of this propositional statement as the particular characteristics that Dan Quayle lacked, for the criticism was bolder. The object was the state of affairs in which Dan Quayle, *qua* politician, embodies the nonbeingness of the character of Jack Kennedy *qua* politician.

Now here is the twist on Meinong that we propose makes his ontology very sympathetic to social objects: Jack Kennedy *qua* politician is a social object that is constituted not only by properties such as being human, but also by beliefs about his political character. But the being of Jack Kennedy *qua* politician is not identical to the being of Jack Kennedy the man. If we understand the Bentsen rebuttal, then, we have sufficient reason to suspect that Russell had an incorrect understanding of Meinong. This reason is sufficient insofar as it is grounded on ordinary use of language and corresponding pretheoretical beliefs. More explicitly, the matter does not hinge on reconciling the assertion that Jack Kennedy *qua* politician has a sort of existence (*Sosein*) by virtue of our thinking of him whenever we do, with the empirical fact that Jack Kennedy died in 1963 and thus does not enjoy real existence now. We are clear, at least it seems to be so, that these are not only two distinct objects but also two different senses of being.

We do not notice how often we advance true predications about what is nonexistent. This, however, does not amount to affirming that any state of no being is a kind of being.<sup>17</sup> This would be objectionable for the same reason that it would be objectionable to refer to counterfeit money as a kind of money since counterfeit it is not money at all (Zúñiga y Postigo, 1998, 161–64). While it still remains unclear whether Meinong commits this mistake, he is nonetheless an outcast in the anglo-american philo-

17. Meinong scholars disagree on this point. According to Reinhardt Grossman, “At times, Meinong was inclined to assume that there is a third mode of being which belongs to everything” (1974, 67–68). He is referring to the second edition of *Über Annahmen* (1910, 79–80). “But,” Grossman adds, “his principal view is that existence and subsistence are the only modes of being.” According to other scholars, however, Meinong conceded in his later writings that even *Aussersein* is a kind of being. I am thankful to Maria Reicher for this comment.

sophical literature for what many characterize as either an absurd or untenable broad ontology.<sup>18</sup> Peter Simons attributes this characterization to Bertrand Russell's "inaccurate picture," which perpetuated a number of misunderstandings about Meinong's work (Simons 1992, 187). But outside of the academy de Soto has unknowingly provided us with what seems to be a defensible Meinongian predication.

In the *Mystery of Capital* de Soto could have chosen other terms in place of the expression *dead capital*—such as wasted resources, unutilized resources, foregone potential—to express his notion of landed property that *by virtue* of lacking ownership representation in the form of a legally recognized title, it has been stripped of its potential of functioning as capital. It must be clear that for de Soto the expression *dead capital* does not merely predicate an absent quality of some parcel of landed property. Dead capital is not identical to asserting that something is *not* capital. Rather, by *dead capital* he means the state of affairs in which the non-existence of capital is realized in such parcel of landed property. Dead capital is thus a social object whose negative status of being *is* its constitution. To talk of dead capital is to talk of something that exists and is present in a given locale.

Consider an abandoned parcel of public land in coastal Peru, formerly rich with anthropological relics that have been mostly lost to theft. When someone says, "These sand dunes are not an anthropological site," what is being predicated of the land here does not refer to what it *is*, but to what it is *not*. The sandy parcel is indeed *not* an anthropological site. This predication is true, but it is possible to make a more significant assertion than this negative predication, which addresses what the sandy parcel could have been had its potential not been stripped away by thieves and poachers.

Now, if we make a judgment that this or that plot of land is dead capital, what makes this negative judgment true? Not, surely, the land itself for there is nothing intrinsic in the land that makes it dead capital. Perhaps the only intrinsic property of all that we call land is that it is the solid part of the earth's surface. But in the human social world land could have the potential of being a capital asset if it belonged to a formal system of property ownership, or it could be the site of natural beauty, or the basis for the demarcation of a political boundary, or the evidence for a geologic period, and so on. What makes the proposition "this is dead capital" true is a different social object, one in which the land is merely the material basis that realizes the nonbeing of capital.

We are now ready to turn to the examination of *human* capital and let us begin by considering the notion of dead human capital. We can conceive

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18. But not all prominent philosophers have waved their hands in dismissal of Meinong, and among these we find J.N. Findlay, Roderick M. Chisholm, and Peter Simons.

of zombies as the material basis that realizes the nonbeing of human experience. As described earlier, our zombies are creatures that although physically identical to human persons, they lack phenomenal awareness. Suppose they could read Aristotle, but they could not gain any insights from such reading. Or, suppose they run a marathon, but they could feel neither the physical exertion nor the emotional elation upon finishing. Zombies, then, can experience fulfillment with respect to neither their labor nor any other sort of personal achievements. Above all, they are incapable of any psychic income. To the best of our knowledge, human phenomenal awareness can only emerge on the physical basis of a human person, specifically his brain. But in the case of zombies, this potential is thwarted even with a brain. Again appealing to the Meinongian terminology, we might say that zombies (if they existed) would represent the being of the nonbeing of a human person.

## 6. From Dead Capital to Dead Human Capital

If we apply the foregoing to the matter of human capital, then we can begin to understand how Meinong's ideas on existence and nonexistence can help us to understand the structure of social reality. Human capital, like capital *simpliciter*, can emerge and be sustainable only on the basis of some real existing physical object. In the particular case of human capital, the physical basis will be always a human body. This applies, also, to the nonbeingness involved in *dead* human capital.

Human capital is a social object in a way similar to capital *simpliciter*: it rests on a combination of beliefs and concrete actions against a background of rules. A person's education, moral character, manners, affable character, and physical health are characteristics realized in actions. And physical health is not only a physical matter affecting a person's body but also influences a person's attitudes in ways that are realized in actions. In order for all of these and other similar characteristics to be put together as human capital, there must be some mind perceiving and recognizing them in a certain way. Such a perceiver must conceive these together as providing the means for producing something new and greater: a better secretary, a better entrepreneur, a great lawyer, a great teacher, an excellent student, and so on. Like the building that an entrepreneur conceives as the final end for constitutive objects of capital such as bricks and cement, so the person-*qua*-something-great results from the unification of some or all of the person's manifested attributes by an observing mind.

Max Weber's remarks in praise of Protestantism, for example, may be understood as pointing to attributes of those German Protestants he observed who were involved in wealth-creating activities—activities that in

his mind constituted the proper end of a good society. He unified such attributes into something he called *work ethic*, an ideal object that has since been accepted as one character descriptor for a good society, and as a goal toward which individuals should strive.

If a person manifests no salient attributes, then perceivers will be unable to grasp the person's attributes-in-potential as human capital, because they will not be able to see a connection between what the person can offer and some productive end. Clearly, mistakes in perception occur. We can think of many cases in which a person's attributes are not fully grasped by one or more observers. We should also bear in mind that the possibility of someone's grasping a person's attributes may depend on the observed person himself and on his own grasping of his own attributes. A professor may see promise in a student, but how could the student after graduating convince an employer of the human capital he can contribute when he himself is not convinced he commands such human capital? Human capital is a social object constituted by beliefs and actions, including one's own beliefs about one's own attributes.

## 7. The Return of the Zombies

The question with which we are confronted now is as follows. Is dead *human* capital a possibility? Here, we mean not merely the unfulfillment of a person's potential, but the complete destruction of his potential. If we think of human capital as a matter of degree, then we could imagine that we find at one end the zombie—a human being with no productive potential and no psychic income—and at the other end the person with fully realized potential and a robust psychic income. The question is, are there actual human correlates to the zombie? To begin to answer this we must consider that the zombie is not part of a social world by virtue of his lack of phenomenal awareness. The fact that human beings typically choose to be in communion with others depends in large part on the human capacity for a wide range of qualitative experiences that typically gain more significance in the context of a social network. We experience comfort and joy in the company of family and friends even if these experiences do not lead directly to new production or increased material gains, or even if these experiences are not consistently pleasant. We also seek an extended group because we have discovered that the gains of cooperation extend beyond the practical and the material. For example, we live in cities, and sit alongside others as spectators of public entertainment, we look forward to exchanging stories with coworkers, and we prefer to eat in the company of others not because they serve our material needs. We enjoy social networks.

In this light, then, any degree of damage to a person's phenomenal awareness or any incomplete development of the senses that permit it, then, may result in a corresponding partial isolation from the social world. This the most likely outcome in cases of dementia, schizophrenia, and other sociopathic disorders. These cases involve social isolation in part because the persons in question may lack the ability to experience the qualitative character of their perceptions or stimulus. Persons who suffer from Alzheimers disease, for example, eat but can no longer taste the flavor of food and are unable to discern whether it is agreeable or not. In advanced stages they cease to recognize loved ones or, if they do, they may be unable to feel any pleasure on seeing them. In the most extreme cases, they may lose all sense of who they are as well as all memories of their lives. Such compromises to the phenomenal human experience undoubtedly erode humanity—that term we often employ to refer to the experience of being human. This includes not only our capacity for language, abstract reasoning, and introspection but also our autonomy, preference for pleasure, aversion to pain, our dependence on others for enjoying the significance of our triumphs as well as our reliance on others for support in difficult times, and the importance of play to our reaching fulfillment. This is not to say that a person who suffers from Alzheimers is less human, only that their capacity for realizing their human experience is progressively thwarted. Ontologically, they increasingly realize the non-being of the human beings they used to be. This recognition is precisely what makes their situation so devastating to their loved ones.

We may conceive also of phenomenal erosion of other sorts. There are social factors that can thwart human experience as much as physical factors. Incarceration, for example, prevents the qualitative experience of autonomy, creativity, and of voluntary social interaction. It must be clear that my point here is not morally relevant; it is merely ontological. As such, it makes no difference whether the incarceration is a just punishment or cruel one, for the state of incarceration is identical in either case. Social oppression or any kind of domination of one human being over another have similar effects to incarceration since these have the same nature: they restrict behavior and freedom. Labor exploitation also erodes the human phenomenal experience insofar as such circumstances prevent the victims of exploitation from enjoying the human experience of achievement and fulfillment, and replace these with psychological effects such as lack of self-esteem and depression that further constrict human flourishing.

Let us also consider the human phenomenal experience in the sphere of economic life. Karl Marx argued that productive activity is the means for man to find purpose and fulfillment. Industrialization, in his view, changed this because the repetitive nature of mass production turned work into a mind-dulling activity. This inverse relation between repetitious work and

mental sharpness sounds not only intuitively true but it is consistent with man's rational nature. Arguably, then, any activities that detract from man's rational nature would, in principle, hamper personal fulfillment. Similarly, terrorism would have the same effect since terror incites only extreme primitive responses of survival in which emotional responses override rationality.

On the basis of these observations, we can advance a preliminary description of those aspects of the human phenomenal experience and activities that are necessary for psychic income gains consistent with human flourishing. These are: language, abstract reasoning, introspection, autonomy, preference for pleasure, aversion to pain, social support systems, play, freedom, creative expression, personal purpose, confidence, sense of well being, emotional balance, and intellectual challenges. These, together, can be indeed effective in deploying new production. In this sense, human capital can be seen as having a common character with capital *simpliciter*. But human capital is not a species of capital *simpliciter*. The reason is that, in addition to being a power to deploy new production, human capital is dependent on the mental, intellectual, or psychological attributes of a person, as well as the physical state of the person—i.e., on brain functions as well as on physical well-being. Not least of all, human capital is also dependent on the proximity to a social network for protection and support.

Before closing we must briefly tie some loose ends. First, let us revisit the economic studies on human capital in relation to this examination. Economists, we shall recall, have focused on education because this is a measurable factor in human capital. But in light of our examination, we must recognize that a person's education can be understood as a contributing factor to human capital but not independently of constraints or negative influences on the person's psychological attitudes, physical well-being, material circumstances, and social network. Education may not offset these other constraints or negative influences. In addition, we must also recognize that aggregate analyses of human capital will indeed show a relation between education and growth. At the micro level, however, education does not necessarily have a positive relation with human capital since education is often not rewarded in the form of human fulfillment. In addition, we must pursue a fuller development of Becker's broad understanding of human capital not only as measurable investments such as education, but also unmeasurable investments, such as migration, living environment, and any others that affect not only future monetary income but also future psychic income. Our examination was one step in this direction but the task now is to attempt a positive description of human capital.

What is left now is an answer to the somber question we left pending earlier: Is dead human capital possible? Dead human capital may arise, in principle, when human capital is not permitted to emerge at all in any form



of productive flourishing because of factors, both internal and external, beyond the control of the agent involved. Our intuition is that a complete destruction of human capital is not possible even if the erosion to the potential for human phenomenal experience is considerable. Perhaps only brain death can bring about a complete destruction of this potential.

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# Property Law for Development Policy and Institutional Theory: Problems of Structure, Choice, and Change

*Errol Meidinger*

## 1. Introduction

Hernando de Soto argues that the less developed countries of the world should reform their property systems to recognize and incorporate the “extralegal” property rights that exist in their various squatters’ settlements, rural enclaves, and other suppressed social fields. By doing this, he says, they will establish the institutional environment necessary to support economic growth. In making this argument, de Soto draws not only on development studies, but also on Western property law and institutional ontology. He does not argue for the simple importation of Western property institutions, but rather for the recognition, codification, and integration of indigenous ones in a way that will support economic development. To do this he draws upon the ontology of John Searle to discern the essential elements of social institutions. He also draws on the history and structure of Western property law to discern basic institutional characteristics that may be essential to economic development.

De Soto’s amalgamation of these three fields is unusual. Assessing his argument requires a broader than usual academic compass. At the same time, it is not possible in one writing to respond from all three perspectives. This article joins the discussion from the perspective of modern, primarily Anglo-American, property law. It aims to render property law in a way that speaks to both de Soto’s development policy and Searle’s ontology. Because few people are familiar with all three fields, I will provide concise summaries of Searle’s and de Soto’s positions, identifying key points introducing the subsequent discussion of property.

I will also examine modern property law with a view to questioning and prompting further advances in de Soto’s development prescriptions and Searle’s ontology. I make several arguments. First, while modern property law has incorporated many innovative forms of property rights, and has

allowed them to operate in multiple configurations, it has simultaneously limited their number and form. This suggests that there may be important, but only dimly understood, constraints on the incorporation of additional forms of property rights in modern legal systems. Second, Western property law has always exhibited a certain amount of indeterminacy and changeability, thus leaving the exact contents of many property rights and duties open to doubt. Meaningful ontology and development policy, therefore, may be well advised to deal with the persistence of normative reasoning and multiple decisional forums in property institutions. Third, modern property law has often excluded or suppressed property rights based in indigenous institutions. Thus, there may be implicit limits on incorporation. Fourth, the boundaries of the communities that define property rights in the modern system seem to be expanding outward. Thus, some property rights within nation-states are effectively being defined by international organizations such as the World Trade Organization, while others are being defined by private transnational networks of Non-Governmental Organizations. Finally, the conclusion suggests that these elements of the modern system, taken together, raise questions about an ontology and development policy that focus on relatively static definitions of rights and duties. A satisfactory understanding of property systems may have to incorporate processual elements that are not reducible to existing rights and duties.

## **2. Background**

The essence of de Soto's prescription is that less developed countries should create integrated property systems incorporating informal or extralegal property rights into their official legal systems. He believes that this institutional adjustment will facilitate economic growth because the resultant general understanding of who has what property rights will allow formerly "dead" capital to metamorphose into "live" capital supporting investment, mortgages, utility hookups, and the like, and thereby economic growth.

One of de Soto's primary empirical bases for this prescription is the history of Western property systems, and particularly the U.S. system, which he argues laid the necessary institutional conditions for rapid economic growth in the late nineteenth century by incorporating informal rights in a unified property system. One of his theoretical bases is Searle's social ontology, which stresses the importance of widely accepted symbolic representations of well-defined rights and duties for functional institutions.

De Soto's emphasis on institutions is neither unique nor unusual in modern policy discussions. Institutional analysis enjoys renewed currency

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across a variety of academic disciplines. Institutions are increasingly treated as a subject of analysis in their own right, and not as mere derivatives of other variables (such as economic efficiency or political power). Part of what makes institutions an appealing subject is that they can be characterized as distinct, yet important and durable, shapers of human behavior, and that they can be discussed without insisting upon a larger social-theoretical apparatus. Since institutional analyses operate in a fairly open-ended theoretical field, they can be relatively pluralistic and consider a broad array of institutional forms. In all, then, it is not surprising that reform proposals from across the ideological spectrum focus on developing better institutions.

To say that there is a convergence of interest in institutions is not to say that there is unanimity on what they are or why they are important, however. Yet, at a general level there is fairly broad agreement: institutions refer to widely accepted conventions that define the roles, rights, powers, and duties of specific types of social actors in specific settings (e.g. North 1990; Powell and DiMaggio 1991; Scott 1987; March and Olsen 1989). Institutions shape and give meaning to behavior, provide predictability to social actors, and play a large role in determining the resources and life chances of specific individuals. While some institutions take the form of law, others do not.<sup>1</sup> Which institutions one focuses on depends on what questions one wishes to answer.

Property is a standard verity of institutional discourse. So conventional is the identification of institutionalism and property, ironically, that some disciplines tend to treat property as requiring no particular analysis.<sup>2</sup> That repose has recently been disrupted by the growing influence of institutional economists on global development policies, particularly through the International Monetary Fund and other lending agencies. These agencies have maintained, often in a rigid, nonempirical way, that adoption of certain Western institutions is a precondition to economic growth in third-world and former Eastern block countries.<sup>3</sup> De Soto's work, while occasionally identified with these positions, is more sophisticated. Rather than the wholesale "cookie cutter" adoption of Western institutions, he advocates the clarification and solidification of indigenous ones in ways likely to

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1. There is, however, little careful analysis on where the line between law and nonlaw falls. Compare, for example, the relatively unexamined distinction between state and nonstate rules in the "law and norms" literature (e.g., Posner 2000) with the more inclusive definition of law in the "institutional theory of law" literature (e.g., MacCormick and Weinberger 1986).

2. In one of my own home disciplines, sociology, property has not been a focus of significant empirical or theoretical concern for three quarters of a century.

3. See Stiglitz 2002 for a summary and critique of the position.

support economic growth. He seeks to draw lessons from the essential characteristics of Western institutions, rather than from their substantive details. It is thus fair to say that he is more interested in the ontology—the fundamental characteristics, categories, and relationships—of property institutions than in their content.

### 3. Searle's Ontology of Institutions and Property

Probably the most influential ontological perspective on social institutions is that of John Searle. Like most empirically oriented philosophers who discuss social phenomena, Searle seeks to describe the distinctive features of social relationships, features which are implicitly not reducible to deterministic workings of atomic and subatomic phenomena. In contrast to the efficiency-driven institutional analysis of economics that has shaped most institutional analysis of property, Searle's ontological analysis is self-consciously indifferent to substantive social goals. While he seems to assume that institutions in general are a good thing (presumably because they facilitate social order) and acknowledges that in practice they function to promote certain values, he eschews commitments to those values. He seeks to describe the essential elements of institutions regardless of the values they might promote.

**Institutional Facts:** Searle builds his ontology on two fundamental categories of facts: brute and social. Brute facts are those that exist independent of human intentionality, such as mountains, molecules, and tides. They exist and are facts whether humans regard them as such or not, indeed whether humans exist or not. Social facts, in contrast, depend on human intentionality for their existence. The simplest examples are physical tools. A screwdriver, for example, may exist as a collection of materials with certain properties, but it is not a screwdriver unless conscious agents regard it as one. Tools do not exhaust the category of social facts, however. There is another, arguably more interesting subcategory, which Searle labels institutional facts. His paradigmatic example is money. Like the screwdriver, money must be regarded by conscious agents as such in order to function as money. Unlike the screwdriver, however, what can function as money is not limited to a specific set of physical characteristics. For Searle this is the hallmark of an institutional fact: it cannot perform its function solely by virtue of its physical structure, but only through collective acceptance. Still, Searle insists, such facts are objective in that, for example, there is a real set of functions that money can perform, and others that it cannot. Institutional facts are thus “ontologically subjective and epistemologically objective.”

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Searle posits three essential attributes of institutional facts: (1) collective intentionality, (2) assignment of function, and (3) constitutive rules.

**Collective Intentionality:** Social behavior, both among humans and among animals, involves and indeed requires collective intentionality—for instance, a shared intention to engage in a transaction or not to interfere with a certain kind of behavior.<sup>4</sup> Collective intentionality for Searle thus involves both a shared mental directedness and a capacity to coordinate behavior. But it is not enough by itself to establish institutions such as money, property, marriage, or government.

**Assignment of Function:** Social institutions also require the crucial process of assignment of a function to a specific thing. As noted above, such functions are never intrinsic to the thing, but always assigned, and therefore always relative to interests of users and observers. Thus, a piece of paper with certain physical features and origins can be assigned the function of money in a certain political jurisdiction and can function that way due to collective acceptance by the relevant actors. The same goes for a group leader.

**Constitutive Rules:** The assignment of a function is itself based on constitutive rules, which create the very possibility of certain types of institutional behavior. They do this by specifying the circumstances under which a particular thing or actor counts as having a specific function. The exact nature of constitutive rules is only partially worked out in Searle's scheme, as Searle acknowledges (1995, 29), but he stresses several important features. First, constitutive rules are to be distinguished from mere regulative rules, which regulate "antecedently occurring activities." Thus, a speed limit is a mere regulative rule for driving a car rather than a constitutive one. Second, constitutive rules often require "performative utterances" (Searle 1995, 34), for instance, saying: (1) "know ye that I give Blackacre to Ethelbert" before witnesses and handing over an actual piece or product of the soil or (2) "I thee wed" before someone empowered to marry people or (3) "I declare this meeting in session" before a groups of people who are gathered for a meeting. Third, each of these constitutive rules is dependent on a web of other constitutive rules, such as those defining whether the grantor actually had the power to convey Blackacre, the bride and groom to marry, the chairperson to call the meeting to order, and so forth.

**General Form:** Searle posits that all constitutive rules have the form, *X counts as Y in context C*, where *X* refers to the thing being given the

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4. Searle also argues that collective intentionality is not reducible to the sum of individual intentions (1995, 26) but that is not important to this discussion.

special status (e.g., Blackacre, the bride and groom, the gathering),  $\mathcal{Y}$  to the status (Ethelbert's property, being married, an official meeting), and  $C$  to the conditions in which that status applies.

The above summarizes Searle's theory of institutions. With it he seeks to account for the distinctive structures and processes which organize human society. It has several important attributes for purposes of further discussion.

**Positivism:** Searle's account is determinedly empirical as opposed to normative. It seeks to describe the nature of things—institutional things—in the world. These things have the status of facts, and may involve brute facts, but cannot be explained in terms of them. While Searle argues that every institutional fact must have some physical manifestation, he also accepts that they may continue to exist after the physical manifestation (e.g., the performative utterance) no longer exists in any physical form (see B. Smith 2003). He seeks to avoid asking whether one should accept a particular obligation, or whether a particular kind of property should be allowed, and prefers to focus on whether one “is” under an obligation or “has” property. These, to him, are “epistemologically objective” matters, although they depend on “ontologically subjective” states.

**Collective Acceptance:** The above summary of Searle's theory emphasizes the importance of collective acceptance to the persistence of social institutions: “The secret of understanding the continued existence of institutional facts is simply that the individuals directly involved and a sufficient number of members of the relevant community must continue to recognize and accept the existence of such facts” (1995, 117). If people no longer collectively accept an institutional status it will no longer be a fact. Yet Searle has not undertaken to develop a theory of collective acceptance (legitimacy). While nodding to the efforts of Durkheim, Simmel, and Weber, he neither elaborates nor spends much time on them (Searle 2003, 5).<sup>5</sup> Indeed, he argues it is not feasible to develop a theory that explains the granting or removal of collective acceptance (1995, 92). Even at a lower theoretical level, Searle does not discuss how to ascertain what constitutes a *sufficient number* of acceptors, nor what is the *relevant community*.

**Iterative Institutions:** The reasons for Searle's neglect of the bases for collective acceptance of institutions are not entirely explicit, but part of his

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5. Indeed, Searle argues that the classical social theorists fall short of the mark by failing to describe the attributes which separate persistent social institutions from mere social facts. Similarly, while acknowledging the influential efforts of Plato and Rawls to develop normative standards for institutions, Searle eschews that project in favor of developing an empirical account of the institutions that exist.



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reasoning appears to rest on the proposition that collective acceptance is often explained by the prior existence of collective acceptance of related matters. This reflects the iterative and interlocking nature of institutional facts in Searle's scheme. For example, the bride and groom are treated as married after the completion of the ceremony because many of the elements of the process already enjoy collective acceptance. These include the authority of the official to marry the couple, the authority of the couple to choose to marry, the general rights and duties of marriage, the elements of the ceremony, and so on. Thus, acceptance of a given institutional fact is largely assured by prior acceptance of many related institutional facts. Moreover, there appears to be no limit on the lateral and iterative growth of institutional facts.

**Plural Origins:** Institutional facts thus appear to be “turtles all the way down” (decisions by authorized actors) in most cases, but Searle acknowledges also that institutions can derive from unintentional *evolution and custom*<sup>6</sup> as well as from occasional *unilateral acts*, such as constitution-producing revolutions or adverse possession of property (1995, 116, 118). Again, the problem of why these facts receive collective acceptance is not treated at a theoretical level. Rather, Searle seems to assume that the collective acceptance speaks for itself, and indeed is good at least in that stability and predictability are better than disorder.<sup>7</sup>

**Status Indicators:** Because institutional facts depend on collective acceptance and are not derivable from brute facts, they often include specific status indicators, such as passports, driver's licenses, wedding rings, property titles, uniforms, and so on. While some of these indicators may be necessary to constituting an institutional fact, they also have independent importance in communicating the status. Communication of institutional status is necessary to its effective functioning in Searle's scheme. What is not clear, however, is how much information such indicators should or do communicate. If a title indicates that Blackacre is “Ethelbert's property,” that does not necessarily communicate much information about

6. His account here parallels that of Hume 1739.

7. “One of the most fascinating—and terrifying—features of the era in which I write this is the steady erosion of acceptance of large institutional structures around the world. The breakdown of national identification in favor of ethnic tribalism occurs in places as various as Bosnia, Canada, the former Czechoslovakia, Turkey, and many American universities. . . . several African Countries . . . Russia . . . The temptation in all these cases is to think that in the end it all depends on who has the most armed might, that brute facts will always prevail over institutional facts. But that is not really true. The guns are ineffectual except to those who are prepared to use them in cooperation with others and in structures, however, informal, with recognized lines of authority and command. And all of that requires collective intentionality and institutional facts” (1995, 117).

what it means for Blackacre to be Ethelbert's property. As is discussed later in this paper, this is currently an important question in debates about the structure of modern property law.

**Process Orientation:** Searle argues that the central importance of institutional facts is not their existence *per se*, but rather the potential they create for social action.

Social objects are always . . . constituted by social acts; . . . the object is just a continuous possibility of the activity. . . . A twenty dollar bill is the standing possibility of paying for something. (1995, 36)

What we think of as . . . governments, money, and universities, are in fact just placeholders for patterns of *activities*. . . . [T]he whole operation of agentive functions and collective intentionality is a matter of ongoing activities and the creation of the possibility of more ongoing activities. (1995, 57)

Thus, institutional facts are resources for collective action, and either are or can be designed so as to make certain kinds of actions possible. Creativity and change in Searle's model generally grow out of authorizations to act in a certain way, however. He does not focus on how people may act creatively to reshape those authorizations.

**Rules, Rights, and Duties:** A hallmark of institutional facts in Searle's scheme is that they are capable of codification, whereas other social facts (like walking together in a park) are not. Institutions thus have a rulelike or lawlike form, regardless of whether their underlying rules are in fact codified (1995, 87–88). Codification will only be done if it is worth doing to achieve some social end.

Moreover, institutional statuses generally take a “deontological” form—that is, one composed of powers and duties. These powers and duties are socially constructed and recognized, but have a simple and pervasive internal logical structure according to Searle. The elements are: (1) collective acceptance (2) that a given individual or group (3) may do something or must refrain from doing something, (4) the doing of which is then realized in social interaction.<sup>8</sup> Searle divides these into enablements and requirements (powers and duties hereafter), which have the following general forms (1995, 105):

We accept (S is enabled [S does A])

We accept (S is required [S does B])

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8. This is as close as Searle seems to come to discussing the problem of implementation of legal powers and duties. It follows from collective acceptance and recognition.

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Powers and duties in Searle's account also exhibit the kind of logical consistency both relished and promoted by philosophers. Thus,

S is enabled to perform act A if and only if it is not the case that S is required not to perform act A.

And,

S is required to perform act B if and only if it is not the case that S is enabled not to perform act B.

While this proposition does not seem troubling as a logical matter, depending on how far it is taken it may have serious implications in a world of epistemological objectivity, for it seems to assume that the rights and duties of social actors can be clearly and accurately ascertained in advance of their action. The question is, to what extent are property rights specified, and to what extent are they left undefined? If one makes the assumption that they are relatively completely specified, and that they can only be changed through predetermined processes, then one has the considerable problem in dealing with real world legal systems, wherein much uncertainty is experienced. If one makes the assumption that rights are often only partially defined, then one may need an additional kind of theory to explain how they are further defined.

**Property:** Although Searle frequently cites property as an archetypical institution, he provides little specific analysis of property institutions. Following a tradition going back to Grotius, he maintains that while property often begins in sheer physical possession of things (a brute fact) it becomes an institutional fact when that possession is recognized by society (Grotius 1625, § II.2.ii.1).<sup>9</sup> Possession may continue to serve as the primary signifier of property status for many kinds of personal property, but some kinds of personal property and all property in land gradually receive other kinds of signifiers, often in the form of registration or title documents issued by governments.

Eventually institutional structures for "buying and selling, bequeathing, partial transfer, mortgaging, etc." (Searle 1995, 84–85), are developed that typically require specific speech acts to signify the changed status of the property. But this concept of status change is largely limited to changes in ownership. It barely extends to changes in the types of interests—rights and duties—that might be created (mortgages being the sole

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9. There is a powerful contrary position holding that property rights are better understood as growing out of preexisting social relationships. E.g., Milsom 1976.

example), and seems to imply a model of property that is greatly limited by the brute facts of things to the questions of which actor owns them. As will be seen below, this may be a significant limit in Searle's conception of property, one which lags well behind the structure of property law in practice. Nonetheless, from within his framework it is possible to express the general form of Searle's concept of property as follows:

Blackacre (X) counts as Ethelbert's Property (Y) in New York State (C)  
 We accept (Ethelbert is enabled [Ethelbert farms Blackacre])  
 We accept (Ethelbert is required [Ethelbert pays real estate taxes])

As already noted, this general form fails to address many questions about property, including: (1) what the full list of rights and duties is, and whether it can be completely known, (2) whether there are inherent limits to structure or complexity of rights and duties, (3) how property rights and duties change and whether there are any limits to change, (4) how new types of interests or rights and duties are created, and (5) how competing claims to property rights based in different collectivities are reconciled with each other.

**Summary:** Searle envisages society as a complex architecture of institutions built out of a huge number of iterated and interrelated rights and duties. Their content varies greatly among different types of social actors. Institutionalized rights and duties are important because they enable future-oriented collective action, often in the form of complex cooperation. Rights and duties have a general, simple, and logically consistent structure. In many cases, holders of rights and duties carry a specific status indicator, which apparently plays an important role in effectuating their rights or duties. Searle's overall approach means that many questions that are often cast as normative ones by others are cast as empirical ones: what rights or duties one has are questions of fact in the specific situation. Although rights and duties depend for their existence on collective acceptance, Searle does not describe what conditions constitute collective acceptance—neither what is a “sufficient number of members” nor what the “relevant community is,” nor how acceptance is achieved.

#### 4. De Soto's Concepts of Property and Capital

While he does not discuss all of Searle's basic premises, Hernando de Soto seems to accept most, with the possible exception of logical consistency in

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rights structures. De Soto, however, is addressing a different question. Rather than *What are the essential attributes of social institutions?* he is asking *Why are third-world and former eastern-block countries consistently failing to achieve economic prosperity?* As is noted above, de Soto finds the answer in institutions. Based on extensive research and analysis of economic activity in third-world countries, he rejects several conventional explanations. The problem, according to de Soto, is not a lack of assets. In fact, enormous wealth exists in the informal urban sectors of all of these economies—typically two-thirds to four-fifths of total wealth (2000, 15–37). Nor is it a lack of markets; markets are everywhere in the third world, and new ones cropping up regularly. Nor is the problem a lack of individual initiative or entrepreneurship; de Soto finds enormous entrepreneurial creativity and energy in many impoverished urban areas. And, finally, the problem is not culture; many areas of the developing world have well-developed cultural traditions of effort, coordination, hard work, and so on. Moreover, the cultures of the developed countries vary enormously, as is illustrated by the contrast among, for example, Japan, Switzerland, and California. The reason for persistent poverty, according to de Soto, is a lack of institutions that facilitate the creation of capital:

Walk down most roads in the Middle East, the former Soviet Union, or Latin America, and you will see many things: houses used for shelter, parcels of land being tilled, sowed, and harvested, merchandise being bought and sold. Assets in developing and former communist countries primarily serve these immediate physical purposes. In the West, however, the same assets also lead a parallel life as capital outside the physical world. They can be used to put in motion more production by securing the interests of other parties as “collateral” for a mortgage, for example, or by assuring the supply of other forms of credit and public utilities. (2000, 39)

**Divided Property Systems:** De Soto maintains that the fundamental obstruction to economic growth in poor countries is the lack of a uniform set of representations of assets that would allow them to function as capital—that is, the lack of a unified property system. Instead, the developing and former eastern-block countries are characterized by multiple, often conflicting property systems. In one social sphere, the “bell jar,” are the official state property systems. These are highly formal and cumbersome. Their high costs and complexity make them accessible only to the upper classes—impenetrable to the poor. Moreover, de Soto argues, the official systems are out of touch with social reality; they are not attuned to the types of relationships and transactions that they should be able to facilitate.

In a separate sphere are the neighborhood or “informal” or “extralegal” property systems. These exist in virtually all large neighborhoods surrounding the centers of third-world cities, as well as in most rural areas. In these places, excluded from the bell-jar legal systems, self-organizing communities have created their own property systems, often borrowing some institutional practices from the official legal system and incorporating inventions or traditions of their own. According to de Soto, local consensus almost invariably exists on “who owns what property and what each owner may do with it” (2000, 186). In fact, in most urban neighborhoods these interests have been committed to paper (184). But, recognition of neighborhood property rights is limited to small groups and there are often plausible competing claimants:

The problem with extralegal social contracts is that their property representations are not sufficiently codified and fungible to have a broad range of application outside their own geographical parameters. Extralegal property systems are stable and meaningful for those who are part of the group, but they do operate at lower systemic levels and do not have representations that allow them to interact easily with each other. (181)

Consequently, unremitting and largely unproductive politicking is necessary to maintain that recognition. The uncertainty, confusion, conflicts, and wasted energy resulting from the cacophony of property systems and interests make thriving capitalism impossible.

**Unifying Property Systems:** De Soto maintains that the problem of conflicting and incomplete property systems can be solved rather simply. Given that property systems already exist in the informal sectors, the first step is to do field work on them. The systems have a structure, and it is not hard to uncover and document that structure. The second step is to fuse the informal property system with the official one. This is ordinarily not very difficult as a conceptual matter, according to de Soto, first because the informal systems have borrowed heavily from the formal one and operate within a common culture, and second because they are reasonably similar to most Western systems.

[M]ost extralegal social contracts about property are basically similar to national social contracts in Western nations. Both tend to contain some explicit or tacit rules about who has rights over what and the limits to those rights and to transactions; they also include provisions to record ownership of assets, procedures to enforce property rights and claims, symbols to determine where the boundaries are, norms to govern transactions, criteria for deciding what requires authorized action and what can be carried out without authorization, guidelines to determine which representations are valid, devices to encourage people to honor contracts and respect the law, and criteria to determine the degree of anonymity authorized for each transaction. (180)

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Given that incorporating informal rights will often involve taking away officially recognized property rights,<sup>10</sup> this position may seem an oversimplification; however de Soto does not dwell on it as a conceptual matter, presumably because he believes that the expropriated properties could not have been enjoyed by their official owners in any event. He argues that the national governments should undertake the job. They have the capacity, and doing so is in their interest since the resultant economic development will increase their revenues and organizational capacities. He stresses that open and reform-minded lawyers—rather than hidebound ones with their attention focused on formal Western legal systems—will have to be recruited to carry out this task.

The resulting unified property system should then allow the effective creation of capital. The economic potential of each asset will be fixed in a formal representation, and there will be a single system of formal representations. Individual asset holders will become accountable beyond their families and neighbors to a much larger sphere of potential partners. Physically differentiated interests will become fungible. Secure transactions will become possible. And, ultimately, the property systems will create “a network through which people can assemble their assets into more valuable combinations” (de Soto 2000, 61).

**The Western Model:** Since unified property systems have not been tested in the developing world, how can de Soto be so confident that their establishment will lead to dynamic capitalism? Much of the empirical basis for his argument is drawn from his reading of the history of Western property systems, particularly that of the United States. He argues that in the eighteenth and nineteenth centuries the U.S. was the equivalent of a modern third-world country, with large amounts of extralegal land settlement (squatting) and development. It suffered from divided, competing property systems, with the imported English property system confronting many localized squatter systems with their own titles, rules, and rights. After the systems grated on each other for decades, a broad unification process occurred late in the nineteenth century, culminating in harmonized property laws effectively recorded in registry systems.

The American legal system obtained its energy because it built on the experience of grassroots Americans and the extralegal arrangements they created, while rejecting those English common law doctrines that had little relevance to problems unique to the United States. In the long and arduous process of

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10. King 2003, 470. This article assesses alternative ways of making these transfers in practice and argues generally that the best way to do it is for the state to act as a developer which formally takes the rights (most often with compensation) and then reallocates them.

integrating extralegal property rights, American legislators and jurists created a new system much more conducive to a productive and dynamic market economy. This process constituted a revolution born out of the normative expectations of ordinary people, which the government developed into a systematized and professional formal structure. (de Soto 2000, 150)

**Summary:** For de Soto, creating a workable property system capable of supporting economic growth is largely a technical and empirical problem, one that can be solved with the application of skill and effort. The task is first to ascertain and codify the property rights that already exist in the informal sectors of developing countries, and then to integrate them into the formal legal systems in ways that are sensitive to local context. Once the institutional apparatus and the representations necessary to effectuate existing property rights are in place, dynamic capitalism can flourish.

De Soto thus shares a number of key assumptions with Searle. First, property rights are largely an empirical rather than a normative question. This is partly because, as the quotations above indicate, de Soto maintains that “social contracts” are already in place in the informal and “extralegal” sectors, and that integrating the rights and duties thereby established into the official legal system should not be seen as a normatively controversial policy. It is probably also because he believes that there is little doubt that poor people in the less developed economies want economic growth through capitalism. He is thus not prone to spend much argumentative time on the question of what would be a good property system. Like Searle, therefore, he relies heavily on collective acceptance as a foundation for institutions.

Also, as does Searle, de Soto stresses the importance of institutions as resources for future-oriented collective action. Better property systems are important not in their own right, but because they will allow people to engage in more productive economic transactions. Both de Soto and Searle see institutions as built up of rights and duties and ways of signifying them. Perhaps even more than Searle, however, de Soto stresses the central role of formal representations, and suggests at least that clear property representations may have a constitutive role in creating stronger property rights.

## 5. The Institutional Ontology of Property Law

This section aims to describe the structure and dynamics of modern property law in a way that tests and develops some of the key arguments made by de Soto and Searle. It does not directly address de Soto’s historical account of the unification of U.S. property law or his causal argument regarding the role of property law in U.S. economic development, much



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less his argument about the nature of property rights in less developed countries. Nor does this paper attempt to give a full account of the institutional ontology of property law. Its goal, rather, is to give an account of modern property law which bears upon the central propositions in de Soto's policy prescriptions and Searle's ontology in a way that might prompt intellectual progress in all three fields.

Before specific problems can be discussed, however, it is necessary to provide a basic overview of the modern property system. This is more important than it might seem because there appears to be some disparity between "commonsense" concepts of property and formal legal definitions of property rights in the legal system (see, for example, Ackerman 1977). Additional caution is in order because there is a real question whether property is a meaningful category. A common quip among property professors is that "the subject is held together mainly by the covers of the textbook." At a further abstract level, moreover, there are strong arguments that property is not a coherent concept.<sup>11</sup> Nonetheless, given that property is a category employed in a huge number of institutional arrangements, this section proceeds on the assumption that property is a fruitful subject of analysis.

**Definition and Scope:** The most elemental idea of property is that it refers to control over a thing by a person. "That thing is mine—I can do what I want with it." This idea also tracks a core legal understanding, which is that property involves rights to things; indeed, this seems to be the conventional definition of the term in civil legal systems (Zaibert 1999, 88). But "rights" also inherently refer to other people; to have a right is meaningless unless there are other people who are obligated to respect it. My right to control a thing thus depends on other people abiding by that right and not acting to interfere with or take it away from me. So, a basic legal definition of property would be that it refers to "relations among people with respect to a thing."<sup>12</sup> However, each of the basic terms in this definition raises some interesting questions.

**Objects of Property:** Taking the last term first, what kinds of "things" are covered by property? Most Western property systems have traditionally focused on two primary categories of objects: land and other things (real and personal property in the Anglo-American tradition, immovables and moveables in the civil law tradition). But neither have the distinctions been simple nor the categories exhaustive. Thus, real property in the Anglo-

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11. Perhaps the sharpest presentation of this thesis is Grey 1980.

12. "The word 'property' is used . . . to denote legal relations between persons with respect to a thing." American Law Institute 1936, at 3.

American system has included things like door keys, title deeds, uncollected loose minerals, and things connected to buildings which, while moveable, were intended to stay (“fixtures”). Conversely, personal property included things attached to buildings but not intended to stay with them, buildings raised off the ground, and rights to possess land defined to last for a lesser duration than a human life (e.g., a term of thirty years) (Baker 1990, 428).<sup>13</sup>

My purpose is neither to argue that traditional categories are arbitrary nor to find a deep structure in them, but rather to point out that they were determined not so much by the things involved as by human assignments of rights with regard to the things. Those rights were shaped by human goals and relationships. This point is driven home by another fact of property: *many of the “things” covered by property rights are hard to describe as “things” at all.* Traditional Anglo-American examples include the real property rights of advowsons (rights of certain land owners to nominate clergy), franchises (exclusive rights of certain land holders to operate specified types of markets or to take royal revenues such as treasure trove), and offices (e.g., exclusive rights to bear the king’s armor) (Baker, 1990, 283, 428).<sup>14</sup> More obvious contemporary examples are so-called *intellectual property rights*—exclusive rights to use certain technologies, processes, word patterns, or images. These are not things in any conventional sense of the word, yet we talk about property in them. Similarly, many other modern property interests, such as shares of corporate stock, bonds, bank accounts, insurance policies, and interests in “commercial paper” (various types of documents promising the payment of money) cannot be characterized as rights to specific things.

The loose-to-disappearing connection between property and things has two possible implications: either some “property” should not be called property at all, or the concept of property should be expanded beyond things. Modern property law has largely settled upon the second course, readily incorporating rights such as those to obtain certain kinds of revenues or to exclusively use certain techniques or patterns of sym-

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13. This distinction between leasehold and life estates in land requires some explanation. In the traditional Anglo-American property system, a life estate was viewed as inherently greater than a term of years, despite the fact that any particular life might go on for a shorter time than a given term of years. This can be partly understood from a modern perspective because a life is at least capable of lasting more than any typical term of years. More important from a premodern perspective, however, was that fact that the holder of the interest would not lose it so long as he was alive; his ownership was guaranteed absent treasonous behavior or other highly unlikely occurrences.

14. There are many other examples of such “incorporeal hereditaments,” including seignories, tithes, easements, dignities, etc.

bols as forms of property.<sup>15</sup> Accordingly, the definition of property has gradually been adjusted to refer to “resources” rather than things. Joseph Singer, for example, writes that property “concerns legal relations among people regarding control and disposition of valued resources” (Singer 2001, 2).<sup>16</sup> If this expanded definition is appropriate, I doubt it is because there is a shared underlying nature in the “objects” involved, one just waiting there to be elucidated by a particularly insightful lawyer or philosopher. Rather, it seems more likely that what qualifies as an object of property depends on how society is organized, what it values, and especially how it structures relationships with regard to what it values.

**Relations of Property:** What are the relations of property? As Searle and de Soto assume, modern property interests are conventionally defined in terms of rights and duties.

**Rights:** At an elementary level, property rights can include powers to take the following kinds of actions with regard to a resource:

1. use it, including:
  - a. manage it
  - b. derive profits from it
  - c. alter it (including changing it to produce more revenue or possibly even destroying it)
2. exclude others from it
3. transfer it, including:
  - a. convey it to someone else during the owner’s life
  - b. bequeath it to someone else after death through a will
  - c. leave it to legal heirs at death by operation of law

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15. Although there is a continuing discussion among scholars of intellectual property about whether theirs is really a field of property or one of regulation, this fact does not undermine the point I am making here, which is that intellectual property is treated and structured in the same way as other property. All property law can be conceived as a form of regulation. Thus, my right to have exclusive use of a house can be understood as nothing more than a governmentally made and enforced regulation that others may not enter my house without my permission.

16. Jeremy Waldron goes part of this distance, and defines property as “a system of rules governing access to and control of material resources” (1988, 31) Waldron’s use of the vague modifier “material” perhaps indicates his caution in extending the definition. Those who cling to thingness in property can see the term as ratifying their views. Conversely, those who think property can include nonphysical assets such as techniques and symbols can draw on its other meaning (“having real importance or great consequence”—*Webster’s New Collegiate Dictionary* 1974) to see it as ratifying theirs.

4. divide it
  - a. in space
  - b. in time
  - c. in interest (i.e., divide the various rights listed above among different holders)

Indeed, some commentators argue that all of these powers more or less follow from the idea of property as control, and therefore are logically entailed in each other (see, for example, Honoré 1961). As I discuss below, however, it also follows from the idea of control that an owner should be able to separate and even further divide these rights, placing them in different people, possibly at different times. When this happens property can get very complicated. First, however, a note on duties.

**Duties:** When rights are defined as above in terms of powers over resources, the duties all appear to fall on non-property owners obliged, simply, to respect whatever rights owners choose to exercise. Typically, property owners are also under duties, such as not to use their property in a way that unreasonably damages the property of others, to let others access it under certain circumstances, to keep it from deteriorating into an “attractive nuisance,” to restrain vermin, to pay taxes, and so forth (Hohfeld 1913, 1917).<sup>17</sup> Certain such rights of other persons in the owner’s property, for instance, to gather *profits à prendre* (the right to take something from the land of another), to use easements, to restrain nuisances, to prevent development, also have the formal status of property rights. Thus the property rights in any given resource can be held by multiple people and can connect them in a variety of ways.

**People:** Relatively unexamined in the discussion thus far, and to some extent in property law as a whole given its focus on powers and duties regarding resources, is what sorts of people are the holders and subjects of property rights. They could in principle range from those who directly use, control, or transfer property to a much broader set of people who benefit from or are precluded from benefiting from property—conceivably as broad as society at large. There is a deep echo of this range in one area of modern property scholarship, which focuses on the “property/contract interface” (Merrill and Smith, 2001). Thomas Merrill and Henry Smith, argue that a central distinction between contract and property rights is that contract rights refer to very specific arrangements between particular peo-

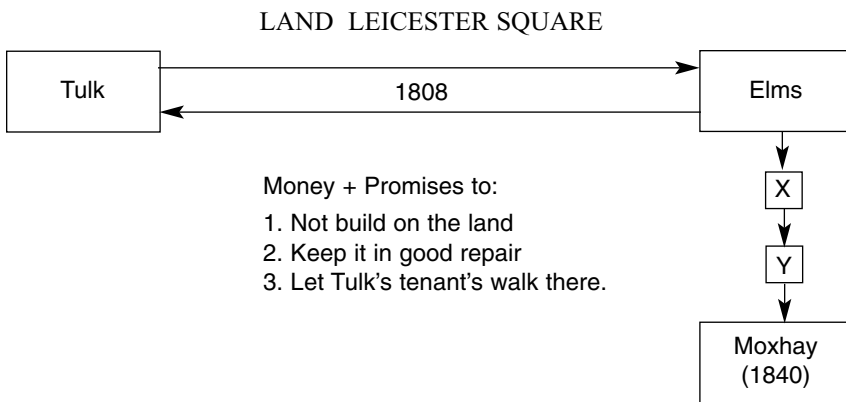
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17. Hohfeld used an eightfold system of rights and their correlatives of categories (right/duty, privilege/no-right, power/liability, and immunity/disability) to classify the various kinds of rights and duties that can exist, but there is no need to go into them here.

ple, whereas property rights refer to very general rights relative to the world as a whole. While this insightful argument is discussed further below I first want to suggest that it both implies and partially obscures a key element of property, which is the idea that property relationships persist through *time* as well as space.

**Time:** The important old decision of *Tulk v. Moxhay* (1848) serves to illustrate both the role of time in property rights and several problems of change and choice discussed below. In 1808 Tulk sold a vacant piece of land in Leicester Square (a “square garden and pleasure ground”) to Elms but retained a number of houses around the square. In addition to giving Tulk money for the garden, Elms promised that he, as well as his “heirs and assigns” would refrain from building on it, would keep it in good repair, and would allow Tulk’s tenants to walk there for a reasonable fee. Over the next several decades the square changed hands several times. Around 1840 it came into the ownership of Moxhay, who made known his intention to build on the lot in violation of Elm’s promise. Thus the overall set of transactions can be diagrammed as in Figure 1.<sup>18</sup>

**Figure 1.** *Tulk v. Moxhay*



18. This is the form that has become conventional among property scholars, and that serves as the basis for discussions of “horizontal” (Tulk and Elms) and “vertical” (Elms to Moxhay) privity. It should be noted, however, that perhaps a more logically consistent diagram would simply continue in a horizontal line such as follows:

Tulk → Elms → X → Y → Moxhay

This second approach better illustrates the conceptual difficulty of subjecting subsequent purchasers to duties undertaken by earlier ones. But it should also be noted that this difficulty inheres in most duties respecting property, which were typically worked out when predecessors were owners.

No restriction on building was included in the property deed Moxhay received, but he was aware of the promises that Elms had made to Tulk. Tulk sought an injunction to prevent Moxhay from building on the lot. Moxhay, of course, had not made the promise; Elms had. More importantly, the longstanding view of the English courts was that regardless of whether the promise not to build bound Elms, it did not bind Moxhay under the circumstances of the case. This was quite clear to the law courts, which had primary responsibility for adjudicating property rights; there was not a sufficient relationship between the two estates—no “horizontal privity”<sup>19</sup>—to justify imposing the burden on Elm’s successors. The equity courts had long followed the law courts, although one or two decisions in the late 1830s had enforced such covenants on successors (Simpson 1986, 257–62). Thus, Moxhay had good reason to believe that he held the land free of the promises made by Elms, and may have paid more for it as a result of that belief.

Tulk’s lawyer took the case to the equity courts and ultimately obtained an order to Elms not to carry through with his building plans. The Chancellor rested his decision on a traditional equity doctrine that promises should be enforceable against subsequent purchasers with notice of those promises. He supported it with the arguments that: (1) Tulk should be able to sell part of his land without the risk of rendering the remainder worthless; (2) it would be inequitable to allow Moxhay to escape the covenant when Elms had probably paid a lower price for the property due to the covenant; and (3) Elms could not sell what he did not have (i.e., the right to build on the property). The Chancellor concluded that Tulk had “attached . . . an equity” to the property, and the decision established an important new species of property right, the equitable servitude.

**Structure—Fragmentation and Bundling:** The Tulk case illustrates the ability of property owners to fragment not only their physical assets, but also their rights to them. When Tulk sold Leceister Square, he sought to withhold the rights to build on it, to exclude his tenants, and to not keep it up,<sup>20</sup> thus giving Elms a custom-tailored set of rights and duties to the land. This case only begins to suggest the potential ability of property owners to rebundle rights to resources, however. Tulk could also have

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19. This term refers to the kind of relationship between the two parties thought necessary to establish an obligation that would stay with the land as it passed from the original promisor to successors. At English law, the only relationship that qualified was a landlord-tenant relationship.

20. The imposition of an affirmative duty on the buyer to keep the property in good repair probably was not possible in English law at the time, but would be possible in American law today, provided Tulk’s lawyer was careful in creating the interests.

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divided rights to the square in time, for example by selling a thirty-year interest to Elms, giving the remainder to his own grandchildren, and possibly retaining a right to retake the property if certain conditions were violated. He could have also transferred the property to a trustee to manage in specified ways and to pay the income to designated people who could vary over time and under different conditions. All of the interests of the managers and beneficiaries would qualify as property rights under modern law. The trustee is said to have legal title to the property while the beneficiaries have equitable title, which itself can be divided into a variety of interests.

While all of the above interests are property rights, they vary greatly—just as one package of rights can vary greatly from the next. The meaning of property, therefore, no longer looks much like the commonsensical one described above—“that thing is mine and I can do what I want with it.” Rather, rights to important resources are often distributed among a number of different people, and in a number of different rights configurations. Practically speaking, the only thing common to property rights is that they involve a *legal right to draw a benefit from a valuable resource* (and correlative duties to respect those rights). Indeed, this is the predominant view of the definition of property rights developed over the past century, first by the legal realists (for example, Cook 1919 and Cohen 1935; see generally Grey 1980) and then by the economists of law (e.g., Coase 1960 and Demsetz 1967). This concept of property as a potentially infinite set of rights to draw benefits from resources accords with the models of de Soto and Searle, who both seem to assume that people will develop whatever rights and duties they choose to develop.

U.S. property law, however, has never followed this path. While it has facilitated the development of some new types of property rights over time, it still has *strictly limited the total number* (Merrill and Smith, 2000). Legions of property teachers continue to regularly educate their students that property interests must fall within a fixed number of categories.<sup>21</sup> Property owners are thus generally denied authority to fragment and rebundle their interests in more than a limited number of ways, despite the fact that the power to do so can be seen to follow from power to control and dispose of property (e.g., Heller 1999; Merrill and Smith 2001). Although new categories of property interests are occasionally established, as was the equitable servitude in the case of *Tulk v. Moxhay* described above, such developments are quite rare. The same general conditions

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21. Much of the practical content of property courses involves learning how to use recognized property interests to achieve the highly variable ends of property holders, and how to deal with interests do not fall readily into the permitted categories.

apply in civil law systems under the *numerus clausus* principle, although the details are different and the total number of property interests tends to be smaller (Merryman 1974).

What does the general limitation of types of allowable property rights in Western systems mean for institutional theories of property? The standard perspective in North American scholarship is a functionalist one: the limitation in the number of estates is assumed to reflect efficiency needs. If new interests cannot be created, it is because the social costs of allowing them would exceed the benefits (following Demestz 1967). The general assumption is that transactions costs (i.e., of information gathering, negotiation, enforcement) are the primary problem. Merrill and Smith have developed a more specific version of this perspective that focuses on information costs. Their fundamental argument, as suggested above, is: given that property rights are rights against the world, their complexity must be sufficiently limited so that the costs of gathering information on them do not become too high for them to function effectively. Contract rights, by contrast, are rights against particular persons that can be tailored to specific situations, and can therefore efficiently be far more complex (Merrill and Smith 2001).

Smith is reworking this perspective based on information theory. He focuses on the limitations on rights definitions that derive from the need to communicate effectively to the duty holders who will be obliged to respect that right. His basic argument is that the complexity of property rights is inversely related to the size and diversity of the audience that must receive the communication of the right (H. Smith 2003). Audiences will vary with the nature of the specific right, and therefore the communication limits on rights and their symbolization will vary as well. As Ed Rubin points out, however, the audience may not be the same as the group obliged to respect the right, since professionals hired to interpret property interests are often the effective audiences (Rubin forthcoming).

There is also a relatively undeveloped functionalist-oriented line of reasoning against fragmentation from an environmental perspective, which argues that the natural resources to which property rights attach are both unique and uniquely interconnected, therefore property law must either limit fragmentation (Arnold 2002, Freyfogle 2002) or require coordination (Meidinger 1998).

While functionalist justifications of finite property rights structures are highly influential, they do not have the field to themselves. A libertarian school of thought argues that bundles of property rights must be limited with the aim of preserving the ability of owners to manifest their freedom through property. The limitation derives from the survival of assets through time as described above. If one owner were able to exercise freedom so as to disaggregate rights to resources to a great extent, that would



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preclude future owners from exercising comparable freedom. Therefore the property system constrains the liberty of specific owners to rebundle property rights to resources in order to preserve a high level of liberty for all (e.g., Epstein 1995).<sup>22</sup>

Finally, there are possible explanations that also refer to effects in society, but are less benign. First, of course, it is possible that property rights are established not because they will make society as a whole better off, but rather because they will give certain powerful social groups an advantage. Saul Levmore (2003), for example, argues that property rights arrangements often reflect the organizational advantages and established power of affluent groups, who often manage to further adjust property rights to create greater wealth for themselves. James Scott (1998) provides a lengthy, well-documented argument that property rights have typically been systematized not to recognize existing social relationships, but to allow nation-states to control and reshape them—that is, to exercise and stabilize political power. In the process of doing so, states have frequently acted to simplify and homogenize property rights by eliminating the complexities of traditional property rights.

The above explanations are essentially instrumental and cultural. It would be nice if institutional ontology could cast some additional light on limitations in property rights institutions. If there is something about the fundamental nature of institutions, or of rights, which helps explain the limited number of property interests, this would be illuminating both for property rights theorists as well as for practitioners like de Soto. At present, however, institutional ontology seems to have little to say about this issue. It is raised here in the hope of spurring further discussion among ontologists. The obvious areas to be explored are whether there is something inherent in the nature of rights, or perhaps in their symbolization, which contributes to such limits in the number of species.

Even without a better ontology, the *numerus clausus* principle has direct implications for a property-focused development theory like de Soto's. First, those in charge of integrating informal with formal property systems in less-developed countries will have to pay attention to how many types of interests are involved. If there are not significantly more than exist in property systems generally, they do not face a particularly complicated fragmentation/bundling problem, and can proceed to deal with the other issues before them. It would still be important to have this information reported to property and other institutions scholars, however, since it

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22. This argument assumes that it is significantly more difficult to reaggregate property rights than it is to disaggregate them in the first place, thereby incorporating a transactions cost perspective.

would suggest that there is a general cross-cultural pattern to be explained. If, however, property law unifiers find a great profusion of potential interests they will be faced with a difficult question of how many and which ones to recognize. If they follow the functionalist analysis offered by Merrill and Smith, they will have to deal with questions of transactions costs and interpretability. If they follow the more culturally based libertarian perspective offered by Epstein, however, they will at least in principle be free to recognize a much larger profusion of interests on grounds that different levels and types of freedom through property are appropriate in different cultures. This could be an important learning opportunity for institutional theory if information is compiled on what kinds of property interests are ultimately recognized in the less-developed countries, and how they fare over time.

**Choice:** The essentially quantitative *numerus clausus* problem may be one of the simpler problems facing institutional theories of property. There are also important questions of choice involved in (1) defining the contents of specific rights and (2) choosing among competing property rights based in different cultural systems.

**Competing Definitions:** Many property interests are only partially defined, and are subject to sometimes surprising elaborations over time. Whether Tulk had the legal right to prevent Elms's successors from building on Leicester Square, for example, was questionable at best when he sold Elms the land. Assuming he had good legal advice, Tulk essentially gambled that a court in the future might see things his way. Elms, on the other hand, may have been confident that his promise was not enforceable against his successors, but if well advised would also have realized there was some risk that it might eventually be enforced. For present purposes, what is important is that a certain amount of indeterminacy seems to be the general attribute property rights.<sup>23</sup> New possibilities, problems, costs, opportunities, and understandings inevitably arise which put them in question. Thus, between the right and the duty in any specific property interest may reside a considerable amount of uncertainty.

Partial indeterminacy of rights may not be a significant problem for de Soto's development policy, since no system can avoid it, but it creates a conceptual gap that a satisfactory rights-based institutional ontology can

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23. There were many other such questions. Could one of Tulk's tenants have enforced Elm's promises? Perhaps, but it is difficult to be sure. Could a married woman have enforced them? No then, but yes later. Thus, who could hold the right was changed from outside the context of the right. If tenants had affirmative rights to walk in the square, did they have the right to bring their guests? Could Moxhay have killed songbirds on the land? One could go on, but the point should be clear enough.

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be expected to address. One approach, of course, is simply to say that definitions of rights and duties are subject to the inherent limits of language and leave it at that. But that approach may fail seriously short of comprehending the institutional dimensions of the problem.

An alternative approach would be to attempt to analyze rights indeterminacy and the institutions which address it in practice. The *Tulk* case, for example, illustrated two interesting institutional legal phenomena. First, two distinct decisional forums—the law courts and the equity courts—had the capacity to define and elaborate the contents of property rights. This is a common condition in legal systems, and one which Searle's model does not really address. It may violate what I called the condition of logical consistency earlier. This is because it is the case that both the law and the equity courts were empowered to answer the same question of rights and, in effect, to answer it differently. One could try to evade this problem by noting that in the end the equity court's answer prevailed, but this would then further enfeeble institutional ontology's capacity to illuminate widespread phenomena of great practical importance.

A second striking feature of the *Tulk* case was that in deciding it the equity court took a general principle that it had been applying in other lines of cases—that a purchaser with notice of an obligation should take the property subject to that obligation—and applied it to the question of when a "real covenant" should run with the land. This too is an extremely common characteristic of legal decision-making. Courts, and, for that matter, legislatures, are constantly asked to treat one claim as certain others are treated (and not as still others are treated). Often these requests call on general principles such as fairness, efficiency, or moral rectitude. It is difficult to describe this process adequately in terms of a rights-based, deontological model—at least if rights are not conceived at least as part containing or being subject to further normative argument. Addressing this phenomenon may require ontology to incorporate certain hermeneutic or discursive elements.<sup>24</sup>

**Competing Systems:** When Europeans arrived in North America they found functioning native property systems (Cronon 1983), although they often did not recognize them as such. Those property systems were inconsistent with the Europeans' own, and generally inconsistent with their claims to resources in the "new world." When the inevitable conflict between rights based in the two systems reached the U.S. Supreme Court in the early nineteenth century, Chief Justice Marshall ruled for the unanimous Court that land rights obtained from the U.S. trumped those

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24. For a pragmatic hermeneutic perspective, see Rose 1994.

obtained from Native Americans (*Johnson v. M'Intosh* 1823). The U.S., he said, had acquired by treaty the rights held by the British under European legal principles. The "doctrine of discovery" gave the first European nation to discover land "then unknown to Christian peoples" the right to take possession of and impose its law on it, which the British had done in much of eastern North America. The U.S. courts, according to Marshall, had no choice but to follow the law of the U.S. system. Neither Britain nor the U.S. Congress had made any effort to recognize and incorporate Indian land rights, and the Court thus felt bound to recognize their decision to override Indian title.<sup>25</sup> Far from incorporating indigenous property systems, the U.S. system sought to override them.

At the same time, however, the Supreme Court did not go as far in overriding Indian property rights as might have been expected. The Court limited its holding to the proposition that discovery gave the U.S. the exclusive right to extinguish Indian title. Until the U.S. did that, native tribes retained a right of occupancy to their lands, a right which could be elaborated or strengthened through treaty and other negotiations. Moreover, the decision tried to limit the U.S. policy to what Marshall presented as the particular difficulties of dealing with Indians:

Although we do not mean to engage in the defence of those principles which Europeans have applied to Indian title, they may, we think, find some excuse, if not justification, in the character and habits of the people whose rights have been wrested from them. . . .

Where incorporation is practicable, humanity demands, and a wise policy requires, that the rights of the conquered to property should remain unimpaired; that the new subjects should be governed as equitably as the old, and that confidence in their security should gradually banish the painful sense of being separated from their ancient connexions, and united by force to strangers. . . .

But the tribes of Indians inhabiting this country were fierce savages, whose occupation was war, and whose subsistence was drawn chiefly from the forest. To leave them in possession of their country, was to leave the country a wilderness; to govern them as a distinct people, was impossible, because they were as brave and as high spirited as they were fierce, and were ready to repel by arms every attempt on their independence. (*Johnson v. M'Intosh*, 589–90)

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25. "The British government, which was then our government, and whose rights have passed to the United States, asserted a title to all the lands occupied by Indians, within the chartered limits of the British colonies. It asserted also a limited sovereignty over them, and the exclusive right of extinguishing the title which occupancy gave to them. These claims have been maintained and established as far west as the river Mississippi, by the sword. The title to a vast portion of the lands we now hold, originates in them. It is not for the Courts of this country to question the validity of this title, or to sustain one which is incompatible with it." *Johnson v. M'Intosh*, 588–89.

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As overwrought as the language about the savage nature of Indians might seem to the modern reader, the overall thrust of the opinion was to ratify the U.S. power to extinguish Indian title, but also to keep alive the discussion of appropriate limits on that power. This discussion has continued in the U.S. legal system for nearly 200 years since the decision, and the issue of Indian land rights still has not been conclusively settled.<sup>26</sup> This suggests several points about property rights for ontology and development policy. First, of course, not all informal rights were incorporated in the U.S. property system during the nineteenth century. The U.S. system refused to give many Native American-based property claims the status of institutional facts, yet it retained them as normative problems to be addressed. This raises the question of what types of rights are and should be incorporated in modern property systems. Like the process of elaborating existing rights, the choice of which rights to incorporate is hard to describe as a purely factual question, particularly when the official decision process continues a normative dialogue on the proper respect for rights originating outside the system.

Development policy has no choice but to address the problem of which rights to incorporate. For example, when, if at all, should state systems incorporate informal property systems that seriously disadvantage women?<sup>27</sup> Similarly, when should informal property rights deriving from violence or the threat of violence be incorporated? Making such decisions will at a minimum require some sort of normative analysis. But the prob-

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26. This unsettled question is part of a larger legacy of plural legal systems. Indian legal systems, although greatly altered by the colonial experience, remain in effect in large parts of the country, creating many complicated questions of rights and identity. See, e.g., McSloy 1994. There are also numerous other property rights systems operating inside the U.S. that are neither incorporated nor effectively suppressed by the official legal system. For example, lobster fishermen working in public waters typically organize into groups that define and enforce boundaries to their fishing areas, as well as other rules for catching lobsters. These property systems are outside the official system, and are occasionally challenged by U.S. officials when the lobstermen's enforcement systems become too aggressive. But for the most part they are allowed to continue without either incorporation or suppression (Acheson 1988). Some systems seem more directly at odds with the official system, but also continue to persist. One of my colleagues, for example, relates the story of how his father bought a window-washing business in New York City. The father needed a loan, but had no real property with which to secure the loan. He obtained a loan from a private financier, with the clear understanding that if he defaulted on the loan several of his limbs would be broken. We could say that the borrower gave the lender a security interest in his physical well-being. The lender in turn provided capital (at extremely high interest rates) but also protected his borrower's "territory," ensuring that competitors would not enter the area so as to drive down prices and reduce the value of the loan. This was a common arrangement for certain kinds of small business loans in New York City for several decades, and might still be.

27. This is a very real question in development policy. See, e.g., Mukhopadhyay 2001.

lem might also be more ontologically complex. For there is also a body of scholarship suggesting that there are fundamental incompatibilities between traditional and modern legal systems, and that translating traditional relationships into a modern system will alter both of them (e.g., Zerner 2003, Engel 1978). If so, the challenges to development policy and institutional ontology are great indeed.

**Externally Driven Change:** One of the most interesting current developments is that definitions of property rights in national legal systems are increasingly subject to transnational influences. Two types of developments exemplify this process. The first is the growth of “regulatory expropriations” law through international trade treaties. The second is the definition and enforcement of standards for property management by nongovernmental organizations.

**Regulatory Expropriations:** The North American Free Trade Agreement provides that no country may “directly or indirectly expropriate an investment of an investor” from another country, or “take a measure tantamount to . . . expropriation,” unless it meets a number of conditions, including the payment of compensation.<sup>28</sup> The provision has close analogues in other trade treaties, and is being vigorously promoted as a desirable trade provision by many transnational business organizations and developed countries.

In a widely noted case several years ago a NAFTA tribunal found Mexico to have violated the provision in the case of a U.S. corporation that acquired a Mexican company involved in constructing a hazardous waste landfill in the state of San Luis Potosi. The Mexican company had obtained several federal and state permits to build the landfill, commenced construction, and indeed transported some hazardous waste to the site. Several years after commencing these efforts the same period the Mexican company began negotiating to sell its assets, including the permits (arguably another example of intangible property rights), to U.S. based Metalclad Corporation. Shortly after the sale was consummated the municipality issued a “stop work” order on grounds that the company lacked a necessary construction permit. There were also ongoing local demonstrations against the plant. Although they maintained that such a construction permit was not required for the landfill, and assured Metalclad that it had all of the necessary permits, Mexican federal officials urged it to apply for the

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28. North American Free Trade Agreement, Article 1110(1): “No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law . . . and (d) on payment of compensation . . . .”

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additional permit and to continue negotiations with the state and local governments. The city continued efforts to block the project, and Metalclad eventually filed a claim under the NAFTA provision quoted above. Thereafter the state governor declared a large area including the plant site as a natural area for the purpose of protecting rare cacti, precluding construction of the landfill there.

While it appears quite unlikely that this sequence of events would have been treated as a compensable taking under Mexican law, the NAFTA tribunal found the Mexican state and local governments to have violated the expropriation provision. It ruled that expropriation under NAFTA includes:

. . . not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property *which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.* (emphasis added) (Metalclad v. United Mexican States 2001)

The Mexican government was ordered to pay Metalclad U.S. \$16.7 million plus interest. On appeal a British Columbia court (which had jurisdiction under NAFTA because the arbitration was officially located in the Province) largely upheld the Tribunal's order, although it reduced it reduced the amount of interest in the award on grounds that the expropriation was not realized until the governor declared the site a protected area (Mexico v. Metalclad Corp. 2001)

Most notably, the standard for defining the expropriated property interest was not Mexican law, but rather the reasonable expectations of business owners as defined by the NAFTA tribunal and foreign appellate court. Thus property rights of foreign investors are coming to be defined not by the national legal system of the country, but rather by international business tribunals authorized to accept complaints by foreign corporations against individual countries.<sup>29</sup>

**Nongovernmental Rights Definition:** A second process of transnational property rights definition operates largely outside the realm of government, and is practiced by transnational civil society organizations seeking to set global standards for proper business behavior. A good

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29. The ironic result is that, at least in some cases, the property rights of a foreign investor will be greater than those of a domestic one, and that in any event they will not be defined solely in reference to national law.

example is the Forest Stewardship Council (FSC), which sets and implements global standards for forest management. These standards are formally voluntary, but companies that meet them can claim to be meeting the highest standards of propriety. Products derived from their forests can carry the FSC logo, which brings with it the approval of transnational environmental, labor, and social justice organizations.

The standards set by the FSC include protections for communities, indigenous groups, laborers, and biodiversity, among other things.<sup>30</sup> For example, certified forestry operations are required to respect customary use rights such as traditional hunting and gathering rights. In many national legal systems these rights are either not recognized or not protected. One of the main goals of the FSC process is to gain them recognition, and thereby to raise the level of protection of customary property rights. Its goals are similar with regard to indigenous peoples' rights, labor rights, and environmental protection. The basic assumption is that if enough public demand for meeting these standards can be established through a formally voluntary certification program, they will eventually become institutionalized duties applicable to forestry operations in general. Perhaps they will be adopted into formal legislation, which has happened in some places, but perhaps not. So long as the duties become established and accepted expectations, property rights will have been redefined to include them.

While it is too early to say that the FSC process has been a thoroughgoing success, it is already clear that it has had a considerable influence. The center of opinion among practicing foresters seems to have moved from vigorous resistance to grudging acceptance to a near embrace of certification system duties. The FSC process has given rise to a number of competing nongovernmental standard-setting processes, some of them industry based and intended to blunt the demands of the FSC. But they have ended up placing a broad array of forest management operations under public scrutiny, and appear to be stimulating a gradual rise in standards for acceptable forest management. Thus neighbors, indigenous groups, laborers, and even various exemplars of biodiversity are gaining an

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30. Sample standards include the following: Principle 2. Long-term tenure and use rights to the land and forest resources shall be clearly defined, documented and legally established. Principle 3. The legal and customary rights of indigenous peoples to own, use and manage their lands, territories, and resources shall be recognized and respected. Principle 4. Forest management operations shall maintain or enhance the long-term social and economic well-being of forest workers and local communities. . . . Principle 6. Forest management shall conserve biological diversity and its associated values, water resources, soils, and unique and fragile ecosystems and landscapes, and, by so doing, maintain the ecological functions and the forest . . . (Forest Stewardship Council 1993).



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institutionalized right to better treatment by forestry management operations, and that right is being constructed in a global process of dialogue and contestation. Property holders are gradually coming under a concomitant duty. The processes in which these rights and duties are being redefined extends well beyond the local polities which have traditionally been seen as the source of property rights, and again, it is hard to see as entailed in any way in the original definitions of rights and duties attendant on property holding.

The kinds of property rights redefinition discussed here can only be partially accounted for within the frameworks of de Soto and Searle. On one hand, they are both open to nongovernmentally created rights and duties, and the FSC process is an example of this. On the other hand, the process is happening at a global, rather than a local, level. For de Soto, this at least raises questions of where to look for institutionalized property rights. Some of them are apparently being negotiated among transnational communities. For Searle, these processes raise questions about both who an authorized actor is and what the relevant community is. Authorized actors in the NAFTA case were created by the national governments. But it is not clear that those governments had authority to give those actors the power to redefine property rights within their jurisdictions; indeed it seems quite unlikely in most cases. Thus, if those actors are exercising that power, they may be seizing it to some extent, or perhaps creating it, in the course of doing so.

## 6. Conclusion

This paper's discussion of modern property institutions has focused largely on features that seem not to be well accounted for in Searle's ontology and de Soto's development prescriptions. These include: (1) the tendency of modern property systems to constrain the available structures of rights and duties to a limited set of forms, (2) the partial indeterminacy and changeability of all property rights definitions, (3) the existence of competing decision makers and principles for elaborating property rights in modern legal systems, (4) the selective incorporation and suppression of indigenous legal arrangements by modern legal systems, (5) the shifting and contested boundaries of the institutional systems—the relevant communities—that define and implement property rights, and (6) overarching these all, a tendency of rights- and code-based models of legal institutions to underplay or ignore the open-ended and creative elements of institutional processes for adjudicating and elaborating property rights.

This of course has been a selective rendering of property law. A different one might have focused more on what the perspectives of de Soto and Searle

can teach us about property. Yet, this approach may be the more productive one in the end. First, of course, it offers Searle and de Soto some material that might be useful to them in further developing their perspectives. And it may turn out to be the case that their work will shed significant light on the appropriate level of fragmentation of property rights, the role of indeterminacy in property rights definitions, and choices among alternative communities in recognizing property rights. That remains to be seen.

Either way, however, the composite picture that emerges from this exercise may indicate some important areas for further development in Searle's and de Soto's perspectives on institutions. Perhaps the most fundamental is that perspectives which focus on rights and duties as facts tend to draw attention away from some of the processes involved in creating, maintaining, elaborating, revising, and contesting those facts. If rights and duties are seen as largely the creation of authorized actors exercising rights and duties that they already have, we have no account of nonreductive exercises of power and politics. Normative arguments and contestation are hard to see as anything other than outcomes. And the process of choice among alternative claims of right will be seen as nothing more than a result of collective acceptance. This will be seriously shortsighted to the degree that that the institutional facts of rights and duties involve provisional allocations of the power to act and make arguments in an institutional framework subject to continuing renegotiation and frequent, sometimes abrupt change.

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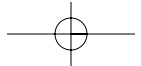
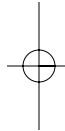
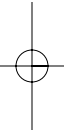
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# The Institutionalization of Real Property Rights: The Case of Denmark

*Erik Stubkjær*

## 1. Introduction

In *The Mystery of Capital*, Hernando de Soto raises the question of why capitalism triumphs in the West and fails everywhere else. He points to “the legal property system, [which] became the staircase that took [presently developed] nations from the universe of assets in their natural state to the conceptual universe of capital, where assets can be viewed in their full potential” (2000, 43–44). De Soto answers this question, in large part, by pointing to the fact that most of the assets in successful Western nations have been integrated into one formal legal property system, resulting in what amounts to a single *formal representation system* for property. While this integration and formalization of capital in Western nations occurred slowly and rather unreflectively over the course of several hundred years, the question of just how it came into being has become an urgent one since the end of the cold war, because we now live in a world where capitalism appears to be the only serious option for development (2000, 44, 46, 57). However, such legal property systems are a complex phenomenon. As de Soto points out, realizing the full economic potential of property demands “an implicit legal infrastructure hidden deep within the . . . property system—of which ownership is but the tip of the iceberg.” The problem, according to de Soto, is that “[t]he Western nations have so successfully integrated their poor into their economies . . . they have lost even the memory of how it was done, how the creation of capital began,”

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Thanks go to my wife, M.A. in Nordic Philology and Cinema, Lone Stubkjær, born Friisberg, who through decades of marriage opened my eyes to literary and theological issues. The Rt. Revd. Henrik Christiansen, Aalborg diocese, pointed out the Danish Conventicler Order of 1741, and commented on a version of the note. Andrew Spear kindly improved the English of the author. Translations into English are made by the author.

and, to remedy the problems the world is currently facing, “[t]hat history must be recovered” (2000, 7, 8, 9).

The following offers such a historical inquiry regarding one of the smaller Western countries: Denmark. This inquiry takes the form both of a recovering of the “hidden infrastructure” underlying current Danish property law and an account of how our present property system came into being. In this chapter, I analyze both the general and economic histories of this issue from the point of view of a geodetic engineer, and this analysis will in turn lead to a new understanding of the role played by mortgaging in Danish property law after the 1960s, as detailed in section 5. However, before setting out on the retelling of an aspect of Danish history, I remind that the events of history can be understood and related to one another in many ways. Thus some methodological issues are addressed in section 2.

De Soto considers formalized property systems to be “controlled environments to reduce transaction costs.” He states further, “By representing economic aspects of the things we own and assembling them into categories that our mind can easily grasp, property documents reduce the cost of dealing with assets and increase their value commensurately” (2000, 201). This reference to transaction costs is in agreement with the idea of presenting Danish events within the analytical framework of New Institutional Economics. The notion of *institution* is adopted here in relation to the historical aspects of formalized property law to be presented. The institution of real property rights has been addressed and traced historically, notably by Douglass C. North (1990), and this allows us to put the outcome of the Danish case in a wider context. As we shall see developed in section 3, Denmark has through some centuries had a uniform Christian religion and a uniform bureaucratic administration, which on the explanatory model offered by North are comparable to the situation in South America, while Danish economic development compares more directly to what has occurred in North America. The Danish evidence, supplemented with readings of Roman Catholic doctrinal texts, suggests a modification to North’s model, one pointing to the societal costs of creating associations.<sup>1</sup>

Section 3 only provides some snapshots of Danish history. In order to give an account of the development of the Danish formalized property sys-

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1. Francis Fukuyama, in ‘Trust—The Social Virtues and the Creation of Prosperity’, examines the role of voluntary organizations around the world and notes, among others, “in certain Latin Catholic countries a relative deficit of intermediate social groups in the area between the family and large, centralized organizations like the church or the state” (1995, 55). The present chapter is thus new not in pointing to the role of associations for economic performance, but rather in the way this role is motivated.



tem, we have to provide more details. These are presented in section 4, which aims at providing information with a bearing on the introduced analytical framework, and section 5, which in more technical terms addresses the formal property system and mortgaging.

## 2. Methodology Issues

An institution is understood here in North's sense as constituting "the humanly devised constraints that shape human action" (North 1990, 3). These constraints can be understood as being created through what Searle has called "collective intentionality" (1995, 23–26). It is assumed here that either an individual role model or a group functions to provide a shared social understanding, which is then reinforced by repeated action. Now, how do these institutions come into being? Searle asserts that "the creation of institutional facts may proceed without the participants being conscious that it is happening according to [the form 'X counts as Y in C']" (1995, 47). Thus, "in the very evolution of the institutions the participants need not be consciously aware of the form of the collective intentionality by which they are imposing functions on objects. In the course of consciously buying, selling, exchanging, etc., they may simply evolve institutional facts" (47).

More subtle factors of institutional change are identified by North (1990), including the institutional structure of society, which may support or hamper the wealth-maximizing opportunities of organizations and other entrepreneurs, and hence economic development. Factors that play a role here include skills, be it communicative or tacit knowledge, and incentives. The institutional structure provides various incentives as to whether skills are developed within its various domains, for example, the religious or the technological domains. Also, the institutional structure may vary regarding its degree of toleration for the development of new knowledge and worldviews. A final factor of development is people's perception that the structure of rules in the system is fair and just (North 1990, 76).

Factors to look for will thus include education and the existence of motivations for learning. Regarding whether rules are fair and just, we will pay attention to their internal structure, for example, whether or not a system of rules involves the occurrence of dual standards.

Since our goal is that of tracing institutional developments in Denmark, we would benefit here from a more fully articulated developmental model of institutions. One way of developing such a model would be to employ what has been called institutional analysis and design, extending from the well-known method of information systems analysis

and design (see Stubbjær 1999 for a survey). Neither institutional analysis nor institutional design nor the combination is new (Ostrom 1991; Goodin 1998; Ostrom 2002). While a full investigation of these sources is outside the scope of this paper, the approach that they offer does help shed some light on how we should view historical changes in property institutions.

Research carried out on transitions in Eastern Europe is in agreement regarding the “invisibility” of institutional change: “It will turn out that ‘design’ [of institutions] is a rare and unlikely mode of change; it is even less likely that the activity of ‘designing’ will be recognized, acknowledged and remembered as such” (Offe 1993, 10–11). However, with many reservations and variations, which are omitted here, some suggestions are indeed offered: “persons (such as Jacek Kuron in Poland), circles and movements that were publicly credited with the quality of being trustworthy proponents of these ideas [alternatives to communism] in Hungary and Poland, turned out to be powerful resources in the process of institution building, as they represented, at the round-table talks, in the media and elsewhere the moral infrastructure and normative meaning of the order to be built” (Offe 1993, 16). These persons, informal networks, and associations made “the visible presence of nuclei of an oppositional political culture capable of entering into relations of compromise and competition with the authorities of the old regime [and] turned out to be a decisive determinant in the process of institution building” (16). The negotiation of modified institutions was thus based on “the presence of a model of the new institutional order that is typically not invented on the spot, but ‘imported’ and suitably adapted from more or less remote points in time or space. Institutional designs are typically copies, and they are frequently advocated as such” (15).

What can be extracted from these findings is that authorities, social movements, associations, and their interplay regarding political and institutional issues should be recorded, and that we should look for “models of new institutional order” in which all of these play a role.

An early effort in reflection on centennial institutional development was made by the German sociologist Max Weber. His works are complex, but a recent interpretation by Randal Collins (1986) is available. Two concepts or “ideal types” put forward by Max Weber: bureaucracy and patrimonialism, promote an analysis of the interplay between governance and property. Weber suggests that the twins bureaucracy and patrimonialism represent two extremes between which national states fluctuate during their social and political histories. In *bureaucracies*, decisions and procedures are rule bound, positions are well-defined, and administrative means and fees are kept strictly separate from the individual material assets of the

staff. In contrast, *patrimonialism* is like bureaucracy in being an organization of administrative staff, but the relations within this organization are importantly different. In a patrimony, the authority relationship is based on personal loyalty to the superior or ultimate leader, with all other members of the organization falling beneath the leader in hierarchical fashion. In such a hierarchy the leader can handle with substantial discretion both his subordinates and the dependent clients or subjects located outside the administration. One could say that whereas a staff member in a bureaucracy is the custodian of his position, a staff member in a patrimony operates as the “owner” of his position in the hierarchy. Within patrimonialism, political rights and economic rights come together, in the sense that political power includes the command of all resources. Property rights or political rights for any group independent of the leader do not technically exist (cf. Collins 1986, 39).

Since we are interested in the issue of individual ownership, it will be important to keep track of the development from patrimonialism towards bureaucracy, which seems to be a precondition for the existence and availability of real property rights. While it seems promising to relate detailed evidence, such as that from Denmark, to the model of Weber and Collins, this first survey of the Danish history is not intended to be a strictly Weberian account.

As for the retelling of Danish history, we have to confine ourselves to a rather discretionary selection of events and relations, mostly taken from the fourteen-volume standard publication on the history of Denmark, *Danmarks Historie* (hereafter referred to as *DH*), and occasionally from a short version of Danish history in English, provided through the Ministry of Foreign Affairs (Jespersen, 2007). Section 5 includes reference to primary sources, namely recordings of assembly deliberations in 1842.

### **3. Explaining Long-Term Economic Development: The Americas and Denmark Compared**

North compares the long-term economic development of North America with that of South America in the context of presenting an analytical framework for explaining such development (1990). The following relates Danish experiences during the same period with the findings of North and argues that bureaucracy does not generally hamper economic development as North seems to suggest. Rather, an alternative explanation can be seen in the past tendency by the Catholic Church and related establishments to control the spontaneous creation of organizations.

### 3.1. *The Economic Development of the Americas and of Denmark*

North notes that there are enormous contrasts between economies, despite the falling costs of information and technological change. Consequently, he asks, what accounts for the persistence of societies whose economies are characterized by poor performance? and what prevents them from adopting the institutions present in more efficient economies? (1990, 92–93). The following is a brief summary of North's answers to these questions for the cases of North and South America, respectively.

The economic development of North America from the 1750s onwards is characterized by *religious diversity*, *local political control*, and the *growth of assemblies*, all of which it inherited from Britain. Development was framed first and foremost by British imperial policy, but within that framework, the colonist entrepreneurs were free to develop, even if the colonists themselves imposed more restrictions on property rights than did the mother country (1990, 102).

During the same period of time, the economic development of South America is characterized by North as involving the conquerors' imposition of a "uniform religion and uniform bureaucratic administration on an already existing agricultural society." Efforts at reversing this centralized bureaucracy were partial and quickly negated. South American wars of independence during the early nineteenth century brought in French- and U.S.-inspired constitutions, but in spite of that, efforts towards decentralization of powers were unsuccessful after the first years of independence. In the nineteenth and twentieth centuries, country after country reverted to "centralized bureaucratic controls and accompanying ideological perceptions of the issues" (1990, 102–3).

Comparing these lines of development with Denmark, it should first be mentioned that Denmark is extremely small when compared with the Americas. The distance, both in the literal and figurative sense, from local political control to centralized bureaucracy is small in Denmark, and thus it is problematic to infer anything from this aspect.

As regards the growth of assemblies, the Danish development fits with the reasoning above on their impact. Provisory assemblies of the 1830s already had some practical impact on real property affairs, as we shall see developed in section 5, and later in the century associations were created, which provided for mortgaging and other kinds of economic development.

However, as regards the religious aspect, the Lutheran Denmark had almost no religious diversity from the time of the Reformation in 1536 through the end of the nineteenth century. The constitutional freedom of religion from 1849 on brought effects only late in the century, and these had almost no recordable economic consequences. The development was

indeed influenced by the Danish version of the Lutheran “uniform religion,” but as described in sections 4.2 to 4.4 below, with an economically positive outcome. As regards the bureaucracy, historians consider Denmark to have had a “stable bureaucratic absolutism” from the late seventeenth century on, implying that the king “by grace of God” and with the help of his advisors, ruled the country in a fairly top-down but also quasi-rational way, (see section 4.2). The improvement in methods of land registration during the nineteenth century fits into this general characterization, and Danish governmental administration was primarily a legal affair until the 1970s, when company management became a model for public affairs. For the case of Denmark it seems that bureaucracy at least permitted if not fostered an economic development comparable to that of North America.

To summarize, Denmark had both a uniform religion and a bureaucratic government, which are precisely the factors that North has used to explain the delayed economic development of South America. Still, Denmark enjoyed a development largely similar to that of North America. We thus have to question the role that these two factors actually play in influencing economic development.

Questioning religious diversity and bureaucracy as relevant factors, we are facing the problem of explaining economic development in a way other than that proposed by North. The factor of the growth of assemblies has so far been taken in the wide sense as including the creation of socially active associations. In the following I intend to show that North’s reference to religion and bureaucracy can be specified in a way that relates to the societal costs involved in the spontaneous creation of associations. These costs were high in South America and other Catholic societies, while low in Lutheran or mixed countries. The explanatory model offered by North can thus be modified in a way that reconciles the evidence presented above and also explains the observed outcome in terms of economic development.

### *3.2. The Impact of Religion on Development*

Before entering into an assessment of the impact of religion, a sketch of reality perceptions may be relevant. The Roman Catholic and the Orthodox conceptions of reality are to some degree the same, and to introduce the issue, I take an example of Orthodox provenance. A thoughtful newspaper article recounted Russian experiences in the field of individual property rights in land. The Moscow-based reporter Flemming Rose notes that even in well-off quarters of towns, where apartments are individually owned, garbage piles up outside the apartments. Further, local

roads are neglected, even when neighbors have sufficient material resources to maintain them properly. An explanation of these phenomena is offered by professor Alexandr Etkind of the European University in St. Petersburg. “Behind these phenomena hides a conception that what we do together in Russia, we do together with the State or through the State, and when the State does nothing, we do nothing either.” (Rose 2003, 7)

I propose that this norm of behavior is not attributed to the socialist regimes of the twentieth century, but rather to a certain Christian way of thinking, a vision of the world held in the Byzantine Empire from the fifth century on. According to this worldview, executive powers emanate from God through the church to the world. By “executive powers” I mean power to act in the right way, according to one’s competencies. The term “executive powers” is usually used for the management of governmental affairs, but here it is used in a much wider sense, referring to the government of God that spans all creation (see Sendler 1988, 55–57, on the Byzantine society, and 169–72 on the doctrine of Pseudo-Dionysos). Returning to the example, it means that the apartment owners do not care for joint areas, because nobody possessing the appropriate authority entitled them to do so.

The above interpretation may be substantiated by reference to official documents of the Roman Catholic Church on the associations of workers. Some of these documents were issued in the context of the general political battles surrounding trade unions in the early twentieth century. Within the German Catholic realm, a specific and divisive trade union controversy (*Der deutsche Gewerkschaftsstreit*) took place. It largely addressed the issues of whether workers’ associations should be clerically led, whether such associations could mix Christians of Catholic and non-Catholic denomination, and what role the Catholic labor movement might take in the democratic process, including attitudes toward the “free” workers’ unions, which were perceived at the time to be militantly atheistic.

A document released by a bishops’ conference in Fulda, 1900 (“Fuldaer Pastorale”), insisted on the operating of the associations on a strictly religious base (“die unbedingte Notwendigkeit, die Arbeitervereine auf religiöser Grundlage aufzubauen”).<sup>2</sup> Without explicitly insisting on clerical leadership, it pointed to the idea that Catholic men should consult

2. The insistency on clerical (establishment) leadership was neither a Catholic nor a German specialty. A Conventicler Act issued in England 1664 forbade religious assemblies of more than five people outside the auspices of the Church of England. Similar prescripts were issued in Sweden 1726 and in Denmark. The Danish Conventicler Order of 1741 requested the parish priest to chair meetings of devout lay people (*DH* 9:236). However, the Constitution of 1849 brought freedom of association and of religion.

their mother, the Catholic Church, stressed the obligation of association leadership to care for religious formation, and advised the leaders to engage “able and willing helpers” (*tüchtige und willige Helfer*) among the laity (Bundesverband 1977, 73, 77). The release of the document was followed by a decade of struggles, because the large majority of Catholic workers wanted associations without clerical leadership. The pope twelve years later issued an encyclica to the German bishops, ruling that under strict conditions the participation of Catholic workers in mixed Christian associations (“christlichen Gewerkschaften”) could be “tolerated” (“es könne geduldet und den Katholiken gestattet werden”). Conditions included that the workers engaged in—and paid to—the “Arbeitervereine” in parallel (Bundesverband 1977, 84).

According to an interpretation by the Nestor of Roman Catholic social teaching, Oswald von Nell-Breuning SJ, a real change was instituted by the encyclica “Pacem in terris” from 1963, which was later corroborated by the Second Vatican Council. It asserted that the clerics should no longer patronize the laity, but rather every layperson should take responsibility within his or her professional domain (Bundesverband 1977, 19). The Council document “Gaudium et spes” from 1965 literally proclaims the laity to be the authorized estate on secular issues. It calls the laity to cooperate most readily with those who share the same tasks. The layperson should not expect a specific solution from the spiritual advisor, who might not have the mission needed. In controversies about the implications of the gospel on a specific issue, no party can claim that its solution is exclusively supported by Church authority (Second Vatican Council. *Gaudium et spes*, paragraph 43). The above excursion into the development of Catholic social teaching relates well to the Russian example of today. Also according to Roman Catholic beliefs, authority emanates from God through the Church. Early in the 1900s, church authorities held that this implied the leading role of priests in secular issues, as documented above. By the 1960s, however, the Council document takes up the issue again by explicitly referring to the different mission and authority of laity and clerics, respectively. In applying the authority of the Church, the fathers of the Second Vatican Council formally (through “Gaudium et spes”) empowered the laity to perform the tasks that people of protestant denominations had been performing for some centuries. Furthermore, the Second Vatican Council formulated a more elaborate self-conception of the Church, marked by the keywords “subsistit in.” It implies, in loose terms, that the light emanating from God is not restricted to work through the hierarchy and members of the Roman church as a sociological entity. Consequently, according to this self-conception, not only the Christian laity but also any person “of good will” may participate in the perfection of creation.

The above quotations of Catholic doctrine from the opening and middle of the twentieth century provide evidence for the position that at least until the first half of the twentieth century, the Catholic belief system generally insisted on providing authoritative approval for societal changes of any importance. Due to the well-known path dependency, such past perceptions and behavior patterns are hard to change, even among those who for various reasons have dissociated themselves from church circles.

### 3.3. *The Cost of Creating Associations*

Returning then to North's interpretation of economic development, it can be established that an important factor in explaining the difference between the Catholic South America and the mixed or Protestant North America and Denmark is *the social costs of creating associations*. In the U.S. from the beginning of the eighteenth century, and in Denmark from the middle of the nineteenth century, people could spontaneously unite into associations, voice their demands, and through the associations contribute to the solving of societal problems by applying domain-specific knowledge to the modification of institutions. In the Catholic south, such associations and their intentions tend to be assessed and monitored by the establishment, generally a resource-consuming process, which might well confuse the original intentions.

This explanation is in accord with the one offered by North as regards reference to the *religious aspect*. Transcendental beliefs do matter in economic development. Thus we find a substantial factor of explanation in the specific conception of reality shared by the Roman Catholic and the Orthodox Churches until the 1960s, when the Second Vatican Council restated Roman Catholic doctrine. The restated view allows us to suggest that the religious factor or power operating in Denmark, South America, and North America is basically the same. The long-term economic development is different, perhaps primarily because the previous worldview hampered economic development in the south by curtailing spontaneous creation of associations. This is again due to the existence of differently constructed institutions, which is precisely the main message of North's model of explanation.

Furthermore, this explanation is consistent with North regarding the importance of *bureaucracy*, which appears to have a fairly open definition. In line with North's terminology, one might interpret the Catholic south as a kind of divine (or Byzantine) bureaucracy, where persons affected by societal problems wait for a person possessing the appropriate authority to bring about a solution. However, while this interpretation might have



some explanatory power, it is definitely a use of the term “bureaucracy” that extends widely from the usual social-science definition provided by Max Weber. It is indeed deplorable that the term “bureaucracy,” even within academic circles, carries the pejorative associations of popular usage. This is deplorable especially from the point of view advocated by de Soto, which points out the importance of real property rights for economic development. The “formal representational systems,” which de Soto suggests are the basis for capitalism, cannot exist without common standards and bureaucratic administration in the Weberian sense (2000, 192). North, too, agrees that there is a need for “effective judicial systems” and “the development of the state as a coercive force” (North 1990, 59).

To summarize: aspects of the Danish development of real property rights can be related to North’s interpretation of the causes of different economic development in North and South America, respectively. Within the general framework of North’s explanation, I offer a modification that reconciles the evidence drawn from the Americas and from Denmark. The modification is based on a more elaborate understanding of the notion of bureaucracy and the factors of religion and religious ideology. It suggests that the economic development of the Roman Catholic south was hampered by a general belief that potential solutions to societal problems should await clerical or otherwise authorized approval. The societal cost of this approval stifled entrepreneurial efforts in the south, while the Protestant north could benefit from the economic creativity of associations of every kind.

#### **4. The Institutionalization of Real Property Rights in Denmark**

This section provides a more complete account of how the institution of property rights came into being in Denmark. I use “Denmark” in the narrow sense of the term, as including the major part of Jutland, Funen, Zealand, and until 1660 also the southernmost part of what is today Sweden.

##### *4.1. Roman Officialdom*

The formalization of real property rights emerged in Denmark during the eleventh century through the influence of the expanding Roman Catholic Church. Written documents were foreign to the Danes, whose legal proceedings were primarily oral, but from the south came the *document* (*diploma*) as legal evidence. The oldest diploma known is a deed of gift

from King Canute to the cathedral in Lund, dated May 21, 1085 (Skautrup 1944, 200). Documents were drawn up in Latin, but interestingly, established Danish technical terms like deed of conveyance (*skøde*) and mortgage (*pant*) are mixed with the Latin texts, possibly due to the varying skill levels of the scribes involved in their compilation (Skautrup 1944, 205).

Education of scribes took place at cathedral schools, in the context of cathedral chapters, which were established, for example, in Lund in 1085 and in Ribe in 1145. Clerics also served at the chancellery of the king, which is known to have been in operation around the twelfth century. About the same time, the country was divided into dioceses and parishes, and a church tax, the tithe, was introduced. The tax established a stable and later formalized relation between users of land and representatives of the community, a relation that may be considered an aspect of the institution of property rights. An inventory of Danish land (“Kong Valdemars jordebog, *Liber Census Danie*”), dated 1231, was prepared by the chancellery (Skautrup 1944, 204–5). This inventory might be compared with the English Domesday book. Late in the period in 1479 a university was established with papal consent.

Legal rulings regarding the local level took place at the approximately two hundred court districts, though for a growing number of boroughs and for church matters, these rulings also took place at the chapters. Around 1200, records of such rulings were frequent and often related to one of the kingdom’s three ancient governing assemblies, called “things.” One thing covering Jutland and Funen lay in the cathedral town of Viborg. A collection of rules for this thing (*Jydske lov*, 1241) was prepared by the bishop Gunner; it differs from the previous by being “given” by the king and adopted by the thing. Village peasants operated through townships with own customary rules. Quarrels could be presented to ordinary courts, which tended to support the township majority opinion.

*Transfer of ownership* originally was ritualized by the seller putting some soil on a cloak held by people present, thereby designating the land to be surrendered, and declaring that ownership be transferred to the buyer (Buhl 1994, 19f). Gradually, deeds of conveyance were drawn up according to recurrent forms (Skautrup 1947, 16, 72; Buhl 1994, 20–21). From sixteenth century on the announcement was supplemented with recordings in chronological thing registers. For transactions within borough boundaries, the town registry served the same purpose. From the seventeenth century we know that mortgage deeds were recorded as well, and specific mortgage registers were prescribed.

Did we have real property rights installed already in the fifteenth century? The formal conveyance did transfer rights in land, but as to the impli-

cations of these rights, we cannot be sure. Exchange of land and other assets was a way of establishing social relations, including mutual obligations, and the impersonal alienation of an asset is something that emerged very slowly. Furthermore, although the collections of rules generally include inheritance rules, we cannot be sure as to what bindings restricted the dispositions or—in other terms—whether the owner in fact was the individual person or the family. Inheritance rules generally followed the Germanic-Nordic pattern of family inheritance. At least for the major land owners, the nobility, restrictions in dispositions on land were manifest in order to protect family interests (*Danmarks Historie* 7:116), but even here formalization of the family unit came slowly (fixed family names were only instituted around 1526 (Skautrup 1947, 261). The religious concern for the individual soul may have opened up a way for greater individualism, fostered also by the introduction of inheritance by will to allow for donations for religious purposes (Halsall 1998, sect. 4).

Finally, general principles for the adoption of formal rules were only just beginning to emerge. From 1360 on new kings had to agree to a *Coronation Charter*. By the same token, the assembly of lords became the forum for adoption of new legislation, until absolutism was introduced in 1660.

The model of the Coronation Charter was the English Magna Carta (1215), which instituted a division of power between the king and the estates, especially the higher clergy and the nobles. The later versions of the Danish Coronation Charters included quite specific regulations regarding the transfer of real property rights between king and estates, and among the estates as well.

Summarizing the period until sixteenth century, we do find a basis for formalization: Clerics, who could set up documents according to law; a legal system, which could proclaim law, but only weakly enforce it; tithe-related recordings; cathedral schools and a university; and a Christian world view with secular implications that would appear only after the Reformation introduced the Lutheran version of Christianity.

#### 4.2. *Lutheran Absolutism*

Danish bishops, cathedral chapters, and monasteries were in dialogue with their counterparts in the Roman Catholic south. However, other than the containing of royal powers by Coronation charter and clerical officialdom and education, Catholic practices such as celibacy of priests and formation of lay people hardly gained a footing in such distant tracts. The Lutheran reformation came in the early sixteenth century after a period of political disorganization as a new spiritual power.

The first Lutheran king, Christian the Third, balancing between the factions of nobles, the major cities, external powers in Germany and the Netherlands, and the Catholic clergy, managed to get hold of the country by force, but then occupied himself with the reestablishment of legal procedures (*DH* 6: 52–54, 279–82). For example, during the sixteenth century the crown was concerned both to protect the peasants from their masters (*DH*, 6: 130, 269, 290) and to consolidate legal prescripts into a general law book (283). The codification effort succeeded in 1683 with the adoption of the *Danske Lov* (Danish Law), well before other European countries prepared comparable law books, such as *Preussisches Landesrecht* of 1794 and the French *Code Civil* from 1804. By the 1660s absolutism was introduced. However, royal willfulness was generally balanced by leading advisors and the chancellery.

Church land and church offices, such as cathedral chapters, were taken over by crown administration without much further change. For example, the chancellor of the king overtook the full office of the next bishopric (Roskilde), including responsibility for the university (*DH* 9:241). Careful management of crown contracting concerning entailed estates gave the crown badly needed income. The accounting practice quickly spread through the whole country. By the late seventeenth century, tax registers were in place both at the manors and centrally. They mentioned every holding, copyhold as well as freehold, and its duties. Due to the remarkable Danish ability to maintain continuity, the name of the central register, *Matriklen*, today still designates what in other European countries has come to be called the Cadastre or Land Administration.

The successor to the throne, Frederic the Second, was quite another character. Nevertheless, he demonstrated how land could be traded in an entrepreneurial sense. He was fond of hunting, and arranged for scattered possessions to be consolidated into larger units by means of exchange of property with the nobility. The nobility followed suit where possible.

Reformation caused a change in higher education, which further supported development towards a state of law and order. Before Reformation, it was common for young nobility to frequent the university with a view to eventually taking up clerical positions. However, the university was reorganized, causing it to become increasingly frequented by commoners, who could now study theology, medicine, or law. This in turn led the youth of the nobility to travel abroad in order to learn law and other disciplines useful for governmental affairs. This practice remained for centuries (*DH* 10:40). Arriving home, many volunteered for the chancellor, hoping to acquire the entailed estate (*DH* 6:154, 205). Installed there, they were responsible for the administration of justice at the local level (*DH* 6:219–20). Sources reveal that the judicial standard in such places could be high indeed (*DH* 7:92–93). Rephrasing this within the analytical frame-

work of North we may say that the changed institutional setting of the Reformation provided other incentives for career planning, changes which supported the formalization of rights in general.

Commoners who became priests formed a mediating stratum between the formal, document-based central administration and the informal village community. They proclaimed the law, be it divine or secular, and in the later part of this period they also issued information on economic development. The title of one of many books published during the time: *Agricultural Catechism* (1782) is indicative (Skautrup 1953, 100).

The Lutheran church may well have been a “means of indoctrinating the population with the Lutheran dogma of divinity of authority,” as a recent Danish historian sarcastically phrases it (Jespersen, 2007). However, the Lutheran dogma also provided all strata of society with a sense of being responsible according to law, divine as well as national. This applied to the king, who generally was charged with the task of providing “happiness” for his subjects and specifically was admonished in writing to judge impartially (*DH* 7:55–56, 59). Worship was performed in the national language, and as worship attendance became a civil duty, the evangelistic message Sunday by Sunday was forming the people (*DH* 8:357). While the model of Roman Catholic formation of the lay people was confession (Morris 1989: 305f; 489–91), the Danish model became singing. A psalm book of high-quality original Danish poetry became popular and has been rehearsed and sung in school and church right up until the age of TV broadcasts. The example below is a morning song:

My soul! Be fresh! Enjoy! let sorrow wither,  
 your bodily perianth is in God’s hand.  
 This very day He gives me strength and power,  
 that through my calling and position,  
 I duly serve my God and Father.

God, join hands with me and grant  
 the generous Holy Spirit thrive my vocational work.  
 Bless me, oh Lord, of your might!  
 If only I today, and every day as well,  
 in You and in my industry be satisfied!

—*Kingo: Nu rinder solen op* 1674, verse 4 and 5

It is perhaps more world oriented than the majority of psalms, but it proclaims the layperson to be a recognized participant in a divine project, an individual entitled to dispose of his resources. The vitality brought about by Lutheranism went along with admonitory sermons on obeying authority: “You have a mortal lord of manor as your master . . . yet later

an overlord over lords, by the name Jesus Christ,” as an early Lutheran bishop put it (*DH* 6:176). The words were directed towards the lower strata, but Christian the Third, called “the priestly king” (*DH* 6:306) abided by the same overlord, thereby reinforcing the legal institutions by outlawing dual standards. His successors on the throne largely followed suit in legal-economic affairs, as witnessed by advisors and the chancellery.

By about 1650, 47 percent of the land of the kingdom (not including boroughs) was under crown administration, including church holdings. Another 47 percent was owned by the nobility, while about 6 percent was freehold. The land was structured into about 9000 townships, which were made up by 920 manors, 70,800 copyholdings, and 4,800 freeholdings (*DH* 7:118). Less than 1 percent of the population owned this land. Interestingly for the further development, freeholdings were unevenly distributed across the country, being most common in periphery areas. In the duchy of Slesvig, south of the kingdom proper, freeholdings were quite common and we find a segment of larger peasants, who through generations provided bailiffs and sent their sons to cathedral or borough schools. Peasants in this area managed to convert villeinage into a cash fee, and in some townships they started a process to consolidate their share of commonly tilled land into parcels, which they could manage individually with benefit.

By 1700, do we have real property rights in Denmark? The answer certainly seems affirmative; perhaps one could even say that we had a market in land, even if a tightly regulated market. Tenant contracts, conveyance deeds, and mortgages were recorded and enforced, at least in some places, quite rigorously. However, what is nicely recorded and easily available for the historian is perhaps only the fraction of peoples with the “best practice.” Still, property rights were far from comprehensive and exclusive. King, landlord, and tenant were bound to one another by a host of rules, contracts, and conventions. Finally, to the restrictions in the exercise of property rights we must add the fact that less than 1 percent of the population actually had owner status.

### *4.3. The Enlightenment and the Land Reform of the Later Eighteenth Century*

Most people outside of the boroughs were illiterate, so economic development had to come from the upper strata of society. Around the 1750s the leading advisors of the king had a power that later history dubbed “a government by Excellencies” (*DH* 9: 304–7, 311). These highborn characters were self-confident in their position as governors of state affairs and were convinced that the general welfare of the kingdom was dependent on their

efforts towards promoting “the common good.” Patrimonialism, the exploitation of a position for private benefit, did occur in Denmark; however, predominant belief in the existence of congruent worldly and divine kingdoms may help explain why a commitment to impartial service in office predominated amongst those in power. Being self-confident in one’s position was not restricted to the upper strata; the artisans, farmers, priests, and civil servants of the time all had similar attitudes towards their own positions. The German word *Beruf*, literally, vocation or calling, fits the corresponding Danish term *kald*, and conveys much better than English terms like “position” or “occupation” the way in which one’s work is conceptualized in the Christian worldview. However, at this time social mobility was virtually nonexistent. When mobility later emerged with commoners occupying ever-higher positions in central administration, the government of the Excellencies was gradually overturned.

The period was characterized by wealth brought about both by international trade and by agricultural experiments that were performed on some of the manors, first in the duchies south of Denmark, and later on crown land and noble manors in Zealand. For example, a new surveying technology, the plane table, was applied in order to measure homogenous pieces of land. Having valued the yield of every piece, the area of each piece was carefully computed and parcels of regular shape were demarcated for every farmer according to his share in the township yield. This radical change in tilling practice was frequently opposed by the farmers, but the general experience was that it was beneficial in the economic sense for all parties. Some farmers became educated, and were identified as role models for their peers by poets writing in the spirit of Rousseau.

Some Excellencies participated in these experiments, bringing about a public debate on these and similar issues. At the occasion of the king’s thirty-second birthday in 1755, the general public was invited to prepare treatises on “every subject that may serve the sustained flourishing of the country.” The treatises could be handed in anonymously and were published over the course of the following decade (1755–1764). They created a spirit of curiosity in economic and political affairs among the reading strata, notably priests and other university-educated officials (*DH* 9: 334–42). The Royal Danish Agricultural Society of 1769 and other patriotic societies acted as forums of discussion, slowly transforming the “top-down” approach of the absolutist regime into a more participative one. In terms of the analytical framework, the general institutional structure not only tolerated, but also promoted the adoption of new knowledge on economic and other affairs.

During and after an interregnum marked by a king who suffered from mental illness (dementia praecox), common people were able to gain higher posts in central administration. A bloodless coup d’état installed the

crown prince Frederic the Sixth as the effective royal ruler until the death of the insane Christian the Seventh in 1808. On May 13, 1776, shortly after taking office, Frederic issued an order on the lifting of joint cultivation. The order was based on previous experiments and further reforms carried out on crown land, as well as on the debates over and outcomes of previous orders. However, it introduced a new mechanism. While the former schemes left the right of initiative with the landlord or—later—with a majority of the tenants, the initiative was now given to whoever amongst them functioned most effectively as an entrepreneur. A single tenant of the village was entitled to trigger a quasi-legal process by which his share was extracted from the joint tilling of the township and consolidated into a few lots. The process was based on the detailed mapping in scale 1: 4000 and on assessment of yield as described above. However, this individualization did not imply the granting of ownership; rather, copyhold generally became hereditary and obligations were gradually transformed into cash fees.

The land reform process was conducted by a land surveyor, while the assessment of yield was done by two village peasants, elected by the villagers themselves. The costs of the process had to be paid by the villagers, and all township parties had to contribute to the costs, whether they wanted to extract their share from the community or not. Claims were submitted to a three-person committee, which was chaired by the chief official of the county. The central administration (*Rentekammeret*) elected the two other persons from amongst the local judges, higher officials or nobles. Further claims were resolved by the *Rentekammer*, except for claims specifically regarding title, which were to be handled by the ordinary courts. No tenant was forced to leave the cultivation community of the township, but the ideal solution would be to spread the new production units equally over the township in order to minimize working distances and obtain parcels of regular shape. However, the township community dealt not only with production matters, but also with other community affairs according to customary and tacit rules. The desire to keep close to the old, secure community is still visible across Denmark in terms of the so-called star allotments, where boundary banks and hedges radiate from the village center between the old farm houses to the township boundary.

#### 4.3.1. SUMMARIZING THE FACTORS LEADING TO CHANGE IN THE LAND REFORM

What were the factors responsible for change during the land reform? As suggested above, the widespread belief in two congruent kingdoms, the worldly and the divine, was a large part of the social background. Thus, the vocational attitude toward work and position that had been fostered by



Lutheranism remained, even when the divinity of the absolutist monarch was questioned by a growing number of people (*DH* 10:39). Furthermore, the royal decrees implied that contracts should be kept, even when a party was not able to defend his rights by his own means and, moreover, that fulfillment of contract ought to be accomplishable by ordinary effort. This concern was first held by commoners among the civil servants, but was eventually voiced by the crown prince Frederic the Sixth as well.

It is generally held that the most important change of the reform period was not the reallocation process, but rather an order given on August 8, 1787, enforcing the economic rights of tenants in relation to their landlords. This decree required that the estate of a tenant holding should be assessed by an independent party at the death of the tenant or other closure of tenure. The job of this independent party was to determine whether the landlord should be compensated for losses or whether the estate of the tenant should be paid for improvements (*DH* 10:74–78). Further, the fixing of obligations in terms of a cash fee was finally forced through after several promptings. Governmental committees traveled across the country, engaging in fierce negotiations with peasants and landlords to establish a fair deal (*DH* 10:82).

Experience demonstrated that the new organization of the means of production was effective. This was due not only to the effects of allowing individuals to till their own land, but also to the fact that resources were used more efficiently. Landlords themselves benefited from the introduction of new crops and methods of cultivation. Some were prepared to alienate tenant holdings in order to invest in new equipment. Moreover, provisions were made for those among the villagers who could not cope with the new individualism, and who could potentially have fuelled riots, by the installment of poor-law authorities in 1803 (*DH* 10, 114–15). Finally, general education was introduced, and by the 1850s illiteracy was largely eradicated.

Did we have real property rights by 1800? By all means: About half of all holdings were acquired by tenants as freeholds (*DH* 10, 90–91), and by 1850, only 1 percent of land was still in joint cultivation, mostly on moors and peat soil (Thomsen 1988, 115). An independent, self-sufficient farming class developed, which was able to compete internationally in agricultural products by the end of the nineteenth century.

#### *4.4. The Extension of Real Property Rights to Lower Social Strata*

In Denmark, two quasi-parliamentary advisory assemblies were instituted by 1835. The assemblies acted as a melting pot for ideas on how to

improve the kingdom, just as the contributions at the occasion of the king's birthday had done almost a century before. The self-conception of "patriot," the term preferred over "citizen," valued a concern for "the common good" (Damsholt 1997). Apparently, this did not block economic development, but envisaged development in a more collective sense than that of English liberalism.

During the latter half of the 1800s, the guild system was abolished, boroughs were expanded through the earthwork bounding the cities, and industrialization slowly emerged. New railroads wended their way through the country and in agriculture the effects of the land reform were consolidated. The farmers established associations, such as dairies and bacon factories, in order to process their agricultural products, and in so doing became competitive in the world market with these products. Although landlords still played an important role in society, the money economy and the improvement of education gradually diluted their privileges. During the first quarter of the 1900s, their entailed property was converted into "normal" holdings. Many smallholdings were established through this process, thereby spreading access to real property rights.

By the end of 1800s, industrialization brought strikes and street fights. The general practice of handling societal problems through associations operated here as well. By 1899 the workers' union and the employers' association reached a general agreement (*Hovedaftalen*) regarding the rules of the game, and some years later set up a quasi-legal body (*Arbejdsretten*) for the purpose of arbitrating in issues of interpretation of the agreements. The workers' union succeeded in keeping a high degree of organization amongst the workers, including the skilled workforce, which gave them a tremendous advantage in labor negotiations. Through the 1900s they used this bargaining position to direct a share of the surplus of production to their members, thereby enabling them to acquire their own detached houses during and after the economic growth of the 1960s. Again, access to real property rights was spread, and now to all strata of the society, thus enabling them to earn their own living. In terms of the analytical framework, the association of workers effected an institutional transaction (Bromley), which redistributed production surplus.

In general, the rise in quality of living conditions may be attributed to industrialization, scientific and technological developments, and other factors that in principle are available to every country. However, what specifically explains the Danish development, especially the spread of property rights to a substantial number of inhabitants?

In Denmark, it is fairly common to attribute the "Danish" way of development to Grundtvig and the cooperative movement (*andelsbevægelsen*) (see, e.g., Ingemann 2002; for a detailed discussion of the political economy of Grundtvig, see Ingemann 1997). Grundtvig

(1783–1872) was a priest, a poet (who contributed to about one third of psalms of the Danish Psalmbook) and above all a spiritual animator. Through studies, writings, and speeches he articulated a worldview that was largely accepted and perpetuated by the following generations. Deeply involved with Christianity, Grundtvig wrote psalms of tremendous clarity and depth. However, this very involvement in Christianity made it possible for him to question its central tenants, and to consider possibilities lying outside the limits that it imposed. He was thus repeatedly in opposition to the established church.

To give an idea of his poetry, I set out a Pentecostal psalm, that is: a hymn to the Holy Spirit and its effects. The psalm paints through the first verses a picture of Danish nature, the farmers' fields and harvest, sun and birds, forests and meadows:

...

and lovely trickles at our stepthrough the meadow the brooklet of the flood of life

—Grundtvig, *I al sin glans nu stråler solen*, verse 3 (1843)

It would have been picturesque, had it not vibrated and eventually burst into a crescendo of praise that included all tongues, including pagan and Jewish. Like Kingo, he relates the everyday and the transcendent, but while “everyday” for Kingo was duty in the presence of the king, for Grundtvig “everyday” was cultivating the created world, especially the countryside. Grundtvig raised the questions, what was of value in the North before Christianity? Did truth only come by Christianity? The answer he developed through countless drafts was that the mythology of the North did contain truth and, furthermore, that this truth was a paradigm of the life that the people of the nation were to perform. Having come to this realization, Grundtvig gave up the “sweet dream” that the whole Danish people would be “deeply Christianized.” He envisioned instead the “national spirit” as the uniting bond, as it manifests itself in language, historical narratives, and mythology (Thanning 1971, 62–74, 66).

Lutheran Christianity was perceived individualistically, as a “Christianity of penance.” Therefore, it did not answer the questions raised by societal life, for example, the question of how the work of creation was to be redeemed. Grundtvig echoes the statement of Kingo that all members of the people “with heart and soul perform their trade, each in his circle, yet intensely participate in one another’s pursuit, as parts of one body” (quoted by Thanning 1971, 69). Significantly, however, Grundtvig replaces Kingo’s hierarchy of God, king, and estates with inter-related circles while conceiving of heart, soul, and compassion for the com-

mon good as Kingo did. The enemies are the spirits of the (German-Roman) emperor, the Catholic pope, and rationalistic enlightenment that kills heart and spirit. The objective was to unfold the Nordic spirit by empowering each and everyone to perform noble deeds (70, 97–99). Grundtvig viewed the peasants' work as the model of a noble deed, a view which at that time was definitely not the dominant opinion. The former tenant thus became the key factor of development and hence the task was to arrange that every Dane could be economically self-sustaining through ownership. Furthermore, teaching itself should not only convey practical knowledge, but also lift the heart.

Grundtvig's gift was twofold. First, he pointed to the existence of legitimate values outside of established Christianity. In so doing he was able to inspire those who were indifferent or even hostile to the church and related authorities. Second, he did this in a way that did not offend those who were comfortable with the more traditional Christian life. The goal of all of this was to set free and empower the poor so that "few own too much, and less too little." Later this program came to fit the interests of members of the workers' union in such a way that the workers' movement became moderate and political, rather than radical and violent. The social democratic party in a sense took up this idea of pursuing the common good. Indicatively, the title of its political program in 1934 was "Denmark for the people."

Grundtvig developed these ideas in the 1830s, which meant that the vision he provided was able to fill the institutional vacuum that opened up during the fairly uneventful collapse of absolutism. The Constitution of 1849 provided, among other rights, freedom of association. This was just the first occurrence of a correspondence between Grundtvig's ideas and historical events. His position that truth could be found outside Christianity and that it should be pursued for the common good inspired Danish politics for more than a century, as we shall see detailed in section 5, and the emphasis on the common good made it possible for low-income families to become home owners.

#### *4.5. Development Factors in the Danish Way of Institutionalizing Property Rights*

How did the formal system of property rights come into being? A number of factors come to mind: (a) impartial service predominated and thus dual standards were ruled out, (b) resources of the realm were managed bureaucratically and yet effectively, and (c) the dominant elite actively defended the rights of the lower strata. These factors are supported by the following:

- Roman clerks and bishops brought formalization of agreements in writing, cathedral schools and universities, subdivision of the realm into parishes, and the habit of restricting the powers of the king through coronation charters.
- The pious king, Christian the Third, restored law and order and installed a Weberian bureaucracy, the Chancellery, after the Reformation in 1536 in order to manage a substantial part of the natural resources of the realm: the former church property. He thus institutionalized what became a path of dependency, which through centennial revitalization lasted at least to the present age of neo-liberalism and materialism. He, his followers on the throne, and the surrounding elite ruled out dual standards and in the late 1700s even insisted that tenant rights be respected long before the notion of the welfare state was conceived.
- The feudal system implied the existence of unequal social strata. However, inequality did not imply stagnation: Out of the hierarchical structure came the message that humankind was entitled to “join hands with God” in pursuing its secular duty. Thus, ordinary people became more actively involved in societal affairs as a result of different factors over three centuries: their forced participation in Lutheran sermons in the late 1600s; the consent of an absolutist crown prince to a shared effort in search of the common good in the late 1700s; and general education as well as economically capable societies and associations during the 1800s.

This summary, although provisional in nature, corroborates the emphasis in the previous section on religion as a determinant factor in long-term economic performance, as especially factors (a) and (c) above are strongly motivated by the Christian belief system. One may question whether this is a valid retelling of Danish history. Though the present author may be inclined towards religious explanations, the evidence here is either directly drawn from or is consistent with standard historical scholarship. Historians of the former half of the twentieth century may be guided by social-democratic (center-left) values and bypass (liberalist) economic thinking, but they could not invent the noble deeds of the past.

I do not claim that Danes were or are more pious than other people. First, a similar economic development occurred in neighboring countries. Next, Denmark is situated at the semi-periphery relative to the shifting centers: the Netherlands, the British Empire, and the U.S. Through international trade and formation journeys of the young nobles, new ideas and experiences were easily available, and the restricted size of the country made it a manageable task to implement them. Furthermore, the Danish

realm decreased during the period, which in combination with the meritocratic bureaucracy tended to ensure that capable civil servants were implementing royal orders. In sum, unique advantages supported the impact of the factor of religion.

## 5. Land Registration and the Role of Mortgaging

Hernando de Soto points to the importance of formalization in terms of land registration for the purpose of bringing “dead capital” to life through mortgaging. In the following, I compare this line of reasoning with Danish evidence of a more administrative-technical nature.

### 5.1. *Procedures and Registration of Transaction in Real Property*

Deeds of conveyance and mortgage had to be announced at governing assemblies, the “things,” already before the Danish Law of 1683. At that time, records were established at the courts. After a reading of the deed, extracts were made in chronological registers of conveyances and of mortgages, respectively. From 1738 on indexes relating names to the chronological entries were introduced and established at every court, and by 1805 it was required that recordings take place at the local courts (Buhl 1994, 19–22).

By 1844 a new cadastre was put into effect for Denmark. It was based on the maps and recordings of the land reform, duly revised and supplemented. It located and identified practically every parcel in the country and provided a new basis for taxation. However, the tax base of the old cadastre from 1688 was still kept, as its failure to reflect the real value of the property units had been taken into account in prices paid by buyers through the ages. The new cadastre was introduced according to suggestions by the advisory assemblies, which were instituted by 1835.

An assembly proposal made in October 1842 for the purpose of improving land registration was motivated, among other things, by the fact that the proposer himself had received an incorrect statement on mortgage deeds from a local court. He also pointed to the fact that the new cadastre would make it possible to establish indexes of property units, and proposed that such indexes be introduced along with the prescription of uniform formats for land registration. Furthermore, he suggested that every document regarding an immovable entity apply the new cadastral identification. These proposals “will be as important for the security of property rights as

for the corroboration of credit in general” (VST, 1842: 768). The resulting act on indexes for conveyance and mortgage registers prescribed that the indexes were to be introduced only “gradually,” that is, at the discretion of the person in charge (Indenrigsministeriet, 1863. Fr. Ang. Registrene over Skøde- og Panteprotokollerne, 28. Marts 1845). The application of the new cadastral identifier was convenient for all and further stressed through a request that the conveyance deed of a subdivided property unit be annexed with a cadastral map of the property concerned (Indenrigsministeriet, 1863. Pl. 21. April 1848). This and similar rules kept the recordings of immovable property in Denmark coordinated from the 1840s on, even when such recordings were performed by different authorities (for example, for purposes of taxation, agriculture, or justice). A reform of the land registration of the local courts was later accomplished by the Law on conveyancing (*Tinglysningsloven*) of 1926.

Considering these incidents, and drawing also on details not reported here, it appears that mortgaging was common by the 1840s, that mortgages were probably recorded with the same degree of perfection as titles, and that forced sales in case of debt default were practiced. The issue of credit and mortgaging is mentioned on a par with real property rights in general in the proposal of 1842, as well as during the deliberations and in the documents pertaining to this proposal. It appears that both are important, and were, in a sense, perceived as aspects of the same institution of property rights.

Formalization can be expensive, and in recent years warnings have been issued against putting too much emphasis on the importance of formalization by means of information technology (Holstein 1996; de Soto 2000, 184–87). Also, in addressing the degree of formalization required in a given context, Steven Hendrix calls for a “situation-specific examination of the [conception of] property and design of any property securitization plan. Furthermore, the expenses of titling must be weighted in each given locality against the *increased* level of security titles provide over existing documents which also evidence ownership rights and interests” (Hendrix 1995, 191; italics in original). A rephrasing of the latter sentence fits the reasoning of the Danish assembly of the 1840s: The assembly majority agreed that the expenses of establishing indexes of property units had to be weighted across each registration office against the reduced probability (increased security) of issuing defective certificates.

Thus, we can conclude that while the formalization that can be provided by information systems is important, it is apparently not the key issue. However, formalization also tends to exclude person-specific dependencies, and as will be explained further below, it is actually this aspect of property rights that will normally be the important issue.

## 5.2. *The Emergence and Role of Mortgage Associations*

Mortgaging was not a key factor during the land reform, as the reform was initially an individualization of cultivation. However, the relief of copyhold was a political issue and suggestions for mortgage schemes were popular, frequently combined with requests for some governmental support (*DH* 11, 356). The government was not in favor of the support for a number of reasons; including the fear that such support would be misused by some landlords to charge excessive prices (Møller 1997, 91). Nevertheless, the tenants gradually gained ownership. By the end of the 1840s the number of copyholdings was reduced to 21,000. Often, the landlord found it convenient to let a mortgage in the holding be part of the charge. Due to the existence of such personal relationships, the conditions for the new owner could thus be more troublesome than a loan offered by an impersonal enterprise.

A mortgage association was established in 1796 for house owners of the city of Copenhagen. A lasting principle of this effort was that the direct contact between a mortgagor in need of money and a mortgagee was avoided and replaced by the mediation of an association. The association issued mortgage bonds, which were secured by mortgage deeds, and sold the mortgage bonds at the Exchange (which had been in operation since the 1600s). While this arrangement is normally seen as the start of mortgaging in Denmark, the actual procedure was generally quite complicated, and most importantly it was not yet available to the farmers. A public debate on the issue resulted in the establishment of mortgage associations for Danish landowners (Møller 1997, 89; on present practices, see Moody's 2002). English liberalism did enter into the debate, but it was the cooperative movement, marked by men like Robert Owen, that apparently best suited the Danish "patriotic" attitude to economic affairs. The Constitution of 1849 allowed for the free establishment of associations, and this led to the passing in 1851 of a statute law, which provided a framework for the existence of regional associations with rather specialized portfolios. In the following years a number of these mortgage associations popped up as well as savings banks for peasants. The cadastral identification of property units and the fairly well-kept land registers provided a robust basis for the mortgage business. A recent account of the role of mortgage associations over a two-hundred-year period offers the following survey:

Møller et al. find the cooperative mortgaging scheme most relevant during the 1800s. The society in that period made the transition from a barter economy to a money economy. The mortgage associations were able to compensate for defects of the capital market in terms of monopolies, asymmetry of information, and lack of public control, and this was much



Year	Savingbanks	Banks	Mortgageassociations
1840	3	0	5
1880	30	12	28
1920	21	56	36
1960	19	27	36
1994	67		118

*Deposits in banks, saving banks, and mortgage banks (percent of gross factor incomes). From Møller 1997, 61.*

less needed during the 1900s. Generally, they warn against attributing too much importance to the fact that mortgage loans were provided by associations as opposed to other organizational structures, as alternative lending opportunities in terms of saving banks and ordinary banks were available during later periods.

Perhaps one could suggest that mortgaging gained its most significant role for property development during the period 1960–80, where the number of owners of detached houses expanded to include low-income families with stable incomes.

1600s: Crown owned about half, nobility the other half (~2000 persons out of 600,000)

1800s: Of the 60,000 farms, about half were acquired by tenants as freeholds

2001: 1,130,241 detached houses and farm houses, owned by individuals (out of 5.3 million)

The mortgaging scheme was robust across social strata as it was not generally dependent on the creditworthiness of the mortgagor, aside from whether or not the mortgagor had a stable income. This made housing construction cheaper, as banks were prepared to supply young prospective homeowners with temporary loans that enabled them to complete the building process all at once, because the loan would be returned by the proceeds of the subsequent mortgage. Finally, it assisted manifestly in making Danish urban planning and development a quasi-rational process, as the hypercautious mortgage associations requested a certificate (from chartered surveyors) that the intended construction was in due accord with public as well as private restrictions (spatial plans, easements, etc.). As the

majority of people were dependent on mortgage loans, the same majority was forced to subscribe to mortgage conditions and thus to spatial planning measures (Stubkjær 2001).

Summarizing this section, mortgaging existed in Denmark well before and during the land reform. It is reported to have enhanced the landlord's investment in equipment, but was not mentioned as a prerequisite or active element of the land reform. Moreover, mortgaging as an impersonal and bureaucratic/formalized activity, a clear benefit for new owners, appeared only a few generations after the land reform. Danish economists find that the cooperative style of Danish mortgage associations fit the values and needs of nineteenth-century Denmark better than a more market-oriented scheme. The impersonal mortgaging scheme financed the widespread extension of real property rights after the 1960s and contributed to a successful urban development. The effects of mortgaging on economic development (of the construction sector) are recorded only after the 1960s. The specific importance of mortgaging for general economic development is thus not corroborated by the Danish evidence, but this does not imply that mortgaging was not of importance.

## 6. Conclusion

The Danish evidence confirms the attention Hernando de Soto has called to the importance of a "staircase" of real property rights for the humbler members of society. In Denmark, a small and in many respects homogeneous country, it took well over two hundred years of more or less conscious efforts to expand real property rights to a substantial fraction of the humbler strata. The development from about 1750, the "construction" of the staircase, took its point of departure from a governmental and judicial structure that had already been bureaucratic in the positive Weberian sense for about two centuries and that retained this quality throughout the period under investigation here. Development was supported by the fact that basic notions like "the common good" and the idea that work is a vocation remained constantly meaningful and inspiring, while the context of these notions moved from divine absolutism via participation in redeeming the created world to a Social Democratic "Denmark for the people."

The Danish evidence, however, only partly supports de Soto's concern for the formalized property system as a development factor, perhaps due to the clean bureaucracy that was at work from the start. The institution of property rights was indeed further formalized throughout the period, but the formalization came along the road. Formalization did make a difference as it introduced an impartial party, the not-for-profit mortgage associations, between mortgagor and mortgagee.

This Danish evidence was put into an international perspective by relating it, in section 3, to Douglass C. North's model of long-term economic development. Some of the factors of development identified by North were discussed. Uniform Christian religion and uniform bureaucratic administration ruled both in Denmark and in South America, but these factors do not unconditionally hamper economic development. The difference in economic development between Denmark and South America has here been related to the Christian proclamation of the competency of the layperson and of the occurrence of true values outside the established church, which in Denmark took place some hundred years before it became part of the Roman Catholic doctrine that prevails in South America.<sup>3</sup>

The paper suggests that North's model of explanation, with its focus on socially constructed institutions, holds not only for the Americas, but for Denmark and perhaps other Northern European kingdoms as well. The difference in economic development between Denmark and South America was related to the Christian proclamation of the competency of the layperson and the social costs of creating associations. Within the context of the hegemony of liberal capitalism, this retelling from Denmark offers an alternative, as the "shared intentionality" of the parties of the Danish society was not directed at economic utility, but at "the common good." More specifically, it was directed at a conception of real property rights that implied a strong concern for common affairs outside the individual unit of exclusive property rights. In business terms, the stakeholder view widely overruled the shareholder view. Factors of development furthermore include considering work a vocation, and actively defending the rights of the lower strata. These norms all fit within the Christian worldview and were in fact derived from this world view during decisive parts of the period.

Mention is made, that both Grundtvig and later the Second Vatican Council played a role in pointing to the existence of legitimate values outside of established Christianity. Moreover, Grundtvig conceives members of national societies as "parts of one body." He thereby again anticipates events, such as an emerging concern for "the body metaphor for society." (Jomo and Reinert 2005, ix).

The cord of institutional change that we have followed through Danish history has a core made of information systems: Pergament diplomas and heavy ledgers at the outset, computer systems today. Paperwork

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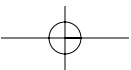
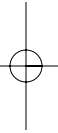
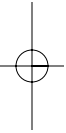
3. While the pope in 1922 welcomed the movement "Catholic Action" and other initiatives of "the laity . . . when, united with their pastors and their bishops," still in 1928, the Church considered itself "a perfect society" with corresponding duties for social affairs (Pius XI, 1922, paragraph 54, 58; 1928, paragraph 6).

comprised the base for the institution of real property rights, and cadastral work further specified the relations required for the formation of Searle's hierarchy of status functions. Through centuries, careful recording of facts, agreements, and decisions based on publicly known rules made the economic aspect of life more predictable and hence more prosperous. Generally, through the centuries, work was considered a calling and because of that, bureaucracy did not constrain the creative among the bureaucrats.

## R E F E R E N C E S

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# A Case for Simple Laws

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## 1. Introduction

In an article with the title “The Economist versus the Terrorist” the *Economist* stated about Hernandez de Soto: “he believes that most poor people, given the chance to participate fairly in the capitalist system, would do so rather than stay outside” (2003). Why laws of ownership in land, land registration, and mortgages are not used and do not have the effects they have in developed countries is the question I will try to answer in this chapter.

Laws are not enough to produce the desired benefits of transformation of wealth in capital. Laws are blueprints for others to use; only if they are used do they produce benefits. The conversion of wealth represented in land and improvements of the land—the buildings and other installations, the infrastructure, and so forth—into capital requires that several actors understand the law and use it. When we concentrate on land, we find that capitalization requires a cooperation of land registration, banking system, and courts of law. For effective utilization of the opportunities afforded by the law a general level of understanding of legal issues are necessary; the legal system must correspond in complexity to general education and legal knowledge available. Checking that the rules are in place is not sufficient; one must also investigate which other legal or social rules make it difficult to use the positive rules of the law.

I concentrate here on land and land ownership because these are the major assets of a country where much of its wealth is concentrated. Land (and the buildings on it) is a primary production factor and its capitalization in developed countries is often an order of magnitude larger than the GNP. Once this wealth is unleashed, resources for massive investment become available and development can be financed.

The chapter is structured as follows. The next section details de Soto’s idea of transformation of wealth into capital. It details the chain

of participants necessary to effectuate this transformation and details the obstacles which are often added to the path, increasing the cost of capitalization. Section 3 describes the “social construction of reality” of John Searle and its contribution to the formation of capital. Section 4 then describes capitalization and its practices, and section 5 lists the impediments typically found. Section 6 assesses the cost of complex legal rules for the developed and the third world. The last section suggests methods to advance the process of capital formation in third world countries, reviewing the European history.

## 2. De Soto’s Concept of Capitalization

De Soto has pointed out eloquently that the poor countries of the third world are very rich but lack methods to transform this wealth into capital that then can be used to fuel economic development (de Soto 2000).

### 2.1. *Risk as an Impediment to Capitalization*

De Soto observed two cities in Peru separated by a river: one of the two cities was prosperous, contained many multistory buildings, where shops were installed on the ground floor. The other city was essentially a shantytown, with most commerce organized as street vendors. The differences between the two cities were striking, but effectively the only institutional difference found was that one had a working system of land registration and the other not. In the town with the working land registration, people felt secured in their property rights in land and were able and willing to invest in improvements on the land. They built substantial buildings to house family dwellings and opened shops and made further longer-term investment in equipment. Such activities create employment opportunities and start the cycle of economic prosperity. In the town without registration of title to land, people felt insecure and were not willing to make long-term investments in fixed assets like buildings and installations. People tried to eke out a living with short-term investments in mobile equipment, which has lower economic yields and does not lead to prosperity (de Soto 1989).

### 2.2. *An Economic Theory with Transaction Cost*

The tale of the two cities demonstrates a simple aspect of economic reality: the high cost of risk, which is not sufficiently considered in many social projects. Classical economic theory of free markets, going back to Adam Smith (1776), assumes three basic simplifications:



- Transaction costs are zero; the cost of buying and selling are negligible.
- All participants in the market have complete information about all other transactions; specifically they know the quantities and prices obtained by other sellers and buyers.
- No market participant has the power (or the market volume) to influence the market.

These assumptions are clearly simplifications and perhaps realized in a farmers' market; they are not encountered in important markets today. These assumptions are necessary to construct a powerful theory in which substantial laws obtain. Markets lead to prices that balance the offer and the demand, and the price of goods equals their production cost and their utility; overall, ideal markets lead to optimal common wealth—the so-called Pareto optimality (Samuelson 1992).

Real markets have transaction costs, and Douglass North has shown that the classical theory can be extended (North 1997). In a transaction several types of risks are involved: risks with obtaining the goods in the correct quantity or quality and their usability for the intended purpose, risks in the assumption about the future and the value of the goods later, and so forth. Risk is reduced by institutions. North uses the term “institution” to describe the aggregate of legal and social rules, customs, and business traditions that regulate the economy. For example, marriage and ownership of land are institutions in this sense, but so are insurance, stock exchange, and the law in general. Institutions consist of rules and procedures to execute and enforce them. North argues that societies develop institutions to reduce cost of transaction. This makes the economy more effective and allows development, through reinvestment of the saved expenditures, and ultimately leads to a higher standard of living. North (1966) and Eggertsson (1990) give numerous examples of how the development of institutions leads to economic development; they also contrast comparable economies and argue that differences in the institutions explain the differences in their economic development. The example of the two cities by de Soto fits well in this schema of explanations: the registration of ownership of land reduces the risk involved with investing in land and the cost of real-estate transaction, and therefore improves allocation of (land) resources.

### *2.3. De Soto's Argument for Capitalization*

A standard explanation for the lack of development in third-world countries is their lack of capital to pay for investments. De Soto starts with the

observation that the poor countries of the world have enormous wealth accumulated in their land, buildings, and infrastructure. He assesses with detailed surveys the aggregate value of land and buildings and the resulting figures are astonishingly high. The accumulation of investments of labor to improve the land and make it more productive over long periods of time have created substantial wealth, which is much larger than the often-discussed debts of the poor countries of the third world.

De Soto through his novel observations concludes that it is not wealth that is lacking in countries with low standards of living and low productivity. Comparing with the developed world where higher, but not substantially higher, levels of wealth can be found, he identifies the lack of capital as the major limitation. Capital is created in the developed world by bringing the existing value fixed in land and improvements on land into the capital market. The investment fixed in land and buildings can be “liquefied” and reconverted in capital that can be invested again. This reduces the need to import capital from other countries with all the dependencies it creates.

Development can be fueled by the improved allocation of capital to productive investments. This can be compared with the historic development in Europe during the seventeenth, eighteenth, and nineteenth centuries. The center shifted from England, then to the Netherlands, and finally to Germany. This shift can be explained by an improvement of the respective capital markets, which started with a primitive form of capital markets in England.

One might ask where the capital comes from. My tentative answer is the need for the transfer of value earned earlier in life towards old age. In traditional societies, “insurance” for old age is founded in social institutions, primarily in the family. Money earned earlier in life is invested in raising children who then have an obligation towards their parents when they are old. Investment can be made in improving the farm, which is then worked by a son who has an obligation to support the older generation. Both methods allow investing early life earnings to pay for old age, but include risk and are not always possible. Modern societies have created insurance, pension, and retirement funds, which are savings productively employed and later repaid to and consumed by retirees. Capital is put to the most effective use.

Countries in the third world lack opportunities for secure investments, other than in the family or the narrow social group of trust. Capital cannot be invested locally and must be exported to the global capital markets of the developed world; capital is not available locally, where needed. The inefficiency of the capital markets in the developing world is one of the major impediments to development. It is often estimated that export—often clandestine and even illegal—and import of capital for third-world countries are of the same order of magnitude.

One could argue here that development outside of capital markets is desirable and start a discussion of the shortcomings of the capitalist system. Amartya Sen has argued convincingly for the importance of the freedom to trade and markets as part of fundamental human freedom (Sen 2000). De Soto argues for the conversion of the wealth found in land and buildings to capital that can be used effectively for further economic development. This is a very specific but important part of economic freedom.

### **3. John Searle's Social Construction of Reality: The Mechanism to Convert Wealth in Capital**

The conversion of physically existing wealth to capital is through social institutions. A piece of land that can be used for agricultural production or a building that contains apartments for families to live in is valuable as a means of production and has value as such. It is useful to separate here the difference between the cost of producing something and the productive value of the same object. In perfect markets, cost and value are the same. In our imperfect world, unwise investments with high cost and little productive value in the end are possible and, unfortunately, frequent.

The market value of an object is—roughly speaking—its productive value minus the transaction cost. If the transaction cost is not zero, trade will only occur if the difference in the benefit from the current owner to the new owner is larger than the transaction cost. If transaction cost is high, inefficient allocations remain for long period. This can be seen in countries—like Austria—with inefficient markets for rental apartments, where large, old apartments are occupied by elderly single persons. The cost of changing to a modern, easier, and smaller apartment is much higher than the improvement in the living situation is worth; often the rent for the new, smaller apartment is higher than for the old, large one!

Markets for physical objects in small quantities are simple: I give you the pound of apples and you give me the money. Risk is small: you can observe me weighing the apples, inspect the quality before the purchase and we exchange goods against money, no risk for me not to be paid. Such markets work all the world over quite effectively.

Trading in land is more difficult: how can I make sure that the purported seller is really the owner, how to ascertain the boundaries of the land, what other rights and easements may reduce the value of the land? Risk is high, resulting in high cost of transaction and imperfect markets. Land registration is the institution created to reduce this risk: in its most developed form, the buyer is guaranteed, by the registry or a separate title insurance, that the seller is the true owner and also guaranteed owner-

ship through registration or title insurance; maps included in the registry guarantee the boundaries based on accurate surveying by professionals (Schoenenberger 1976). Such an arrangement reduces risk for buyer and seller, reduces transaction cost, and leads to efficient markets.

Land registration as an institution creates social reality exactly as Searle describes (Searle 1995). The brute fact of possession of land that can be plowed or where animals can graze or possession of the family dwelling is socially reified as a property right; property rights are created by actions and exist in documents. Searle uses the formula: "X counts as Y in the context Z." The document counts as the property right. Inscription as an owner of parcel A on a page in the land registry counts as ownership of the parcel A in the context of, say, Switzerland and its civil code. In this context, property—a concept of the law—includes physical possession and use of the land and the buildings on it; I obtain property to have a socially sanctioned possession that I can defend against intruders and ask society to help me defend.

Land registration as an institution creates documents that count as ownership or other rights in the context of the law. These documents are valuable because they give the socially created right to a physical valuable object. Land registration connects a written document to a valuable brute fact, namely, possession of land. This link consists of two steps:

- the social institution of ownership, which is a sanctioned form of brute possession;
- the documents that establish my ownership.

Land registration reduces risk of possession of land, reduces its cost, and simplifies its buying and selling.

Legal ownership reduces my cost of defending my possession against intruders and others who intend to take it away from me by force. Because society will help me against adverse actions, I need not invest heavily in walls, constant surveillance, and armed guards; I can rely on the courts and the police force to keep me safe from intruders.

Documented ownership of the physical land is vested in a document, which makes transfer much less costly. This is better visible in a commodity exchange, for example, the Chicago market in pork bellies: in lieu of exchanging actual physical pork bellies, trading is in contracts to deliver or accept a fixed amount of pork bellies of a standard quality at a fixed time. Only the paper documents, the contracts, are exchanged, which reduces cost of trading enormously! Nowadays, not even documents are exchanged, but rights to buy or sell are electronically added or subtracted from accounts.

The legal system is part of the social construction of reality. The legal realm creates a parallel “world,” where the brute facts, such as physical possession of land, are transferred to abstract concepts, which are then documented. This transfer to the realm of documents and business processes organized by law is prerequisite for the conversion of brute valuable objects that have value for the physical production process to the realm of capital.

#### **4. Capitalization of Land and Its Improvements**

Capitalization of land is completely achieved not only by registered ownership—albeit this is an important step—but also in the possibility of obtaining credit, that is, new money, against the value existing in the land. If I own a valuable piece of land, I can obtain money from others because they are certain that I will pay back my debts. If I default on my obligations, the creditor will take the land from me and sell it to be paid. This institution is typically called mortgage. A debt is secured by a piece of land against the risk of my not paying back what I owe; this reduces the risk of the lender greatly, assuming that the land has a lasting value.

The legal institution of mortgage creates a link between a personal debt and a piece of land, the value of which guarantees the repayment of the debt. This link is in the realm of documents: the land must be legally owned and documented. In countries where this institution is established, mortgage credit is often obtained for a very low cost, making such credits often half the price of a business or consumer credit. Often the credit is less expensive than what is gained annually by appreciation of real estate in a developing economy, and owning land bought with borrowed money is a good investment.

In countries where mortgage is a well-established institution, most buildings are used as collateral, or guarantee, for credit. Often the credit is used to improve the land or the building—for renovation of buildings, irrigation systems, and other improvements that would be difficult to finance otherwise. The functioning capital market provides the money.

Mortgages are part of the capital market. Traditionally banks were restricted to investing savings of private people into secure loans—government loans or loans secured by mortgages. The legislator was of the opinion that land could not lose its value, and therefore the investment would be of extremely low risk, a chain of reasoning which is usually justified.

Savings and mortgages are important for people to save money—that is, transfer value or consumption—from one time in their life to another: we save during the productive part of our lives to finance the same standard of living when we are older and retired with no productive income.

Such savings are converted by the finance markets into productive capital instead of saved under the mattress for lack of secure and productive investment.

## 5. Impediments to Capitalization of Land

There are numerous impediments to the effective use of land registration to achieve the capitalization of the wealth accumulated in land. They can be related to the law, the organization of the registration of land and mortgages, the organization of the capital markets, or the foreclosure process.

### 5.1. *Legal Institutions*

The legal institution of private ownership of land can be missing; this was typically the case in socialist countries, where all land belonged to the state. The institution of lending against interest can be missing—often due to religious restrictions, in, for example, Muslim countries. Whenever private ownership of land and lending against interest is legally constructed, then it seems that mortgage—a debt secured by ownership right in land—is also defined.

The construction of mortgage is not sufficient; the law must also define procedures for “foreclosure,” the termination of the loan agreement when the debtor does not pay, and the taking of the land by the creditor. In general, the legal organizations necessary for capitalization of land are available in developing countries, but they are not used.

### 5.2. *Organization of Registration*

Many of the impediments restricting capitalization of the wealth in land are organizational. They are either related to the ownership of land or to the risk and cost of land-related transactions.

#### 5.2.1. BURDENS ON LEGAL OWNERSHIP OF LAND

The legislature in every country I have knowledge of has succumbed to the temptation to connect obligations with the ownership of land. The extension of the rights flowing from ownership is limited, for example, through planning laws. Such laws restrict the type and size of buildings one can build on the land, how one can use the land, and so forth. Such restrictions are often distributed over several laws that are difficult to

obtain and uncertainly applied, but affect the value of the land. This increases the risk in the assessment of the value of the land for securing a debt.

The legislator also attaches multiple taxes to land, for example, fees for infrastructure built by the community, but often just general-purpose taxes. Taxing land is attractive to legislators because if the owner does not pay the taxes, the tax debt is converted in a lien, a debt secured by the property, similar to a mortgage. Such liens are created by law and need not be documented in a land registry. Many countries allow such liens to emerge not only for tax debts, but also for debts to public utilities as water or electricity, debts to tradesmen for work contributed to improve the land, and so forth. A buyer must research what liens exist because they reduce the value of the land; this increases the risk when assessing the value of the land.

#### 5.2.2. RESTRICTIONS ON TRANSACTIONS IN LAND

The transaction itself, rather than the ownership of land, is another good candidate for taxation. It is a situation where the parties have cash in hand and the state wants its share. Taxes are often defined by law for several authorities, each of which computes the tax on different bases, and paid to different agencies.

Rules intended to improve agrarian exploitation of the land are notorious. They might limit the smallest size of a parcel and restrict subdivision, give preemptive rights to next in kin or neighbors when a piece of land is sold, and so forth. This increases the risk associated with a transaction, delays the execution until all agreements are documented, and increases cost.

The simple procedures of registering a transfer of ownership in land or erecting a mortgage can be made into burdensome, costly, and time-consuming operations. In Ecuador during the 80s there were five taxes as well as several agreements regarding preemptive rights of neighbors, next in kin, and the agrarian reform commission to satisfy before a transfer of land could be registered. In consequence, most transaction went unregistered, taking these parcels out of the "legal" realm into the informal (practically, transfers were cleverly constructed as adverse possession so that the restrictions on transfer of ownership would not apply).

The situation is similarly burdensome in developed countries. A real-estate transfer of ownership in Austria may still not registered, a year after signing a contract. Such costs can be borne in a developed society with an already highly capitalized real-estate market, but they are prohibitive in developing countries.

### 5.3. *Organization of Capital Markets*

Land registries convert brute possession of land into documented ownership in the legal realm. To convert documented ownership into capital depends on the capital markets, the banks, and their organization. Banks collect money from people who have money that they do not use for consumption now but intend to save for later; banks loan the savings to these who need money to pay for present consumption. Interest is paid that compensates for delayed consumption and inflation. Mortgages secured by land seem a safe investment, as land should participate in the inflationary rise of prices.

Banking systems in any country are a prime target for operations serving political and personal interests and are therefore heavily regulated. Often the banking system is nationalized or partially nationalized. A population's trust in national banks is often low. Bank procedures, whether nationalized or not, are often as bureaucratic as the worst public administration.

Banks are not everywhere prepared to give loans secured by land against low interest rates to the large number of small owners; folklore has it—internationally—that it is easier to swindle a bank out of ten million euros than to obtain a credit of 10 thousand euros, even secured by land. Large commercial credits are more prestigious internally in a bank and consumer credits pay higher fees than mortgages.

Banks are justified in arguing that mortgage credits are cumbersome and have high risk, because the numerous organizational burdens are connected to legal ownership of land, and that land as a security is of little commercial value when the debtor defaults (see next subsection). It is therefore not sufficient to create new banks to overcome the banking system's organizational resistance, because the newly created organization will be hurt by the same impediments; rather, it is necessary to overcome the impediments.

### 5.4. *Foreclosure*

If the debtor does not pay back the debt when agreed, the creditor has the right to obtain the security. If a debt is secured with a mortgage on land, the creditor can demand that the land be sold and the debt be paid; the previous owner receives the remainder if the proceeds amount to more than the amount owed.

Foreclosure is a complex legal procedure, where multiple interests must be balanced. There is the interest of the current owner and his family: a family can lose its home through foreclosure, and social arguments have



added multiple restrictions on the process. There is also the interest of the creditor who wants the money paid back as soon as possible. There are also the interests of other parties linked to the land—next of kin, neighbors, those affected by agrarian reform; it should not be possible to circumvent these restrictions through the foreclosure procedure.

If the foreclosure procedure does not lead within a reasonable time to repayment of the debt to the bank, banks will not consider mortgage credit a viable line of business. From the bank's point of view, the risks are:

- The land has no market value; this may occur in countries where markets for agriculture products are depressed or swamped by imports, and therefore demand for agricultural land is nil. For example, I have encountered this situation in the Baltic states in the mid-1990s.
- There is no organized market for land, and sale is difficult and takes a long time; the bank ends up owning the land as a nonsellable asset.
- Procedures in foreclosure are costly and the bank must advance the cost; the more social restraints and restrictions for public interests are built into the foreclosure process, the higher the risk for the creditor, the higher the cost, and the longer the delays.
- Foreclosure is typically a procedure involving the court system, which may not be capable of diligent procedures due to complex procedural laws, overburdening, and understaffing. For example, in Italy, court procedures typically go on for years before a decision is rendered.

The development of the court system in Europe in the late nineteenth and early twentieth century has created a social expectation that debts are always paid without delays. Foreclosure and other enforcement procedures are rare, because they are swift and have a foreseeable outcome with a high price for the offender. Therefore, people pay whenever possible before foreclosure procedures start. This custom permits credit at a low cost to the creditor.

The expectation that debts are promptly paid is not universal. Reports from those doing business in the People's Republic of China point out that collecting outstanding debts is a major problem for foreign firms (Blackman 2000). The same is in my experience true for most of South America. In large parts of the world, there are no effective court procedures to enforce payment of debts or other contractual agreements; this is not to say that there are no legal procedures, but the practical observation is that enforcing the payment of debts is not feasible for ordinary business.

In contrast, mortgages are very common in Hong Kong; I deduce that the Hong Kong legal and court system is patterned after the English system, with effective, low-cost, and low-risk property registration, well-regulated banking, and swift foreclosure procedures.

## **6. Complexity of Rules**

The concept of giving credit against a security and using ownership of land and buildings as security is simple enough. De Soto describes it as the liberation of the wealth existing in land, buildings, and other improvements, creating capital that can be used to finance the development process in third-world countries. The principle is certainly correct; for example, I would argue that the rapid development of Spain in the last part of the twentieth century was financed by individual higher revaluations of real estate, which then was mortgaged to pay for renovation and other improvements.

What is limiting this process? It is the cost of converting the wealth into capital. There are not only the fees for registration, the taxes associated with the mortgage, and the bank fees, but also the total cost to the person initiating the process. The risk associated or perceived to be associated with a business translates to cost. The effort necessary to obtain information about the process, the risks involved, and so forth is a cost. Information reduces risk; lack of information is perceived as a risk. The cost resulting from risk makes it unlikely that the process of transforming wealth into capital will be initiated.

The amount of knowledge necessary to understand the construction “mortgage” and the processes involved is substantial. There are not only the rules of civil code regarding ownership, security for debt, and so forth (which in the Swiss civil code are about twenty-one pages of readable legal text), but also the procedures of foreclosure, with their limitations. The substantial set of rules of public law, agrarian reform laws, and urban planning must be evaluated as well. In many countries, the legislature has decided that a seller must obtain professional advice to mortgage real estate property—a testament to the complexity of the process, and an often-disproportionate addition to the cost, since laws restrict who can provide such advice. The legislature would have been better advised to reduce the complexity of laws and make the procedures comprehensible to the layperson.

## **7. How to Advance Capitalization of Real Estate**

De Soto has asked whether we should suggest that developing countries follow our present-day methods, which may or may not be appropriate for

their situations. He points out that we have forgotten how we got to our current system in the course of our development. I see three concrete points:

- Rules in the nineteenth and early twentieth century in continental Europe were simpler and could be understood by most citizens.
- Self-help groups organized to give and obtain mutual credit.
- There is a social compact that calls for orderly administration and for citizens to obey the law.

It is necessary to review the history of the mortgage system in Europe to understand how it evolved.

The institution of mortgage resulted from Roman law combined with the Germanic-law tradition of registration of real-estate ownership, which included registration of transfer and registration of contracts. It was originally described in few articles in the widely-translated Napoleonic code that formed the base for most European and South American civil laws. Foreclosure laws were originally equally simple, and were a step up from medieval customs of exposing or dunking debtors who had not paid. That is, if you did not pay, your valuables—especially your land—were seized and auctioned off, with the proceeds going to the creditor. This is documented in literature of the nineteenth century, where mortgage and foreclosure are regular themes described in simple lay terms (see descriptions in the novels of Gotthelf, Balzac, Zola, etc.). The rules were simple—credit secured by land and swift foreclosure when not paid—and generally understood.

The banking system evolved to provide mortgages to small owners—mostly in a process of self-help in rural and urban communities (Stubkjaer 2004). Later, the same lines of business were also offered by the large commercial banks. Savings and Loan Associations were constructed as self-help in a social group where members were known to each other; this permitted to assess the risk involved with a loan—which remained related to the person's abilities and business conduct, even if secured by real estate—and to use the institution in a socially responsible way. When the system became commercialized and anonymous, potential for abuse emerged, as demonstrated by the bank failures of the 1970s and 80s in the southern states of the U.S.A.

European countries and the U.S.A. benefited enormously from these institutions, which provided credit for reasonable terms. In comparison, loans in many countries are usurious, bearing interest rates of 10–20 percent *per month*. Mortgages could be used to finance not only improvements to land for agricultural purposes, but also the construction of single-

family dwellings. Over time, the institutions were refined to improve the flow of capital with a secondary market for mortgages. Foreclosure laws were improved to prevent abuse by lenders and became more socially aware but at the same time less effective for the creditor and thus more costly for the regular debtor. A host of social restrictions was attached to the land to improve agriculture, to be fair to neighbors and to the next of kin; all these rules made it less predictable how mortgages would work and increased risk. This is most likely a good example of the “law of unintended consequences”: a law usually does not have the effects that the lawmaker intends; sometimes it has exactly the contrary effects. The refinement of the laws regarding land and mortgages increased risks for all parties involved, increased the requirement for accurate information and up-to-date knowledge of the often-changing laws, and in consequence increased cost.

In developed countries where a firm base of understanding of the basic mechanism of mortgage together with a high level of document-oriented culture are available, no detrimental effects obtained. If we export today’s elaborate law systems of developed countries to the third world—as it is often done in development projects (I admit that I was technical advisor to one!)—the effect is not the desired one, because the legal foundation is not sufficient that a working land market and mortgage system develops. The related institutions (courts, banks, etc.) cannot cope with the complexity of these developed laws and the fine distinctions that are the result of a hundred years of experience. It is necessary to create simple laws appropriate for the situation, considering the technology used in agriculture and the traditions of inheritance and neighborhoods, and restrict the complexity of the law to principles that can be communicated to the users, that is, the citizens. Laws that are understood only by specialists do not recommend themselves.

Third-world countries seem not to lack mortgage and foreclosure laws. What they lack is the application of these laws in a form that puts them in reach of the farmers and small entrepreneurs who need the capital for development of small enterprises. Not only the cost and the procedural difficulties but also the intellectual difficulty to understand the current highly developed systems makes them unobtainable for normal citizens. De Soto’s current position seems to favor the construction of a parallel system of simple laws, as it has evolved in the informal sector of third-world countries (de Soto 1989). The revision and simplification of the current complex systems with highly technical rules of law seems not to be a viable path—too large are the vested interests of the legal profession and the administrations. This is not a situation without precedence: the banking system developed in the thirteenth and fourteenth century as an initiative of the private sector; one could say “informally.” One might even advance

the hypothesis that many institutions of civil law were created in self-help cooperative-like groups before the rules that these groups developed became official law.

## 8. Conclusion

De Soto has pointed out that exporting the legal institutions of developed countries to the third world is not successful. The lack of capital in third-world countries is due neither to a lack of wealth accumulated in land and buildings, nor for want of legal institutions like land registration and mortgage laws, nor, probably, for a lack of savings. What is missing is an effective use of these institutions. Complex laws are perhaps appropriate for developed countries, but a major impediment to institutions defined by citizens of countries with lower levels of formal education and less experience with today's "document culture." This culture cannot be achieved through the application of rules the persons concerned cannot understand.

We have forgotten how our legal system evolved from simple principles—the Roman law, captured in the *Digestes*—before it reached today's complexity. Research to identify the "simple core" of a legal system is necessary. The historical development of legal institutions from simple rules to the complex constructions we have today can inspire such research. I believe that such "simple laws" could also benefit the developed countries, where complexity of law has probably passed the optimal point. The core of land ownership and mortgage credit is simple. A person possesses a plot of land with determined boundary and is its registered owner. The owner can use the land as security for a loan to guarantee his repayment of a loan: if I do not repay the loan as agreed then the creditor can use the land to get repaid.

Not only are legal institutions necessary, but also a full set of customs must develop to achieve capitalization of the wealth in the land and its improvements. That is, banks must offer mortgage credit and the courts must be prepared to deal with defaulting debtors. The European and U.S. tradition points to self-help groups that initially organized mutual credit in Savings and Loan Associations, where reliance was not exclusively on the legal rules, but on simple rules laid down by the associations and social control of the debtors; giving loans to people well known in a face-to-face community is much less risky than the anonymous, standardized commercial bank proceedings of today.

The European experience justifies de Soto's skepticism that the established administration and the legal system are capable to provide the capitalization of the smallholders necessary for the development of a country. European history demonstrates the self-help group that uses simple rules

that can be understood by the participants; in today's parlance one says that these first mutual credit organizations were "informal." Looking for solutions in the informal sector in third-world countries may be the path to the future.

I conclude with an observation of an Egyptian student of mine, confirming my position from a different perspective. He said that effective and functioning courts are necessary today for the middle class. The upper social strata know how to use them for their advantage and the poor cannot use them because the cost is too high. In reverse: without effective court systems, the ability of the poor to become middle class is not possible.

## P O S T S C R I P T

### **Postscript to Andrew Frank: A Case for Simple Laws**

**Carlos Alejandro Cabrera Del Valle**

Director, National Cadastre

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Professor Frank began his presentation by showing the importance of the connection between philosophy and the institutional world. He takes the ontology of social reality from Professor Searle, and shows us how useful they can be in understanding, for example, systems of property rights.

He indicates that in many countries there are laws and procedures related to the property, the registry and mortgages, banks and credit, which while in place, apparently are seldom used. In cases such as Guatemala and other Central American countries, Professor Frank certainly is correct in terms of absolute percentages. Why are these laws and procedures not used?

Professor Frank considers that the principal reason is that they are very expensive to apply, in both monetary and nonmonetary terms. There are also other costs, in that certain laws and institutions, far from alleviating the costs of acquiring actual rights, may in fact make such acquisition more difficult. Another group of laws seek to obviate the misuse of those already established, and these provide in practice even more barriers to acquisition. Here again we find that Frank has hit the nail on the head not only for developing countries but also for many cases in the developed world.

On the other hand, it seems that the misuse of the established laws derives from the lack of effectiveness of the institutions that are involved in maintaining them (such as banks).

And finally, in a third phase, there are the courts, that regulate the margins of error in social transactions. These, too, create a new constructed

reality, and its manner of being intertwined with the others explains in good part the structures of social understanding created in different societies to promote or suppress development.

Professor Frank asserts that it is indeed difficult to know where the collective understanding for the execution of a norm is born, because it is also clear that in many developed countries, the laws have become very complicated, the associated institutions have weakened, and the legal order has been reduced. However, the collective behavior nonetheless allows for interactions on a variety of levels that generate conditions that allow real capital flows.

I have had the opportunity to read several papers by Professors Searle and Frank and by Hernando de Soto. It is difficult not to agree with much of what they say, not just on the theoretical aspects of the constructions of reality which arise from collective understandings of the laws and institutions, but also of the real abyss that exists between the rich and poor nations.

In the case of my own work, which focuses on the cadastre and land registration in the developing country of Guatemala, I wish to present some ideas that I believe would help to supplement the previous ones that I consider fundamental in the construction of this new interpretation. I only want to refer to the Central American societies, although I believe that my remarks apply at the Latin American level as well.

It is important to remember that our societies have a deep history. That history explains the construction of the modern state and has left ancestral roots that are revealed in many of its collective behaviors. How this has happened is of course not completely clear, and in many cases the history was not documented. However, the fact that it has not been documented does not mean that its effects cannot be noticed many years later.

There are discontinuities in the social constructions of the various collective organizations involved. Politically and economically, we are societies formed by truncated initiatives. This means that the social cost of establishing norms based on these initiatives is difficult to measure in terms of any single scale.

In 1823, the third year of its independence, the Federation of Central American Countries held its first legislative assembly. At that very first assembly, laws establishing a cadastre were passed. More than 180 years later, none of the countries involved has achieved a fully operating and complete cadastre. Neither have any of these countries been able to establish a solid base for the rights of property, which is not even established at the constitutional level. If we have not created the conditions for the use and enjoyment of the property rights, then we have also not created the conditions for a market economy based on the circulation and generation of capital.

The topic is neither linear nor simple. Many countries do not find the path to development, and the main reason is that in the construction of the state and of its relationship to society they created an institutional reality different to that which they intended to build. The construction of social reality, the scaffolding that allows the transformation of abstract capital into real capital, cannot obviate the history of the countries.

The countries of Central America are Western countries, and many people believe in the market economy. We also have laws that protect private property and institutions that promote capitalist development. But how many of us really believe that we have this, and how many of us trust it?

I also know that a good percentage of the lawyers of Guatemala have never read the Civil Code, nor the more than two thousand laws that are effective in my country. For example, many people ignore the importance of the right of property, and they consider social security as a privilege of the few. There are thousands who do not understand the rigidity of the tax system, nor how it is structured and why it is so difficult to pay taxes. Even though many people are illiterate, we like to show off our education system. It is certain that the laws are not understandable, and therefore the institutions that accompany them are very weak.

Many developing countries, including ours, need to be reinvented; we need to look for a window in history to redraw social and institutional reality. This must be based on an understanding of the most rural as well as the urban dimensions of our countries. On this new base, we should elaborate a new social construction that reflects our collective vision.

Without this new interpretation of who we are as countries or societies, it will be difficult to rejuvenate capital. There won't be successful market economies. It will not be possible to have an effective social contract or to achieve synergy with the necessary scaffolding of laws to support the economy.

Let me finish by telling you that in my country, we are currently discussing the modernization of the laws for registration of property and for the cadastre in order to regularize the market for land transactions. Concern has been raised by the political, economic, and academic sectors in the country regarding whether the registration effort and cadastre can be economically sustainable. We are determined to explain to them the benefits of having a modern system of registration and cadastre, and we have only one concern: Is our country "economically sustainable"?

When we are delivering property titles in Guatemala, we try to explain to the people the value of being owners. A radio provides a good analogy. The physical radio without energy (batteries or electricity) is only a piece of plastic, iron, or aluminum, just that—dead material. But when you put batteries into the radio or connect it to the mains, then this radio gives you



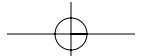
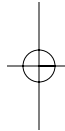
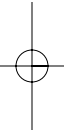
a lot of things: You can receive music, news, poetry, speeches, even theatre. You get enormous benefits from being connected to the radio system. When you get these, of course, it doesn't really matter to you how it works, as long as it *does* work. The same happens with land: Land is inert material, but the title to property is the energy, and the institutional reality of land registration is the radio system.

I think Professor Frank's contribution begins where Hernando De Soto's book leaves off—*The Mystery of Capital*. Implementing a property system that creates capital is a political challenge, because it involves getting in touch with people, grasping the social contract, and overhauling the legal system.

To meet this challenge, we need a sound philosophy of information, and we need to use it to create a cadastral regularization system that is able to guarantee property rights and to represent them in an information system. This will provide the basis for modeling, understanding, and transforming the reality of land in Guatemala and elsewhere.

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# Sovereigns, Squatters, and Property Rights: From Guano Islands to the Moon

13

*David R. Koepsell*

## 1. Introduction

The law of territoriality, sovereignty, and individual property rights has evolved greatly in the last two hundred years. These areas of law illustrate clearly the nature of laws as social objects. The fact of possession of a parcel is what John Searle would call a brute fact. An individual occupies a certain physical space. With the development first of notions of a sovereign, who in the Anglo tradition holds primary title to land, and later the conflicts among various competing sovereigns who each claim title to newly discovered lands, various new legal and social artifacts have grown and come to be recognized to varying degrees in “international law” or settled by resort to force.

Ordinarily, legal systems establishing property rights over land have been governmentally created monopolies owing their origin to some claim of sovereignty, and some expression of ownership by a sovereign in possession. Property rights in the Anglo-American tradition emerge by a sovereign or its agent’s monopolistic control by acts or indicia of ownership, such as fence-building, planting, or improvement of the land. Hernando de Soto’s book *The Mystery of Capital* (2000) nicely summarizes the developments and refinement of the U.S. real-property regime. Of particular interest is the recognition, unique in the U.S., of squatting as a legal means of establishing priority of ownership over a parcel. In fact, as we shall see, squatting has not only been perfected in the U.S. as a means of individual attainment of title over other, even more perfect claims, but it has come also to be institutionalized as a means by which a sovereign may come to claim legal ownership through its agents and to recognize and pass title in newly discovered territories (Groos 1948), which are automatically annexed through its agents, in such cases as Guano Islands and even the Earth’s Moon.

## 2. The Three Historical Means to Legal Title

While we take the notion of sovereignty and territoriality for granted, its emergence as the primary recognized means of claim by nation-states to land is relatively recent. Up through the medieval period, sovereigns' claims were based more or less solely on possession by ongoing and continuous force, with many levels of conflicting feudal claims each expressing some different source of legitimacy. In 1648, the Treaty of Westphalia established for the first time the modern notion of territorially based national or state sovereignty. With this treaty emerged the conception of the state as the ultimate territorial entity, with sole power to acknowledge claims within it and to broker or settle by force the claims of other sovereigns. The central concept of the Treaty of Westphalia is the notion of territoriality. From this basis, the notion of international law, by which states came eventually (sometimes) to recognize the claims of other states, slowly emerged. The Westphalian model grew over the course of the eighteenth and nineteenth centuries in the Western world. The central view of this model is that a sovereign state has "exclusive sovereignty and jurisdiction throughout the full extent of its territory [and] No state can, by its laws, directly affect, bind, or regulate property beyond its own territory, or control persons that do not reside within it, whether they be native-born subjects or not" (Wheaton 1866). By a certain amount of common agreement among Western ("civilized") states, this notion of sovereignty was extended only to a select group or states and cultures. Thus, colonization and empire-building were simultaneously justified and accepted. Territories could be annexed by force from non-Westphalian states, and colonized without recognizing the statehood of less-developed (non-Christian) polities.

For individuals within states, there were and are three major means to gaining legal possession: (1) by deed from the sovereign, (2) by deed from the previous owner, or (3) by adverse possession (later recognized by the sovereign). In many ways, legal individual possession and ownership tracks the means by which sovereigns themselves express their territoriality in the post-Westphalian West. For individuals, these three methods may result in ownership of a parcel in "fee simple": providing the owner with all the benefits accruing to a property owner under the dominion of the sovereign, subject only to the laws, rules, or regulations that may prevent certain acts to or dispositions of land. The first two means of individual ownership of land occur by means of complex "cadastral" systems whereby the title to the land is recorded by the sovereign. Adverse possession is essentially how a "squatter" may come to legally own land. Depending upon the jurisdiction, the squatter comes to be the legitimate owner of a property by the open, notorious, and adverse possession of lands that are

not originally his. But eventually, even squatters must have their right recorded by a sovereign.

These “squatters’ rights” shall be the primary focus of this chapter, in relation particularly to certain legal anomalies created specifically by sovereigns regarding such rights. As de Soto recognizes, recognition of squatters’ rights is unique in the West, at least to the degree and extent which such rights have come to be recognized in U.S. law, and suggest something about economic efficiency that is also expressed in the anomalous laws, particularly the U.S. “Guano Acts” discussed herein.

### **3. Squatters and Sovereigns**

Squatters’ rights to parcels are typically defined by the extent to which an individual squatter can establish indicia of ownership. Inasmuch as property rights over land might be “natural” as opposed to positive, they are defined by the degree to which an occupier of land may reasonably assert his ownership, through improvement, delineation, and other such indicia of ownership, despite a lack of actual title. The extent to which a squatter has asserted ownership through such indicia typically defines the extent to which a squatter may come to be legitimately recognized eventually, and legally, as the true owner of the parcel against all other claims. There are parallels to these indicia of ownership in the post-Westphalian world of territoriality and sovereignty.

Sovereigns come into possession (and “legal” ownership following the customs generally recognized after the Treaty of Westphalia) by (1) treaty, (2) war, or (3) fiat. In the case of treaties, lands are agreed to be owned by a particular sovereign by the other signatories of the treaty. In the case of war, lands are taken by the victor from the prior owner, and the occupation eventually (usually) comes to be recognized by the international community as legitimate ownership. In the case of fiat ownership, unoccupied lands are taken by virtue of the sovereign’s exercise of dominion over the lands without regard to formal initial recognition of that ownership by other sovereigns.

In Anglo-American common law, the sovereign is held to be the primary title owner, and in the West, the sovereign retains at all times the right of eminent domain against any individual title owner subordinate to the sovereign’s necessity to claim title. In this way, all other owners of parcels are subordinate to the sovereign and all legal title must flow from the legal recognition by the sovereign of the possessor’s just ownership rights.

In many ways, the most interesting means by which sovereigns come into possession is by fiat. In fact, most of the Western lands of the United

States were taken by wars or treaties, such as the Treaty of Guadalupe Hidalgo, or by the Louisiana Purchase. Through both of these expansions, the United States assumed primary title to certain lands, and recognized in so doing prior individual land claims asserted as against the possessory sovereign. In these cases, the lands taken were contiguous to lands already owned. The allegedly “natural” rights of the sovereign over contiguous lands are expressed in a Supreme Court decision from 1842:

The laws of nature and nations establish the following propositions, pertinent to this questions: 1. Every nation is a proprietor [owner] as well of the rivers and seas as of the lands within its territorial limits. Vattel 120, 266. 2. The sea itself, to a certain extent, and for certain purposes, may be appropriated and become exclusive property as well as the land. Vattel 127, 287; Ruth. Book 1, ch. 5, p. 76, 3. 3. The nation may dispose of the property in its possession, as it pleases; may lawfully alienate or mortgage it. Vattel 117, 261–2. 4. The nation may invest the sovereign with the title to its property, and thus confer upon him the rights to alienate or mortgage it. Vattel 117, 261–2. The laws of England establish the following propositions material to this point: 1. the common law of England vests in the king the title to all public property. [further citations omitted] *Matin v. Waddell's Lessee* 1842.

Ordinarily, the territorial limits of a sovereign are defined either by geography or by treaty. Geography, for instance, defines the eastern and western borders of the United States (apart from Hawaii, Puerto Rico, other island territories, and Alaska, recognized by treaties or purchase), and treaties define the northern and southern borders following armed conflicts. Treaties also define the territorial limits or legal jurisdiction of sovereigns over the seas. For a long time, three miles from the shore was recognized as the territorial border of a sovereign with a shoreline. This was “cannonball” distance. Now, the territorial limits recognized by the UN extend to as much as two hundred miles out to sea.

#### 4. Territories and Strategic Minerals

Special rights and privileges of a sovereign over strategic minerals and deposits within a state’s territories have long been acknowledged by some states to take precedence over rights retained by the title owner. In much of Europe, such rights and privileges flow from the same basis as the right of eminent domain. French law, for instance, made mines found on private property the domain of the state, which could grant owners or others the right to extract minerals from them. Similarly, in Spain, mines on either public or private land were the property of the Crown. However, in Germany and England, the title owner of the land had the original right to

dispose of its strategic minerals and deposits however he saw fit. "Therefore, if a man grants all his lands, he grants thereby all his mines of metal and other fossils, his woods, his waters, and his houses, as well as his fields and meadows" (Blackstone 1766, 18).

In the mid-nineteenth century, a number of states began to address strategic deposits of nitrates on what are commonly called "guano islands." The U.S. was the most comprehensive, and also one of the first states to deal with such deposits by offering certain rights in exchange for territoriality.

### **Guano Islands: Sovereign as Squatter**

In the mid-nineteenth century, the U.S. adopted a law that would significantly alter the means by which it could acquire certain territories. Essentially, it laid claim to a whole category of islands based not upon their geographical position or any other treaty, but based instead upon the mineral composition of any undiscovered island and certain other conditions. The Guano Islands Act of 1856 established the United States' claim to any so-called guano island upon which any American citizen may set foot, and which is not otherwise occupied or laid-claim to, and which has any "deposit of guano" (48 U.S. Code, chap. 8, 1411 et. seq.). This odd example reveals how sovereigns may take possession of lands by fiat.

Notably, the Guano Islands Act necessitates entrepreneurial activity by a citizen taking possession of a guano island. It grants him, in return for possession and legal title, profits from the extraction of guano from the island. While the U.S. becomes the territorial sovereign, without necessity for formal occupation, the possessor becomes the parcel owner simply by virtue of "improving" the island by exploiting the natural, strategic resource. This sort of improvement is akin to the indicia of ownership which granted tens of thousands of early American squatter legitimate title to lands in the continental U.S. (de Soto 2000, 113–15).

Besides granting land to squatters in the contiguous American states— noted by de Soto as essential to the entrepreneurial role of land in the U.S., the state has also granted title to possessors who have at various times exploited other strategic minerals in existing U.S. territories. For instance, in the western states, title has been granted to possessors (including squatters) who discovered gold. But this sort of grant, in existing territories, is qualitatively different from the Guano Islands Act, which empowers any citizen to act in the place of a sovereign in claiming new territory on behalf of the sovereign. It replaces war or treaty as a means of territorial expansion, and recognizes the same productive value of improvement in light of

natural resources in entitling one to possess and own land by title, with the recognition of a sovereign.

In contrast, Germans who settled the island of Nauru, which then became a German protectorate, discovered guano deposits and began exploiting them on behalf of themselves. Until 1906, German mining law gave to the state exclusive right of possession and disposal of minerals, but excluded phosphate (guano). In 1905, the law was changed to give the exclusive right of mining guano in this Marshall Islands protectorate to the state through the Jaluit Company. Ultimately, the state therefore took the right to exploit minerals, specifically phosphate, away from those who should have been recognized as title owners, and transferred it to the state by way of a private company (MacSporran 1995, 7). In net effect, the German *ex post facto* grant reduced the rights and incentive of private would-be possessors to discover and exploit new guano islands. On the other hand, the U.S. experiment led to a number of acquisitions by guano entrepreneurs.

## 5. The Strange Case of Navassa

In 1857, the United States claimed possession of the uninhabited island of Navassa, between Haiti and Jamaica, pursuant to the Guano Islands Act. As it turned out, the sea captain who thought he had discovered guano on the island was mistaken. What he had in fact discovered was phosphorite, of which nearly a million tons were promptly mined from the island by the Navassa Phosphate Company based in Baltimore. Mining operations there ceased by the time of the Spanish-American War, although the island still comes under the flag of the U.S. The U.S. Coast Guard maintained a lighthouse on Navassa until 1997, but abandoned it when the prevalence of global positioning systems replaced the usefulness of lighthouses. Haiti has asserted an adverse claim to Navassa, and it seems likely that, given the means by which the U.S. came into accidental possession of the island and its current failure to continue to occupy it, Haiti's claim may yet prevail if pursued.

The Guano Islands Act and the case of Navassa underscore some interesting issues concerning the means by which sovereigns come into possession of territories and maintain their claims. Specifically, the class of strategically important islands were claimed by a mechanism which amounts to fiat ownership, rather than by war or treaty, and claims were asserted even prior to the sovereign's actual occupation or possession through the act of a citizen agent based only on the presence of a certain substance on such an island. It is interesting to note that these claims have not, by and large, resulted in major confrontation between sovereigns vying for possession of guano islands. There were no "Guano Wars."



Beyond mere recognition of and encouraging entrepreneurial squatters' rights, the Guano Islands Act was the official institutionalization of squatters' rights in the U.S. and *by* the U.S.

## 6. Natural versus Positive Monopolies

De Soto's reflection on the emergence of squatting as a *bona fide* means of legitimate property ownership in the U.S. and governmental acceptance of this previously illegal act emphasizes the largely entrepreneurial role of property owners in the U.S. as opposed to elsewhere. I contend that the distinction between land patents (state-created monopoly rights over carefully delineated parcels) and "squatters' rights" is analogous to the distinction between intellectual property patents and trade secrets.

Natural monopolies arise not due to some government-sponsored right or positive law, but rather through the mere assertion of possessory interest over some resource. Natural monopolies are what Searle would call "brute facts," not social objects. The only natural monopoly that might be extended over ideas, for instance, is via secretiveness, recognized in the common law as "trade secrets." Similarly, my possession by occupation of a particular parcel, or a piece of movable property, to the exclusion of all others, gives me a natural monopoly over the resource, until my factual possession or occupation is displaced by some other.

In many ways, property rights flow from the brute facts of possession. Thus, we often hear that "possession is nine-tenths of the law" and this is actually so in regard to conflicting claims of possession over most movable property, and in some cases, real property as well. The layers of property claims by sovereigns, title owners, and other possessors in interest are artifacts of social reality.

Sovereignty as a social object is the exertion by a political unit of a monopoly over land by virtue of some consensual right of primary or ultimate ownership by the sovereign. All other subordinate rights to land flow from the sovereign's monopoly where recognized. In fact, the name for the monopoly power of intellectual property patents owes its etymology to "land patents," which are state-created monopolies over land granted by sovereigns to citizens. Eventually, the Crown began to grant "letters patent" to individuals wishing to express and protect certain ideas as well. Both land patents and intellectual property patents continue to exist as institutions, and continue to be recognized as monopolies granted exclusively by sovereigns:

The patenting process is essentially a judgement [sic] of the Land Office tribunal, serving as documentary evidence that:

Legitimate national obligations (compliance with international treaties and extinguishment of Indian occupancy) have been discharged so that national “interest” in the property can be quitclaimed;

The courts held that the operation of a patent as a deed was of the nature of a quitclaim to any interest as the United States possessed in the land; *Beard v. Federy*, 70 U.S. 478, 3 Wall, 478, 18 L.Ed. 88. A patent to land of the United States constituted a full conveyance of title out of the United States; *McArthur v. Brue*, 67 So. 249, 250, 190 Ala. 563. The issuance of a patent divested the government of all authority and control over the land; *Moore v. Robbins*, Ill. 96 U.S. 530, 24 L.Ed. 848.

A patent passes to the patentee all interest of the United States, whatever it may have been, in everything connected with the soil and in fact everything embraced within the meaning of the term “land”; *Damon v. Hawaii*, 194 U.S. 154, 48 L.Ed. 916, 24 S.Ct. 617; *Energy Transp. Systems, Inc. v. Union P. R. Co.*, (DC Wyo) 435 F. Supp. 313, 60 OGR 427, *aff’d* (CA10 Wyo) 606 F.2d 934 [further citations omitted].

From the British Crown’s first issuance of letters Patent to land patents in the U.S., it has been the exclusive dominion of the sovereign to extend this form of artificial monopoly to both ideas and land, for the purpose of encouraging improvements and innovations. It is a bargain struck between the sovereign and subject that creates an exclusive control not otherwise established by any brute fact.

Artificial monopolies are not necessarily efficient, as they are granted despite market forces in the hopes of generating new modes of creation, new markets, and innovation. The Guano Islands Act, and other recognitions of squatters’ rights whereby the benefits of improvement and exploitation of natural resources are rewarded via an *ex post facto* grant, indicate a market-driven efficiency that patents otherwise granted do not recognize or reward. De Soto notes the rise in entrepreneurial activity in states that grant to squatters some form of legal title despite their adverse possession against title owners or sovereigns. His work has resulted in a general liberalization and spread of squatters’ rights regimes in third-world countries wishing to expand markets and increase ownership. The efficiency of natural monopolies is encouraged by such governmental grants, following some sort of possession and improvement.

## 7. The Efficiency of Natural Monopolies

Artificial monopolies, created by positive law and granted or enforced by governments, are not necessarily efficient. They are granted without regard to market forces, and endure irrespective of those same forces. In intellectual property, patents are routinely granted for new and inventive products

or processes, although those new and inventive products or processes may not have a market, and may never in fact enter the stream of commerce. The patent itself has become a valuable form of property, because of the strong and exclusive nature of the monopoly granted, so that a company may be valued not necessarily by what it makes or sells, but by the perceived value of the intellectual property it may be sitting upon.

As I have argued in *The Ontology of Cyberspace*, patents are in many ways a drag on the economy, slowing the movement to market of new and innovative technologies, and ultimately unnecessary as a means to promote innovation. Rather, given new technologies, innovators may reap huge rewards by speedier innovation, and getting more quickly to market, even without governmentally created monopolies (see Koepsell 2000, 108–10).

So, too may the government-sponsored monopolies of land patents be a drag on economies. This fact is implicit in the willingness of U.S. jurisdictions to accept squatters' rights as valid, where land has been improved and other indicia of ownership asserted. Much like the potential economic benefit of a *laissez faire* world without governmentally created monopolies over intellectual property, a "squatters' regime" recognizes that government sponsored monopolies over land, which divvies up parcel without regard to the prospective owner's ability to usefully improve the land, may not always be the most efficient use of a limited resource.

The Guano Islands Act mixes the role of *bona fide* possession and improvement with an *ex post facto* grant of governmental legitimacy. As opposed to the usual course of a sovereign's initial assertion of territoriality, the Guano Islands Act affords a guano entrepreneur the profits of his or her exploitation of a newly discovered resource in exchange for a later grant by the sovereign of title. It is a rare form of expansion of territoriality, which accomplishes expansion not by war or treaty, but by fiat, driven by the value of private entrepreneurs willing to undertake the risk of exploration where a government lacks resources, time, will, or capital.

De Soto's thesis is that the expansion of individual, private property rights to those willing to undertake entrepreneurial activities, improve upon land, and feed the engines of economies frees up hidden capital otherwise unrecognized due to complex, outdated cadastral systems. Those systems that are unwilling to recognize the value and role of adverse possession, as with the German example of the guano island of Nauru, will ill-serve the release of this hidden capital, and will suppress innovation and growth.

## 8. The Future of Institutionalized Squatters' Rights

The monopoly exerted by the sovereign may be defined legally as among equal sovereigns (as in treaties), or may be taken by war, or may be asserted

by fiat, as in the case of the Guano Islands Acts. The former method is particularly important for the future of exploitation not of Guano Islands, but rather of outer space. For instance, the U.S. and most other major nations refused to sign the "Agreement Governing the Activities of States on the Moon and Other Celestial Bodies," 1984 (The Moon Treaty). The U.S. Senate's refusal to ratify means that the Moon Treaty's provisions are not "the law of the land" in U.S. courts, and therefore need not inhibit the actions of U.S. citizens or legislators. In this brave new age of privately funded space exploration, the U.S. could further encourage the entrepreneurial exploitation of the Moon and other celestial bodies by passing an interplanetary version of the Guano Islands Act (which remains good law, though we won't be finding guano on the moon), which would authorize private individuals to take and improve the Moon and other such bodies, and increase our territory strategically, and exponentially.

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# The Property Rights Prescription: Urban Migrants versus Rural Customary Land Tenure in the Developing World

*Jon D. Unruh*

## 1. Introduction

Significant attention is currently focused on the economic potential of undocumented property held by poor people in developing countries.<sup>1</sup> Such property (especially land) is characterized as being occupied and used but not formally owned, and is thought to amount to a considerable sum of capital—a total much larger than all foreign investments in and assistance to the developing world in recent decades. This notion of undocumented property, which is strongly advocated by Hernando de Soto (2000), suggests that given the existence of such vast resources, the possibility of documenting them with individualized formal titles has the potential to produce substantial economic benefits. Further, recognizing the value of this already existing but undocumented capital suggests that developing countries would do well to begin the process of fostering economic growth at home, rather than first seeking aid from abroad. This idea is caught up with two issues. The first concerns land and its potential to be used as collateral, while the second and more fundamental issue is that of law and legal institutions. The issue of law is more fundamental because those who informally occupy and use capital are very frequently unable to prove ownership by way of the formal titles that lending, credit, and other civil institutions require.

The legal problem concerns the ongoing disconnect between formal state law and the informal customary or traditional law that governs how a great deal of the world's poor intersect with property. The former allows assets to be fungible and thus to be used by individuals for purposes of exchange in the open market. The latter, however, has evolved under a

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1. Portions of this chapter initially appeared in *Land Use Policy* 19 (2002): 275–76.

different tenurial logic: specifically the logic of maintaining the communal and familial ties to land that provide for personal safety and ensure personal and communal access to essential resources, often in physically, socially, and politically risky environments (Unruh 2002a). An important distinction lacking in the poverty–property rights argument is that the benefits of informal or traditional law described here are most robust in functioning rural tenure systems, and are weakest in informal urban tenure systems. Whereas formal law is created by legislation, customary laws and associated rights are created by “ad hoc arrangements that develop to meet the variety of situations in which people find themselves” (Riddell 1982) and are thus backed by what Riddell (1982) calls “law-in-action.” Searle also notes this distinction in the way in which “institutional facts” are created, namely, the deliberate act of legislation versus the roles of “natural evolution” and “collective intentionality” (Searle 1995).

The solution to the legal problem offered by de Soto is to formalize customarily held land and property so as to unleash the economic potential latent in the “dead capital” (de Soto 2000) that is bound up in such informally held property.

However, this chapter argues that there is a fundamental distinction between intact, functioning rural customary tenure systems and the disrupted informal property rights arrangements pursued by those who have migrated to cities, and that recognizing this distinction brings to light some important limits to de Soto’s poverty–property rights argument.

## 2. The Nature of the Disconnect

### 2.1. *The Rural Domain*

#### 2.1.1. THE UTILITY OF RURAL CUSTOMARY TENURE SYSTEMS

Much about the poverty–property rights argument focuses on what customary tenure systems do not do—hence the label “dead capital” (de Soto 2000)—and the relevance of Searle’s (1995) discussion of partial representation. However, customary tenure systems are very effective at accomplishing certain goals. An examination of the rural tenure domain reveals a number of aspects that are critically important in their utility.

First, a primary reason for the gulf between formal and customary tenure regimes is the very different purposes for which each is designed. Significant components of customary tenure are bound up with notions of property rights that facilitate risk reduction at the group level. This contrasts sharply with the goal of formal tenure regimes, which is that of mak-

ing capital accessible to and usable by the individual, something that essentially promotes risk taking. When land is treated as a commodity it exists separately from group-based institutions that focus on ensuring the availability and security of essential resources such as food. In the reduced form of a commodity, land can easily be bought, sold, and used as collateral, and in societies where this occurs successfully one can still separately acquire forms of security and insurance.

While much importance is placed on the “invisible” aspects of the capital–property rights nexus (de Soto 2000), equally invisible and useful are the operative aspects of rural land tenure regimes. These aspects standardly provide for important forms of security and insurance, as well as contribute to a sense of identity, under circumstances that are very risky (e.g., Unruh 1998). That these aspects are bound tightly together for participants in customary tenure regimes is a good example of what Searle (1995) calls the Background, insofar as the connections are largely taken for granted by participants within customary tenure systems.

The creation in rural areas of formal property systems and institutions, along with alternative provisions for personal security and insurance, would go a long way in enabling and promoting risk taking, as well as awareness of the opportunities associated with land that can be used as a commodity. However, not only are these arrangements variably available, expensive, corrupt, and beyond the financial and educational means of most in the developing world (where they are not lacking altogether), they can also be quite difficult to put together for whole populations, requiring the use of more resources than many countries are able to afford (Unruh 2002a). Additionally, moving from community- or lineage-held land in rural areas to individually held land in the form of a commodity would in many cases destroy the institutions that have traditionally provided security and insurance.

Second, in developing countries with scarce financial resources and low administrative capacity, land administered by rural customary tenure systems occurs at no cost to the state. This is especially important for countries unable to bear the cost of such administrative activity—particularly where titles, registries, and enforcement would be needed over large areas.

Third, there is the idea of homeland or home territory, where identity based attachments to land can run very deep for very uneconomic reasons (see Shipton 1994). While the Middle East is an acute example of this, there are many others. Such identification with land is not only about where one does belong, but also frequently about where one does not belong. Identity-based attachments to land(s) are pervasive over large portions of the developing world, and will not be changed by legislation in national capitals without considerable tumult.

### 2.1.2. TITLING OF SMALLHOLDER LANDS

Recognition by the international development community of the discrepancy between customary and national tenure systems and the problems that result has led to attempts to bring small-scale landholders into national tenure systems, or to link the two systems through titling of smallholder land. Numerous experiences, however, have revealed that giving title to small scale agriculturalists neither brings them into the national tenure system nor links the two (e.g., Bruce, Migot-Adholla, and Atherton 1994; Lemel 1988; Roth, Cochrane, and Kisamba-Mugerwa 1994; Roth, Unruh and Barrows 1994; Golan 1994, Migot Adholla, Benneh, and Atsu 1994; Wade 1988; Bromley and Cernea 1989; Leonard 1986).

As an artifact of a system that smallholders can have little understanding of, title can quickly lose its value if not updated when land, or portions of a piece of land, are transacted, given away, or inherited (Bruce, Migot-Adholla, and Atherton 1994). There is extensive evidence that systematic titling exercises for rural smallholders are followed by widespread failures to register transfers and successions (Bruce, Migot-Adholla, and Atherton 1994; Shipton 1994). The accuracy of registry records made at considerable cost is lost as the position on the ground—and in the minds of the local people—eventually diverges from that on the register. This is because most rural smallholders, even after receiving title, do not do the things that titling seeks to empower them to do, such as selling or mortgaging their land without consulting family or neighbors. Use of those powers would go against important cultural norms that are responsible for the functioning of the customary tenure system, and would disrupt relationships fundamental to risk reduction, security, and insurance (Bruce, Migot-Adholla, and Atherton 1994).

Similarly, the problem of alienability applies to the presumed connection between title and credit—since it is the possibility of foreclosing on the mortgaged land and realizing its value in the market that drives offers of credit (Platteau 1992). Despite the effort, hopes, and assumptions of economic development planners, rural land in developing nations is seldom just a commodity. In fact, some tenure policies that seek to make land marketable have instead made it the center of tremendous conflict (Shipton 1994).

While the freehold mortgage system is a primary strategic aim of many development planners, it remains extremely problematic in areas settled by lineages (Bruce, Migot-Adholla, and Atherton 1994). The presence of sacred graves or kin on and around the land of loan defaulters often inhibits creditors' attempts at seizure. Further, the act of seizure by creditors is perceived by some lineages as an act of war (Shipton 1994). Disputes over mortgaged land can also frequently be violent (Verdier and



Rochegude 1986; Shipton 1994). This of course discourages creditors from offering credit in the first place. Bruce, Migot-Adholla, and Atherton (1994) have come to the conclusion that these norms cannot be legislated out of existence, even where land policy reform is followed up with costly and extensive cadastral survey and registration. In land titling programs, market logic never simply shuts out political and cultural reason (Shipton 1994). And even if smallholders attempt to pursue title change, local-level state institutions (such as a land registry) in the developing world can have very limited capacity to process, record, and communicate to a central registry the details of a land transfer, if such local institutions even exist. The costs of such title change or transfer are thus frequently borne by the smallholder, who for numerous reasons does not or cannot follow through with such transfer (Bruce, Migot-Adholla, and Atherton 1994).

While a primary objective of titling efforts can be to provide increased tenure security, individual title for rural smallholders does not necessarily accomplish this. Land tenure security, defined as the degree of control over land resources that an owner possesses, plays a crucial role in the functioning and development of third-world agriculture. However, actual tenure security is based upon much more than labels and artifacts such as documented title. Such documents must represent both a system of rules and a capacity to use and enforce the property rights those rules guarantee. The system must be understood, accessible to and, importantly, viewed as legitimate by, not only the holder of the document, but also those who may wish to make claim against it. Such a system must also be connected to local social, cultural, and biophysical realities. Attempts to substitute rural customary entitlement with state titles can actually reduce tenure security in some cases by creating confusion, of which those more powerfully placed can take advantage (Bruce, Migot-Adholla, and Atherton 1994). Where state titling is welcome locally in rural areas, it is often as a defense against dispossession by other arms of the state, or by those acting for themselves under the state's aegis (Shipton 1994). Further, titling under a weak state tenure system—as such systems frequently are in much of the developing world, particularly in rural areas—rarely provides meaningful security (Bruce, Migot-Adholla, and Atherton 1994).

There is also the problem of what exactly is being titled. If land currently under cultivation is titled, then this creates difficulties in systems of swidden fallow agriculture, and/or where community common lands are used for a number of purposes such as gathering fuel wood, extracting minor forest products, and grazing. Shipton (1994) notes that when dealing with the administration of land the question of who controls the “language,” and the “translations” of reality regarding how land is dealt with and divided (demarcations, transfers, inheritance, access, etc.) becomes

critically important (also Murphy 2003). Such control legitimizes or delegitimizes units of aggregation, kinds of rights, transactions, rituals, and ways of land use (Shipton 1994). While titling presently cultivated small-holder land may make areas available to be granted as concessions (commons, fallow land), in aggregate this becomes a problem when small-scale agriculturalists are no longer able to feed themselves.

## 2.2. *The Migrant Domain*

### 2.2.1. RECONFIGURED SOCIAL RELATIONS

The primary explanation for the disconnect between formal and informal legal domains is that formal law in much of the developing world has little to do with what most people are actually doing “on the ground” (de Soto 2000, *Economist* 2001). In countries afflicted by this problem, there can be little opportunity or willingness on the part of the state to formalize the actual customs and norms that contribute to the determination of rights and obligations about land. In this regard, the way in which American formal property law evolved over time to reflect actual processes of land use, claim, and dispute is thought to be an important example of successful integration of the informal and formal legal systems (*Economist* 2001). The American example, however, captures a primary problem in the capital–property rights argument. How the American pioneer intersected with lands and how this system evolved into or merged with formal law is much less relevant to the situation of developing countries than is how the property rights systems of Native Americans intersected with formal law, however “evolving” the latter might have been. With significantly different conceptual foundations, customary law and formal law in developing countries (the latter usually inherited from European colonial law) have less to do with each other than the “on the ground” activities that migrants and settlers around the world have employed (and still employ in places such as Brazil) that have managed to merge successfully with subsequent formal law (Unruh 2002a).

Migration profoundly changes relationships between people, especially migration that results from severe circumstances (e.g., food insecurity, resource scarcity, conflict, economic and political insecurity). Separation of people from established home areas and ways of land use and tenure can be the first and most dramatic step toward the development of a changed approach to land rights. Physical separation changes, terminates, or puts on hold prevailing social rights and obligations connected to land and property. This is especially true in cases where actual occupation, social position, or membership forms the basis for or a significant aspect of claim and use

rights. The socio-spatial repercussions and subsequent reduction in the relevance of specific customary administration, enforcement, and other property-related institutions, norms, and obligations result in altered relationships between people, land areas, land uses, agricultural production systems, and population patterns. In essence, migration and its repercussions for small-scale rural landholders reconfigure the network of social relations upon which all land tenure systems depend.

### 2.2.2. ALTERNATIVES SOUGHT

For migrants arriving in destination locations, land, even if only for residential use, must be sought and secured. However, this usually occurs in the context of an approach to access, use, and claim quite different from what prevailed in the migrants' rural home area. This issue is often exacerbated by a change in social status, as rural community members become dislocatees, migrants, squatters, female-headed households, and refugees in new locations. In a migration context securing legitimate property rights becomes significantly problematic, as migrants must accept, emphasize, modify, and derive new notions of legitimacy that allow secure access to and use of property.

The possession of evidence to prove and therefore secure claim and right of access to property is a fundamental feature of all land tenure systems. It is also a particular difficulty in urban migrant circumstances. Rural customary tenure systems contain a wide variety of informal evidence that derives its legitimacy from customary social and cultural features (Unruh 2002b). During the course of migration, especially to urban areas, such evidence and legitimacy of evidence either disappear or are subject to considerable change. This is primarily due to the role that community plays in determining what evidence is legitimate (Unruh 1997). One example of this phenomenon occurred in Mozambique subsequent to the RENAMO conflict. In this situation land rights for the customary tenure system were bound up in historical features of community interaction, therefore migration resulted in a pronounced shift in what counted as legitimate evidence of ownership. As a result customary "social" evidence such as testimony, community and lineage membership, and history of occupation, were greatly devalued. At the same time, alternative forms of evidence such as physical occupation greatly increased in value (Unruh 2001). Such situations are often optimal for titling.

The goal of acquiring what is perceived to be legitimate evidence is, of course, to *prove* that one has a claim to property and to secure that claim. But tenure security can play a dualistic and unwieldy role in migrant locations. On the one hand, tenure *insecurity* in destination locations for migrants can be a significant attractor. Amacher et al. 1998 found that land

tenure insecurity was a primary factor in the selection of destination sites by migrants in the Philippines, with similar examples elsewhere in Asia. Migration destinations in this context are often places where the state has neglected development of land tenure systems, or where other forms of neglect, instability, or confusion have caused tenure insecurity (Amacher et al. 1998; Myers 1997). Such insecurity has created opportunities for new migrants to arrive and make a claim to property. Such situations are seen as attractive for migrants in that they represent the possibility for pursuing various forms of claim for themselves in a fluid institutional environment, however temporary or unofficial (Amacher et al. 1998; Unruh 1995b). The initial migrant search for locations possessing a high degree of tenure insecurity is, however, usually followed by a concerted search for tenure security once claims have been made (Amacher et al. 1998).

The search for widely accepted, legitimate proof of claim and possession of property in a physical, political, and socioeconomic environment that is new and unfamiliar is an important driver in the search for alternative ways of configuring property rights, and an important factor in the acceptability of alternatives. This search and acceptance can be particularly robust when multiple forms of insecurity (personal, economic, food) function as compounding influences—an important consideration given that most migrants are poor and lack the means to provide for near-term security (Ghimire 1994). Thus the ways in which settlers and migrants intersect with land are very much more amenable to the institution of formal law than are in-place, functioning indigenous rural tenure regimes. In many instances—including the American example—migrants can share, or come to share, a tenurial logic similar to that reflected in state law because the state itself has facilitated settlement. As a result, the sociocultural distance is smaller, and formal and informal institutions can be mutually supportive.

### 3. Attempts at Connecting Formal and Customary Property Law

#### 3.1. *Uniform Codes from Customary Law?*

At this point in history, the problem for developing countries is larger than just that of fashioning customary notions of property into a set of uniformly enforceable laws along the lines of the capital–property rights argument. It is also the dilemma of attempting to connect in a meaningful way in-place, formal, European-derived property laws<sup>2</sup> and the customary laws

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2. Which won't be going out the door any time soon given how they are favored by urban elites.

and activities that are tied up with ongoing social relations about land—laws and customs which function to fulfill important social needs in rural areas that individualized title alone cannot similarly fulfill. Further, any “translation” of local reality into formal law must also have some continued meaning in customary law. The reason for this is that if only the rules of customary law are incorporated into formal law, and not how and for whom such rules operate, then the formal construction will most likely lose meaning and hence legitimacy in customary practice.

Such translation can be difficult insofar as the perceived necessity to preserve the integrity of the document in matters relating to property leads to the inability of many formal property systems to deal effectively with “parol” or oral evidence as proof of ownership and as a factor in resolving disputes. Of course, verbal or testimonial evidence is in most cases all that customary communities in developing countries possess. Further, it cannot always be assumed that important aspects of customary law regarding property can simply be “translated” into the formalized uniform laws that service the operationalization of capital, insofar as this is not what these rules were originally designed to do. A further consideration is that when a uniform enforceable code is to be derived out of the laws or norms of different customary groups (and in some countries a great many different groups), this will certainly mean that some or all groups will be expected to give up their primary evidence for right of access to rural lands, namely, membership in a lineage with claims to specific real estate.

In addition, attempts to incorporate aspects of indigenous tenure regimes into formal law have found that customary law can often be fluid, including, for example, capricious decision-making by leadership. This feature of informal rural tenure regimes is in part a response to the fluid nature of the social, economic, political, and biophysical variables that surround them. A fluidity suggesting that those who do well must be able to rapidly adapt, requiring changeability in certain aspects of property rights to be at a premium. The goals of formalized property laws are of course otherwise. Such laws are much less subject to change, hence their predictability, wide application, and value in operationalizing capital and other aspects of property associated with land as a commodity.

### *3.2. Changes in Formal Law?*

To move from rural property tied essentially to a sense of identity based on community, lineage, and geography to something based primarily on the individual that is able to create and take advantage of capital as we presently understand it would be a significantly long and arduous process. What will be needed in the end are not just attempts at formalizing aspects

of customary law, but also a change in the concepts dear to formal law, such as the integrity of the document and the static nature of rules.

There is ongoing experimentation in certain African countries where attempts are being made to bridge the disconnect between customary and formal law concerning land tenure by making fundamental changes in formal law. The Mozambican Land Commission has, as part of the peace process in the 1990s, rewritten its legislation concerning land rights in order to accommodate the reintegration of approximately six million people who were displaced by the war. This process has involved making significant changes in formal property law in order to make it intersect more successfully with customary law. These changes have primarily had to do with increasing the admissibility of customary evidence, such as parol evidence, and with relaxing the primary role of the document as singularly valuable evidence in relation to property issues (Unruh 2001). In Zambia, the government-funded Law Development Commission has reworked its Commonwealth mandate to examine specifically the intersection between customary law and state law, with land tenure being a primary focus. In this case, studies are carried out by the Commission on specific tenure problems, and recommendations are provided to parliament regarding necessary changes in formal law, sometimes including fundamental concepts of formal law. In post-conflict East Timor new formal property rights laws are being proposed after significant research into customary land tenure, laws admitting parol, and other customary evidence to be considered in cases involving claim, possession, and restitution.

In a highly significant book entitled *Searching for Land Tenure Security in Africa* edited by Bruce and Migot-Adholla (1994), eight research projects in seven countries together with a comprehensive literature review approached the question of land tenure security in African agriculture. Given the problems associated with attempting to replace customary tenure with formal tenure systems, the authors come to the conclusion that there must be a movement away from the "replacement paradigm," according to which customary tenure systems are to be replaced by formal state tenure systems, and towards an "adaptation paradigm." Such an adaptation approach requires a legal and administrative environment that is supportive of the evolutionary nature of change in customary practice, and also requires a clear acknowledgement of the legal applicability and enforceability of customary tenure rules (Bruce, Migot-Adholla, and Atherton 1994). Bruce, Migot-Adholla, and Atherton (1994) highlight that a certain amount is known about the process of transformation in customary land tenure systems, including the centrality of conflict resolution in that process (also Moore 1986; Rose 1992). They also point out that there is a need to look at "how and on what terms formal recognition of indigenous land tenure rules is most effective, and how dispute settlement

mechanisms can best be framed to facilitate the process of legal evolution” (Bruce, Migot-Adholla, and Atherton 1994).

#### **4. Urban Migrant Settlements and the Prescription**

De Soto’s approach found its initial application in Lima’s slums, and potential for such an approach remains strongest in the informal urban domain. The world’s urban population is expected to more than double by 2025, to over five billion, with 90 percent of this increase to occur in the developing world (*Global Environmental Outlook 2000*). This “urbanization of poverty” occurs concurrently with deteriorating conditions for the urban poor, weak local government structures, weak administrative capacity, and inadequate practices and concepts of urban governance (UN Habitat 2001). But as large successful cities have demonstrated, urbanization does not cause impoverization, but rather poorly managed urbanization that leads to marginalization and increasing costs of living (UN Habitat 2001). However, the reality is that governments in the developing world are unprepared and under-resourced to properly manage the scale of the phenomenon, which will exacerbate the unsustainable and unstable character of the growth. As a result we are very unlikely to see an infusion of resources into the informal urban settlements of developing countries that will in any way match the scale of the problems emanating from these locations. In this context the argument for unleashing the capital, entrepreneurship, and innovation associated with formalized private property is strongest, and where policy change along the lines of the de Soto prescription will be most effective. However, while the temptation to view the approach as a magic bullet can be strong, considerable caution is warranted in applying the prescription to all customary tenure regimes, particularly in the rural domain where intact, functioning tenure systems serve important needs, and where substantial differences will require that evolution occur at a different rate.

The connection between urban and rural tenure systems occurs via migration, an event whereby many connections with rural tenure systems are disrupted or severed, and new arrangements in urban areas must be sought. Searle’s contribution is significant here. The continued functioning of institutional facts requires that “a significant number of members of the relevant community must continue to recognize and accept the existence of such facts” (Searle 1995, 117). Migration from intact, functioning rural tenure systems to chaotic, fluid urban tenure systems disrupts this recognition and acceptance, in a way similar to Searle’s own property rights example regarding how the existence of institutional facts is discontinued: “The moment, for example, that all or most of the members of a

society refuse to acknowledge property rights, as in a revolution or other upheaval, property rights cease to exist in that society" (117). The lack of effective property rights in migrant urban settlements then makes adoption of alternatives much easier. But at the same time, where intact rural tenure systems continue to provide benefits to participants, there will be considerable resistance to the imposition of new designs.

A final note on the relevance of property rights and de Soto's prescription to one of today's primary issues. The problems resulting from non-participation in the benefits of successful urbanization exist in their most acute form in the informal, impoverished urban settlements of the developing world. This is to a large degree due to the simultaneous exposure and lack of concrete access to the positive aspects of the globalizing economy, along with the physical size and concentrated nature of such slums. Processes of impoverization and marginalization deepen economic inequities and disparities in access to resources. Such an arrangement then fuels notions among some segments of the poor that increasing wealth for some is provided for by the impoverization of others. This population is arguably among the most vulnerable to forms of extremism, and policies that seek to address this vulnerability will need to examine specifics. One of the more interesting discussions of specifics is de Soto's earlier book *The Other Path: The Economic Answer to Terrorism* (1989, reprinted in 2002), in which the first topic addressed in the introduction is migration, where de Soto articulates the Peruvian experience with migration from rural to urban areas.

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# Geographic Regions as Brute Facts, Social Facts, and Institutional Facts

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## 1. What Are Geographic Regions?

*Geographic regions* (henceforth, *regions* for short) are spatially extended pieces of (near) earth surface that share some aspect of similarity across their extents. The most fundamental aspect of similarity shared within a region is “locational similarity”—proximity. But regions nearly always share common thematic content or activity too. That is, regions are defined not just spatially but according to the human and natural entities or processes occurring there. Regionalization is spatial categorization, and importantly, this spatiality is literal rather than metaphorical, as it is with most other category systems. The modifier “geographic” implies a region of space that is prototypically two-dimensional (though often bumpy or uneven) and at or near the earth surface. Volumetric exceptions exist underground and in the atmosphere, but they are rare given the geographer’s interest in the earth as the home of human habitation. Also because of the human-centered focus of geography, the human and natural themes that provide content for regions are usually phenomena at human-centered spatial and temporal scales—not too fast or small, not too slow or large (Montello 2001).

The fact that geographic regions typically encompass places that are close together is interesting and conceptually nontrivial because it leads to a generalization about the shape of regions. Regions tend to be

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“compact”?spatially contiguous and unfragmented areas that extend roughly equally in all directions (i.e., roughly circular).<sup>1</sup> This locational similarity within regions arises for an intriguing variety of reasons. In fact, closer places *are* more similar, on average. This principle (famously called the “First Law of Geography” by Tobler 1970) holds true as a generalization because more interaction occurs between closer places, which in turn holds true because interaction (movement of air masses, distribution of newspapers) has less “friction” (air pressure, delivery cost) to overcome between closer places. But people also tend to perceive and conceive of closer things as being more similar. A lower-level perceptual example is provided by the Gestalt law of proximity as a basis for figural organization in visual perception; a more high-level cognitive example is provided by the tendency people have to interpret closer graphic elements as representing more similar entities in graphical spatializations of databases:the “distance-similarity metaphor” (Fabrikant, Montello, and Mark 2006; Montello et al. 2003). It’s also been shown that people care more about closer objects and events (Ekman and Bratfisch 1965). Furthermore, compact regions are more useful intellectually and administratively. The efficiency of resource distribution in compact countries as compared to elongated, prorupt, or fragmented countries provides a clear example of the latter. “Remote” means away from the rest of a region; severe remoteness does not occur in compact regions. The notion that regions are naturally or rationally compact, at the very least contiguous, was in fact expressed during mid-twentieth-century debates in the U.S. in opposition to giving statehood to Alaska and Hawaii (Jones 1959). This notion is also reflected in laws about the proper design of electoral districts and legal challenges over the acceptability of noncompact “gerrymandered” districts (Forest 2001).

As a subset of categorical thinking, regional thinking is fundamental to the human conceptualization of built and natural landscapes; the universal verbal labeling of places and features on the earth reflects this. It has been fundamental specifically to geographers, too. In the intellectual toolbox of the geographer, the concept of regions has been one of the basic tools:a standard claw hammer rather than a cooper’s howel. The region concept has always provided service to geographers, whether they worked primarily in natural language, formal language, or spatial language.<sup>2</sup> It has helped

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1. The tendency toward compactness is strictly true only on an *isotropic plain*, a flat two-dimensional surface that has no barrier or facilitation to interaction differentially in different directions. On the real earth, oceans, mountains, uneven population distributions, transportation networks, and so on lead to nonisotropic surfaces that help create noncompact regions. However, the modifications these factors impose on compactness can be accounted for analytically in order to predict more accurately actual region shapes (e.g., Haggett 2001).

2. Aside from the fact that geographic regions concern scales of human activities on the

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geographers describe their domain of interest, the (near) earth surface that supports its natural and human phenomena; it has also helped geographers in their attempts to achieve the other traditional scientific goals of prediction, explanation, and control (Tobler [1973] discussed an analogy between regionalization and time-series analysis, pointing out how in both cases continua are discretized for statistical analysis). Regions still serve these functions and will likely continue to do so, even in the digital world of the Internet, virtual reality, and geographic information systems; Stubkjaer (2001) provides several examples that show how the advent of digital geographic information systems make an understanding of the ontology of regions even more important. Still today, Kimble's (1951) claim that geography is the "study of regions" is viable (his criticisms concerning the lack of agreement about specific region identities notwithstanding).

The ontology of geographic regions may be further articulated by considering a taxonomy of region types (originally presented in Montello 2003), a taxonomy that incorporates and hopefully clarifies traditional conceptualizations of regions by academic geographers. The taxonomy is based on the information and procedures that people, including geographers, use to identify the regions. The taxonomy consists of four types<sup>3</sup> of geographic regions: administrative, thematic, functional, and cognitive. *Administrative regions* are created by legal or political action, by decree or negotiation. These include regions based on property ownership (i.e., cadastral regions or "real estate") as well as regions based on bureaucratic or governmental control, such as census tracts, provinces, and countries. *Thematic regions* are formed by the systematic measurement and mapping of one or more observable content variables or themes; those based on more than one theme are *multivariate* thematic regions. Thematic regions express where particular entities or properties exist, whether natural (rainfall, pine trees) or human (languages, crops) in origin. *Functional regions* are based on patterns of interaction across space (and time) between separate locations on the earth. Spatial interaction is the movement of matter or energy from place to place: people, commodities, water, seeds, earthquake tremors. Patterns in transmitted matter or energy

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earth's surface, I do not intend to restrict the term "region" to a specific scale. Geographers have often spoken of a "regional scale" (e.g., Meyer et al. 1992; Richardson 1992; Stubkjaer 2001), a term meant to exclude smaller entities like places and larger entities like continents. I consider all of these entities to be examples of regions.

3. People commonly use the same region label at different times to refer to different types of regions, a phenomena that might be termed *region polysemy*. For example, the name "California" is typically used to refer to an administrative region but at other times could refer to a thematic region, a functional region, or a cognitive region (a "California state of mind").

can encode information, the basis for communication, which is thus a form of spatial interaction. As with thematic regions, multivariate functional regions may be based on a combination of more than one type of interaction. Finally, *cognitive regions* are produced by people's informal perceptions and conceptions of the earth surface, based on direct experience, maps, hearsay, and so forth. Examples include downtown and the Midwest (as these concepts are used informally by lay people); another would be our special meeting place in the woods out back.

## 2. Boundaries and the Ontological Status of Regions

The nature of the boundary between the inside and outside of regions is central to an ontological exposition of regions (Jones 1959; Kristof 1959).<sup>4</sup> Boundaries are prototypically thought of as lines but often are not lines. Instead, they are two-dimensional bands or "transition zones." The two-dimensionality of region boundaries is usually due to their vagueness (Mark and Csillag 1989). *Vagueness* means that a boundary is less than absolutely precise in its second dimension; a perfectly precise region boundary is a one-dimensional line. A variety of near synonyms for vagueness include *imprecision*, *indeterminacy*, *ill-boundedness*, *gradation*, *error*, *uncertainty*, and *fuzziness*. There are several potential causes for boundary vagueness:

- a) measurement error or imprecision (measurement vagueness)
- b) boundary changes over time (temporal vagueness)
- c) alternative variable combinations in multivariate regions (multivariate vagueness)
- d) disagreement about boundary locations (contested vagueness)
- e) fundamentally vague concepts of reality (conceptual vagueness)

These are quite distinct causes of vagueness, with very different practical and philosophical implications (e.g., Burrough and Frank 1996). With respect to the ontology of regions, two distinctions suggested by this list are perhaps most important. One is between contested vagueness, which

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4. Kristof (1959) reviews the once-lively history of academic discussions about the concepts of boundaries and frontiers. They are related but definitely distinct. Frontiers are necessarily two-dimensional zones of transition between thematic, functional, or cognitive regions. The term has typically connoted the leading face of an expanding hinterland; it derives from the French "front," meaning forehead. This suggests the source of terms like "outback" and "back country," except that whether a particular territory is considered "front" or "back" country" is not always consistent.

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allows single persons or groups to identify regions with precise boundaries (just not the same ones), and the other causes, which produce “universally held” vagueness (time leads to universally held vagueness whenever a sufficient interval of time to allow boundary changes has elapsed). A second critically important distinction in the list is between the first four causes and the last, conceptual vagueness. The first four may always or typically lead to vagueness in practice even though they need not in theory. Conceptual vagueness, in contrast, necessarily leads to vagueness even in theory.

The four types of regions from the taxonomy tend to differ in the extent and nature of their boundary vagueness. For example, all four region types, not just administrative regions, may have boundaries that are vague in the contested sense, though only contested vagueness over administrative boundaries tends to lead to war. In contrast, only administrative regions typically have boundaries that are conceptually precise. And this is not just an invention of modern Western thinking; Jones (1959) cites several anthropological instances of hunter-gatherers precisely demarcating their territories with fences or rivers or other markers. This suggests the special status of administrative regions. For the other three region types, the degree to which places on earth have the region’s characteristic property or properties typically varies more or less continuously, and only a partially arbitrary decision can locate boundaries. For example, it would be impossible in practice to ever measure all of the natural variables relevant to defining an ecosystem region at every location at the same moment in time with perfect accuracy and precision, and if you could, you would not get a completely contiguous region anyway. But precisely delimiting an ecosystem region cannot generally be done even in theory. The ecosystem region is simply not defined precisely enough as a concept to produce crisp boundaries, whatever the measurement fantasies entertained. Similarly, cognitive and functional regions are typically fundamentally vague, with every crisp representation a fiction to some extent. There is not in principle, let alone in fact, a precise boundary around the Bible Belt or the region where people receive the *London Times* (there must be at least one person in almost every corner of the world, not just in the Commonwealth, that receives that paper). This is not to say there is no transition in reality corresponding to the boundaries of these regions, only that the transition which really exists is really not sharp. Nor does boundary vagueness nullify the fact that the utility of region systems depends in part on their correspondence to states of the real world. I revisit the question of the reality-correspondence of regions below.

Administrative regions are thus unusual in being the only one of the four region types that typically has potentially precise boundaries (see

Couclelis 1992; Frank 1996; Smith 1995).<sup>5</sup> But the potential precision of their boundaries does not absolutely distinguish region types. What might distinguish them more clearly is the structure of their membership functions. Administrative regions are special in the uniformity of their membership functions. Every place inside of New York State (considered as an administrative region) is completely in New York State; no places outside of New York State are in New York State at all in this sense. Uniform membership functions are characteristic of administrative regions, even those having boundaries of non-zero width, but quite unusual among other region types. The special character of administrative region boundaries has been the focus of a series of papers by Smith and his colleagues (e.g., Smith 1995; Smith and Varzi 1997). Smith contrasts *bona fide* boundaries, boundaries that correspond to real physical discontinuities existing independently of human intentional acts, with *fiat* boundaries, boundaries that exist only because of human intentional acts. This is quite similar to an old distinction by geographers between “natural” and “artificial” administrative boundaries (e.g., Jones 1959). In the former case, natural features such as rivers or mountaintops provide a basis for the placement of administrative boundaries. In the latter case, boundaries are surveyed in the world or “drawn on a map” in a manner that does not *directly* correspond to any real transition in the world. The distinction between *bona fide* and *fiat* boundaries does not, in fact, correspond well to that between administrative and nonadministrative regions, insofar as only administrative regions have *fiat* boundaries (according to Smith), but not all administrative regions have *fiat* boundaries (i.e., some have *bona fide* natural boundaries or a combination of the two). In Montello (2003), I argued that the *fiat/bona fide* distinction is overdrawn in the context of geographic regions, primarily because all administrative boundaries, whether marked by rivers or not, are identified as a product of human intentionality. This leads to questions about the role of intentionality and the mind-body problem in the ontology of regions.

### 3. Brute Facts, Social Facts, Institutional Facts

In *The Construction of Social Reality*, the philosopher John Searle (1995) distinguishes brute facts from social facts (see also Smith and Searle 2003). *Brute facts* are facts independent of human intentionality, often but not

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5. To be exact, administrative regions have boundaries that can be made as precise as they need to be for a particular purpose, which has often been relatively imprecise in practice (Kristof 1959). There are numerous administrative boundaries in the world that are vague, but only because no one has yet cared to make them precise.



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always facts about physical reality. A stone is a brute fact, as is a cloud, but so is an automobile, even though its genesis as an automobile is anthropic. In contrast, *social facts* fundamentally depend on human intentionality for their existence. An exposition of the ontology of regions is a social fact, as is a gathering of scholars discussing ontology at a conference (though a spatial agglomeration of humans is a brute fact). One may note a further distinction between social facts that are idiosyncratic to an individual person's cognition and those that are shared among a collection of individuals. Thus, social facts might better be termed "intentional facts," which can be further subdivided into "individual" and "collective" intentional facts (Smith 2003). Intentionality, in the specific philosophical sense meant here, concerns the fact that certain entities apparently have the property of "aboutness" or "directedness" (Dennett and Haugeland 1987; Searle 1983; Siewert 2002). That is, they necessarily refer to some object or event, actual or imagined, outside themselves. To many scholars, intentionality has been seen as a defining property of mental states. An example would be a belief that a region of some type exists—the belief is about something outside itself, in this case a portion of the earth's surface.

In much of his writing, Searle is particularly interested in a subset of social facts he calls *institutional facts*. These are collective social facts that have deontic powers resulting from the assignment of status functions, functions that create obligations, rights, and duties. *Deontic* refers to the modal logic of obligation and permissibility—what one may or may not do, or ought or ought not do. Classic examples of institutional facts are money and legal codes. A cadastral region (i.e., real estate) is a good example of an institutional fact. Land ownership conveys certain obligations and permissions on its owners. Philosophically, this is interesting because the status functions of real estate derive from a social contract, not from any physical reality such as a barbed-wire fence surrounding the perimeter (although such a fence may well be in place).

Thus, when we consider the identity of geographic regions as brute facts, social facts, or institutional facts, we see that administrative regions (including cadastral regions) are clearly not only collective intentional (social) facts but also institutional facts. Their institutional nature makes administrative regions different than other region types. Searle's (1995) heuristic formulation for the definition of institutional facts—*X counts as Y in context C*—applies to administrative regions. This seems true no matter whether the boundaries that designate such regions are, in Smith's terms, fiat or bona fide or some combination. In his reply to Smith (Smith and Searle 2003), Searle questions Smith's claim that there are fiat administrative boundaries that are not brute facts. On the surface, Smith's claim appears quite correct. Administrative boundaries often exist that are not *directly* marked in any way in the world. For example, the Law of the Seas

recognizes “ocean economic zones” as (administrative) regions that extend offshore from sovereign lands. Dominion over these zones is an institutional fact lacking physical reality or markers. Another example is provided by so-called *geometric* boundaries, fiat boundaries that are “artificially” straight, quite common for administrative boundaries in many parts of the U.S. (Jones 1959 claims that the papal line of demarcation in South America was the first one). As I argued at greater length in Montello (2003), however, the fiat or “brute-free” nature of boundaries should not be exaggerated. Administrative boundaries are always located relative to some brute fact; even administrative boundaries that are unmarked by physical objects are identified by surveying from other marker objects or from absolute coordinate systems based on physical aspects of the earth’s geodesy, such as the equator, the Greenwich Observatory, the edge of a landmass, or satellite positions and signals.

In contrast to Searle’s doubts, I have more concern about Smith’s claim that *any* administrative boundaries are solely brute facts, even if he were correct to claim that *some* are not brute facts. In fact, even when physical features mark administrative boundaries (quite common at various times and places), or have served historical roles in establishing boundaries, the features are generally not the boundaries, only markers for the boundaries. “The *boundary* . . . has no life of its own, not even a material existence. Boundary stones are not the boundary itself . . . only its visible symbols” (Kristof 1959, 272). The area in the American Southwest known as Four Corners exemplifies this point nicely. This location, where the boundaries of four states meet at a point, is marked on the ground with a plaque showing four borderline segments. Although tourists are seemingly impelled to straddle these line segments, they are not in fact the boundaries—they *denote* the boundaries. When a vandal moved the plaque several feet on January 25th of 2004, Reuter’s news service reported that “a debate has ensued as to whether this means the state borders have been shifted.” The story does not make clear whether this debate is uninformed or tongue-in-cheek.

What about other geographic regions, what kinds of “facts” are they? Thematic and functional regions perhaps seem to be examples of brute facts only. But that is not the case, because these types of regions are always created as a product of human intentionality. The common existence of multivariate vagueness makes this clear; different maps of vegetation regions vary because different vegetation scientists (such as biogeographers) choose to include different themes, and measure them differently, in their definitions and delineations of the regions. Thematic and functional regions definitely are *about* something, namely the earth surface, so they are intentional (social) facts. At the same time, they have a physical, brute reality.

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Cognitive regions too are clearly intentional facts. As we noted above, intentional facts may be individual or collective; similarly, cognitive regions may be quite idiosyncratic or shared across a collection of individuals.<sup>6</sup> “The Bible Belt” is relatively shared; “my special place where I daydream by the river” is relatively idiosyncratic. Of course, the two blend into one another: Aggregated individual cognition helps make culture, and instantiated cultural cognition helps make individual minds. But whether individual or social, recognizing the intentional nature of cognitive regions does not deny that they too depend on physical brute facts about the earth surface, not just human ideas. Reality is a major basis for human experience and conceptual structure. The bend in the river that makes my spot so apt for its purpose is really there.

Recognizing the role of intentionality in the identification of geographic regions is critical to understanding their ontology. Intentionality confers the property of semiotic reference, defined and understood either idiosyncratically by an individual person or socially by a collection of individuals. *Semiotics* is the study of sign systems (Berger 1999; MacEachren 1995; Sebeok 2001). According to Peirce’s conceptualization, sign systems consist of *sign-vehicles* (marks, patterns, physical objects, or events), *interpretants* (concepts, semantic interpretations), and *referents* (real or imagined entities or properties that are connected to the interpretant by the sign-vehicle). Alternatively, the conceptualization of semiotics provided by Saussure referred only to sign-vehicles, which he called *signifiers*, and interpretants, which he called *signifieds*; in other words, he omitted the referent.

All geographic regions are thus, in part, semiotic entities. This is clear in the case of administrative regions. Searle uses the term “status indicator” to refer to outward signs of deontic status; these are sign-vehicles for institutional facts (“Private property—No Trespassing” is a good example). This is reminiscent of Peirce’s term “legisign,” the case wherein a law acts as a sign-vehicle. But thematic, functional, and cognitive regions are also semiotic. The property of intentionality, not the property of deontic reference, makes regions semiotic entities. Intentionality creates a mapping of social facts onto brute facts; this mapping can be many to one, one to one, or one to many. Furthermore, using Searle’s terminology, there are freestanding “Y-terms” that are themselves sign-vehicles but with referents that are not brute facts (though it is likely that all such freestanding terms can ultimately be connected to brute facts, real or imagined). An example would be small red hexagons on a map that stand for stop signs at street

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6. Cognitive regions shared by cultural subgroups of nonexperts have traditionally been called *vernacular* regions.

corners, which are themselves sign-vehicles. But geographic regions do not involve freestanding Y-terms, because real regions (not imaginary or literary regions) refer to parts of the earth's surface.

#### 4. Conclusions: Regions as Social Facts and Brute Facts

Above, I described a taxonomy of geographic regions said to be based on the way regions are *identified*. One might instead say the taxonomy is based on the way regions are *created*. Such a usage points to the semiotic identity of regions. But this is not say that regions, even administrative or cognitive regions, are merely conceptualizations. They are also brute facts. Real estate is made of soil and rock as well as deontic prerogative. To ask whether regions are brute facts *or* intentional facts is misleading (see the exchange in Smith and Searle 2003). It creates paradoxes by insisting on a dualism in which social or even institutional facts are claimed to be exclusively physical truths *or* conceptual truths.<sup>7</sup> All geographic regions are the product of mind-body interactionism (a swineherd and an accountant discussed this further in Montello 2003). They are not just idealistic entities, nor naively realistic entities, but semiotically realistic entities. Semiotic realism requires sentient intentionality in a real world of differentiated physical reality.

Even administrative regions always refer to a brute reality. Administrative regions are special in being the one type of region that is institutional, as Searle defines it, but that does not make them idealistic chimera. It is true that the physicality of administrative regions (or any other type of region) is not a sufficient condition for their identification, but it is a necessary condition. Intentionality leads to alternative regionalizations of the same piece of earth surface, but there is still only one "tract o' land." Regions exist in laws and regulations, in minds and cultures, *and* in the real world that must ultimately be a concern of an animal species that has a natural existence.

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7. A good argument can be made that there really are no pure brute facts as Searle defines them. A stone, a cloud, and a tree obviously have physical, intention-independent existence—but not as a stone, a cloud, or a tree *per se*. Only human intentionality uses the property of size to distinguish a stone from a sand grain or a mountain. Without human intentionality (including perception), thresholds in the continuously varying density of water droplets in the atmosphere would not appear as the boundaries of discrete clouds. In the context of regions, Kristof stated it thusly: "Not only boundaries but all limits ascribed to an area . . . are always subjective. They are defined anthropocentrically" (1959, 276–77).

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# Collective Intentionality, Documentation, and Real Estate

16

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## 1. Introduction

Real estate transactions, as opposed to other kinds of economic transactions, such as purchasing an item in a store, have a number of salient features, the more notable of which are that all the facets of such transactions are gone into in great detail and in writing. (For the moment I am referring solely to real estate transactions in formal legal systems). The reasons for going into great detail are fairly obvious; in very general terms, real estate transactions are often complex and it is important that each side understands exactly what is being exchanged and under what terms. And the same reasons could be given for putting it all in writing. But I argue that writing plays a further role in such transactions in that the signing of documentation is often tantamount to completing a real estate transaction. To some, this claim might appear to be simply obvious; certainly, on its own, it might not appear to be a controversial one. However, it contradicts a consequence that follows from Searle's well-known account of social and institutional facts. This consequence is that the signing of documentation, on its own, does not mean that a transaction has actually taken place; this is because, according to Searle's account, only when the relevant form of collective intentionality is present in the heads of all participants can there be said to be an institutional fact, such as the completion of a real estate transaction. In addition to this, I argue that Searle's account needs substantial elaboration, enrichment, or refinement in order to deal with specific problems that his theory encounters with respect to real estate. To illustrate precisely how these issues arise I will first of all provide a brief outline of the relevant features of Searle's account.

For Searle, all social facts (including institutional facts) involve collective intentionality (Searle 1995, 26). By intentionality Searle means "that property of many mental states and events by which they are directed at or

about or of objects and states of affairs in the world” (Searle 1983, 1). For Searle, human beings and some animals “have the capacity for collective intentionality. By this I mean not only that they engage in cooperative behavior but that they share intentional states, such as beliefs, desires and intentions” (1995, 23). These shared collectively intentional states take the form of the first person plural, as in “we intend,” “we accept” or “we believe” and cannot be reduced to states of individual intentionality, such as “I intend,” “I accept” or “I believe” plus something else; in fact, Searle claims that collective intentionality is a biological primitive (1995, 24–25). But one aspect that collective intentionality does share with individual intentionality is that both are subject to his “brain in a vat” condition, according to which, “Each of our beliefs must be possible for a being who is a brain in a vat because each of us is precisely a brain in a vat; the vat is the skull and the ‘messages’ coming in are coming in by way of impacts on the nervous system” (1983, 230). The impact that this condition has on Searle’s version of collective intentionality is best illustrated by the example he uses of a ballet in a park (1990, 402–3). This example involves two contrasting cases; in the first case, people in a public park are each moving independently towards a structure at the centre of the park so as to shelter from a storm that is threatening. Each individual’s intentions are entirely independent and are not collective. Whereas in the contrasting case the park is taken over by a *corp de ballet* and their moving towards the building at the center of the park is part of their performance. Viewed externally, and if we take it that the movements in both cases are identical, there is nothing to distinguish either case from the other. Therefore, what distinguishes the first case from the second must be internal to each individual, according to Searle’s view; since the second case involves collective intentionality and the first does not, each individual’s intentionality in the second case is collective and must be internal, in the head. This example of the ballet in the park is intended to illustrate that, with respect to any instance of behavior, it is impossible to say, when viewed externally, whether it involves collective intentionality or not.

In keeping with Searle’s account of collective intentionality and his view that all social and institutional facts (and this includes economic transactions) involve collective intentionality, all the usual behavior involved in engaging in an economic transaction, such as signing documents, handshakes, uttering certain words and sentences, and so on, when viewed externally, does not amount to actually engaging in an economic transaction if the appropriate collective intentionality is not present in the heads of all the relevant parties involved. This is also applicable to real estate transactions where, though all the usual and expected behavior such as signing documents and issuing written undertakings takes place, all relevant parties do not possess the appropriate collective intentionality in each



of their heads respectively, and therefore no actual real estate transaction can be said to take place. Elsewhere I have argued against this position on the basis that it introduces an element of privacy into such transactions that is utterly incompatible with the need for public accessibility of the conditions on the basis of which we take social and economic facts to obtain (Fitzpatrick 2003). But here I want to raise some further issues with respect to this alleged primacy of intentionality over behavior in real estate transactions. I will argue that, in the case of real estate transactions or ownership in developed formal legal systems, often the only collective intentionality involved, if any, is some sort of generalized and vague collective acceptance of certain aspects of the law. Only in extralegal scenarios, as described by de Soto, must collective intentionality in the form of collective beliefs or acceptance be directly involved in real estate ownership or transactions along the lines of Searle's account. I will also argue that Searle's ballet in the park example illicitly separates intentionality from behavior and takes intentionality to be of paramount importance, over and above or in isolation from behavior. I show that this privileging of intentionality encounters insurmountable problems when it comes to real estate transactions.

## 2. Real Estate Ownership and Collective Intentionality

In order to proceed further with the discussion concerning what role collective intentionality plays, if any, in real estate transactions and ownership, some further examination of Searle's account is required. According to his account, in addition to collective intentionality, two other ingredients must be present in the case of any institutional fact, namely, constitutive rules and status functions. Typically, a status function is collectively assigned to an object, according to Searle, thereby allowing that object to then take on the new function of standing for or representing something else. For instance, to use Searle's own example, "We impose the [status] function of 'value' on the substance gold because we desire to possess that kind of substance" (1995, 42). Gold takes on a new status to which the function "value" is assigned, according to this view. This leads us to the second component in his account, constitutive rules, which can be stated in the form of a formula, "X counts as Y in C." According to Searle, in effect, a status function is collectively imposed on the X term in a certain context C whereby it now counts as Y and this Y term now "names something more than the sheer physical features of the object named by the X term" (1995, 44). Of course an additional status function can be imposed on a preexisting one, where the X term already refers to a preexisting institutional fact, but this need not detain us here. Is it possible to apply this account to own-

ership of a piece of real estate? On the face of it, this might appear to be relatively straightforward. Simplifying a little by leaving aside the issue of whether collective intentionality is necessary for the existence of landed property (Smith and Zaibert 2001, 171), the social fact of Jim owning a piece of real estate is explained, according to Searle's formula, as a piece of real estate (X) counts as Jim's property (Y) in a certain context (C). But what is the context referred to here?

I am presuming that what Searle means here by context are those contextual elements that are most pertinent to the makeup of institutional facts. So sometimes the most pertinent element in respect to real estate ownership might be the context of local opinion or local collective intentionality; on other occasions it might be the relevant legal context. While it is clear that the status function that is imposed on the piece of real estate is, in this case, Jim's ownership of the land, what is not clear is the role that collective intentionality is supposed to play in the application of the formula, X counts as Y in C, to such scenarios when the C term refers to a context where a developed formal legal system is in operation. The problem is that, in such formal legal contexts, it is not the case that the status function of Jim's ownership is conferred upon the piece of land simply by the collective acceptance or beliefs of those acquainted with the property in the way that Searle claims for other institutional facts, such as that a certain piece of paper is a dollar bill because it is collectively accepted and believed to be so.

To set this point out clearly I want to draw an important distinction between a generalized form of collective intentionality, whereby the whole population or significant groups collectively accept or agree on some general social or institutional facts, and a more specific form of collective intentionality whereby individuals or groups accept or agree on some specific instances of institutional facts. There is both a normative element and an empirical element in the argument I am presenting here; I will first present the empirical observation which concerns formal legal (as opposed to extralegal) contexts that are found in developed legal systems—the normative element comes later.

In formal legal contexts there is usually some sort of general if vague collective acceptance by the population of certain aspects of the law; in such contexts it is generally accepted that:

- One can own land and buildings.
- When a court makes a ruling, then that ruling is binding unless an appeal is lodged.
- If a court ruling is not obeyed, then the disobedient persons may face sanctions of some sort.

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There may be additional points of law that are generally accepted in a vague sort of way, or it might be argued that I am making too strong a claim concerning the beliefs or knowledge of the average person concerning the legal system, but these concerns need not detain us here. The empirical point I am drawing out here is that, at least with respect to the ownership of a particular parcel of land or a piece of real estate, the question regarding who owns it is not settled merely by the collective beliefs or acceptance by those acquainted with the property. Only in those extralegal scenarios described by de Soto might such collective beliefs or acceptance be relied upon. But in a scenario that is not extralegal, although those acquainted with the property might collectively accept or believe that the land in question is owned by Jim, this would be a false belief if, in actual fact, the land is owned by Joan. In formal legal contexts, the ownership of real estate is usually settled by the examination of documentation, checking registers, and so on. When there is an apparent doubt or when documentation is missing or otherwise faulty, legal advice can be taken and sometimes a court is asked to settle the issue. But in formal legal contexts, ownership of real estate does not normally require any collective acceptance or belief on the part of those immediately acquainted with the property beyond a vague generalized acceptance of certain aspects of the law.<sup>1</sup>

Of course the general acceptance of some aspects of the law as it relates to real estate, in conjunction with some additional information, might lead those who were acquainted with a property to correct their mistaken beliefs at a later stage. But the point is that the proper role of collective intentionality with respect to the institutional facts concerning real estate is at the generalized level. The collective acceptance of the ownership of a piece of property in formal legal contexts is primarily rooted in the vague generalized collective acceptance of some aspects of the law, documentation, and rulings of the court system. In such formal legal contexts, whether or not those acquainted with the property originally thought that the property was owned by another party is neither here nor there.

This brings out one of the problems associated with property in extralegal scenarios, as outlined by de Soto, and leads up to the normative point I want to make. If all there is to property ownership is collective

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1. Such vague generalized acceptance in this context may spell additional problems for Searle's account of social facts to the extent that it might be argued that such acceptance may not amount to intentionality. Such collective acceptance may simply reflect some level of ignorance or indifference or even some unthinking acceptance that falls short of a mental state as such. If acceptance of a social fact can be interpreted at least on occasion as arising from some sort of lack of awareness (in the way that some people may be unaware of specific rules of language that they still actually unthinkingly follow), then it is not clear exactly how this falls into the category of intentionality as it indicates more the lack of a mental state in the individual rather than the presence of one.

acceptance by those acquainted with a specific piece of real estate, such ownership is likely to be unstable because of the tendency of local collective opinions or beliefs to change with the passage of time. Also, collective views concerning the ownership of a specific piece of property at any one time might diverge at a later stage. Such views might be informed by all sorts of informational inputs; a certain person seen working on the property might be assumed by neighbors to be the true owner. Or the eldest son of the original owner might be taken by the younger generation to be the true owner. But if there is no single collectively accepted owner in such circumstances, then who is the true owner? If we are to have clarity of title of real estate, we had better ensure access to legal mechanisms that are generally accepted by the population; for the reasons I have just given, such legal mechanisms in conjunction with a generalized collective acceptance of those legal mechanisms are superior to a local collective acceptance of specific instances of ownership when it comes to generating clarity of title. In addition, de Soto has shown that when ownership rights are not recorded and documented, “these assets cannot be readily 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” (de Soto 2001, 6). In effect, Searle’s account of social facts is only directly applicable to real estate ownership in the case of informal legal contexts; in formal legal contexts, his account leaves too much out to be applicable to specific instances of real estate ownership. At best, in formal legal contexts, his account would have to be severely watered down in that it could only be applied in a very general way to real estate ownership; in other words, his formula could be applied as follows: it is generally or collectively believed or accepted by the population at large that all (or most) land and buildings (X) count as property (i.e., are owned by some agency or someone or other) (Y) in this formal legal framework (C). But there may even be difficulties with this much weaker and more general claim, as I discuss below.

### **3. Division of Linguistic Labor and Collective Intentionality**

To what extent can we even rely on such a generalized acceptance of certain aspects of the law when it is not even clear what such a generalized acceptance might amount to? As I stated above, for there to be a particular social or institutional fact, according to Searle, the appropriate collective intentionality must be present within the heads of all parties concerned. So, according to Searle’s account, it would have to be the case that each relevant member of the population shared the same generalized

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collective intentionality, that is, some set of generalized beliefs or acceptances concerning ownership or transactions as well as certain additional aspects of the law such as those set out above. (Perhaps here the term “relevant” could be said to refer to all those capable of being involved in a real estate transaction or ownership of real estate.) But even this might be open to doubt, as it is perfectly possible for a formal legal system of property ownership and trading to operate even when the population at large is largely ignorant of the legal system as it is applied to real estate. The relevant generalized collective intentionality required by the general population need only be of the vaguest form indeed, and it is unlikely that the same collective acceptances or beliefs are shared by even large sections of the population. In fact many of these collective beliefs or acceptances might be false. But then how it is possible for the formal legal system of real estate or the real estate market to function in the face of so much ignorance of the relevant parts of the law?

Generally speaking, many of our social systems operate quite well even though relatively few individuals understand or know how those systems work. For instance, many employees in large corporations do not know exactly how the corporation’s production systems operate or even how their products are produced. But the division of labor in such corporations is such that as long as even a small number do know how these systems work, and everyone else carries out their own tasks according to certain standards, the companies’ products and production methods are safe and productive. There is also a division of labor in society with respect to real estate in formal legal contexts in that as long as lawyers are in a position to interpret and communicate the relevant parts of property law to their clients, judges are able to properly arbitrate, and officials authorize and register property, the property system continues to function and real estate can be owned and transferred. This notion of a social division of labor has a strong resemblance to Putnam’s concept of division of linguistic labor (Putnam 1975, 227ff.); in fact, it is meant as a generalization of Putnam’s concept on the basis that language use is also a social activity. Therefore, a linguistic division of labor is also a social division of labor.

According to Putnam, while many individuals within a linguistic community might use a certain term, often they have to turn to an expert in the relevant field for the full explication of the term or the ways of distinguishing it from other terms. For instance, we can all use the term “gold” and talk with a certain degree of facility about gold even though we might have huge gaps in our knowledge concerning gold. For instance, we might be totally unaware how to reliably discern whether something is or is not gold; this latter task we leave to scientific experts. The same also holds in the case of various legal terms or concepts in relation to real estate. While ordinary individuals can use the term “ownership” in their daily lives with-

out much difficulty, this does not mean that they are aware of all the legal implications, rights, or nuances with respect to ownership, especially as it relates to real estate. While ordinary individuals may talk about buying or selling real estate, they do not usually understand all that is involved in the transfer of property title. For that they invariably have to rely on that special subclass of experts, the legal profession.

Consistent with his brain in a vat condition, Searle rejects Putnam's linguistic division of labor to the extent that it implies semantic externalism, namely the view that at least the meanings of some components of intentional or mental states are not contained entirely within the head. To illustrate this I want to briefly examine Searle's rejection of what are known as *de re* beliefs. According to Searle, *de re* beliefs "are relations between believers and objects; for them, if the world were different in certain ways, the beliefs themselves would be different even though what is in the head remains unchanged" (1983, 209). But Searle claims that *de re* beliefs in this sense are impossible because they are not consistent with his brain in a vat condition; they would not be completely contained in the head. Although Searle's brain in a vat condition rules out *de re* beliefs in the sense just mentioned, it must be emphasized, however, that Searle does not deny that some beliefs are about real people, things, or states of affairs. He allows that we can choose to use the term "de re" to describe those beliefs so as to distinguish them from beliefs that are not about or directed at real people, things or states of affairs. But this minimal sense of *de re* does not allow that beliefs can be individuated or identified by anything outside the head. So, Putnam's division of linguistic labor cannot be allowed because this would mean that certain beliefs inside one's head would be constituted by something outside ones head. All beliefs are *de dicto*, according to Searle, because all intentional states "are entirely constituted by their Intentional content and psychological mode, both of which are in the head" (1983, 208). Beliefs are necessarily *de dicto* because they are independent of how the world actually is, according to this view. *De re* beliefs, in the special and minimal sense allowed by Searle, form a subset of *de dicto* beliefs.

Searle's rejection of Putnam's notion of a division of linguistic labor does not mean that he must reject the possibility of a division of social labor in every sense. It is perfectly possible for Searle to allow for a version of the social division of labor without compromising his brain in a vat condition in that he can allow that large groups or the population generally collectively accept that certain individuals are specialists in a certain respect.<sup>2</sup> For instance, he can claim that people can collectively

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2. Here I am constructing the sort of argument that I would expect Searle to make although I am not aware of him actually making this argument in any of his writings.

accept that certain individuals are specialists in property law or collectively accept the rulings of certain individuals, such as judges, in relation to issues concerning real estate. But given that linguistic activity forms a subcategory of social activity, this places Searle in a seemingly paradoxical position; he cannot accept social divisions of labor that happen to be linguistic even though it is perfectly possible for him to accept all other social divisions of labor. One way for Searle to resolve this would be to claim that he can also accept linguistic divisions of labor as long as they do not carry externalist implications. For instance, whether we are talking about gold or property title, we can collectively accept that there are experts who have a more informed notion of these terms and it is to them we turn when we require a full explication of the terms in question just as long as we accept that our own beliefs are not individuated, identified, or constituted by anything outside the head. Therefore, following this line of reasoning, the meanings of these terms, as contained inside the heads of nonexperts, are not the same or are not connected or continuous with the meanings of these terms within the heads of experts. This topic is the subject of much debate in philosophy; I will have to curtail this part of the discussion here as further examination of this point properly belongs to the wider debate in the philosophy of language and meaning.

#### **4. Real Estate Transactions and Collective Intentionality**

Even though, in the case of property ownership, collective intentionality seems to be restricted to a vague generalized acceptance of certain aspects of the law, might there not be a role for Searle's account of institutional facts to play in some of the specifics of real estate transactions, at least in relation to the transacting parties? On the face of it, Searle's formula appears to be applicable in that signing relevant documentation (X) counts as completing a real estate transaction (Y) in formal legal contexts (C). The status function of *legal document* is imposed on the piece of paper with the relevant markings on it. But what role does collective intentionality play in such real estate transactions with respect to the transacting parties? Applying Searle's account, each party would have to have the same we-intention in relation to the transaction. But if one is operating with a generalized acceptance of the law by all parties in conjunction with a division of linguistic labor, then does there have to be the entertainment of we-intentions by all parties with respect to the particular transaction as such? It is true that each party intends to part with something in exchange for something else and is prepared to make undertakings to the other party and sign documents, and

so on. But must each party entertain a we-intention in addition to that? I argue that all that is required in such scenarios is the generalized collective acceptance of the law (even if this only amounts to each being prepared to accept the law just as long as everyone else accepts it) plus some I-intentions along the lines of, "I intend to provide an undertaking to the other party" or "I intend to hand over a sum of money just as long as the other party hands over the title to the property."

The problem with Searle's account of institutional facts, as illustrated by his ballet in the park example, is that, when it comes to social acts, it artificially separates off intentionality from behavior and then privileges the role of collective intentionality. My claim is that, at least in the case of real estate transactions in formal legal contexts, intentionality (collective or otherwise) should not be taken to be of utmost importance over and above or in isolation from behavior, such as the uttering of documents and the signing or otherwise making meaningful marks on a page, in other words, the documentation of a real estate transaction. The problem with intentions is that, taken in isolation from behavior, they can be impossible to discern. One way to get clear about this issue is to examine what happens when something goes wrong with a real estate transaction.

Normally, in developed legal systems, when something goes wrong with a transaction, one of the parties takes the other to court. The court will usually review and examine the available evidence to establish whether there had ever been a *bone fide* transaction. If any defendant were legally allowed to claim that, despite his signing the relevant contracts and other undertakings and otherwise behaving as if he were willingly entering into the transaction (and I take it that there are no mitigating factors such as mental illness or duress), he still had not entertained the relevant intentions or intentionality to enter into the real estate transaction and therefore should not be bound by the terms of the contract, then it would not be possible to enforce such contracts. What this amounts to is that it is the actions of signing and issuing documents that take precedence here. In this sense, issuing and signing documents is tantamount to purchasing or selling a piece of real estate because such actions are taken to be the intention (or at least indicative of the intention) to be bound by the conditions of the contract, to take on the commitments involved. It is of course possible to bring such documents or actions into question but this requires some basis, such as allegations of trickery, coercion, or incapacity. I am not suggesting that intentions are irrelevant, nor that courts merely restrict their activities to verifying who made which mark on a page; it is well known that courts examine and interpret evidence as to the intentions of parties to transactions as well as various contextual matters.



## 5. Real Estate and Documentation

In formal legal contexts, signed documentation (which usually has to be registered at some government agency or otherwise executed depending on the legal system) is the cornerstone of the real estate transaction for another reason. Here, I want to borrow a concept from the art world to illustrate this point. Experts in the art world are often called in to establish whether a work of art is genuine. Often the expert turns to what is known as the *provenance* of the work of art in question. This can take a number of forms depending on the circumstances. A very strong provenance will usually include documentation relating to the transfer of the work of art from the original artist to an original purchaser as well as documentation reflecting subsequent purchases of the same work of art. To ensure that an artwork is the one that was originally transferred, it is useful if paperwork exists documenting each subsequent transfer from the original owner to the current one. In this way, such a complete provenance can also help to establish whether the individual claiming to be the current owner is in fact the rightful owner. Documentation plays the same role in the case of real estate, in that it forms the provenance of a property with respect to ownership. Just as in the art world, ideally all provenances would be complete and impregnable to doubt, so too would all documentation with respect to real estate ownership.<sup>3</sup> Invariably one element in the creation of such a provenance or paper trail is the registration of changes in property title or changes of interest with the relevant government agency; this creates a further element of stability and transparency in the creation of the kind of paper trail that is required for a complete provenance. As de Soto points out, in informal legal contexts the paper trail or chain of title “is blurry at best to the outsider” and the absence of such a provenance forces local people in such contexts to “have strong, clear and detailed understandings among themselves of who owns what today” (2001, 194).

This links us to a point that Searle makes regarding the persistence of speech acts. Searle points out that a speech act, such as a promise issued on Tuesday, creates an obligation that exists long after the utterance has been made (Smith and Searle 2003, 305). This point also holds for institutional facts such as contracts in real estate transactions. In such cases, the commitments undertaken and rights bestowed when entering into such a contract also persist long after such contracts are signed. The crucial point

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3. Although there is a similarity between provenance in the art world and documentation in real estate, provenance can only begin when the artist has stopped working on the work of art whereas the beginning of documentation with respect to real estate is often arbitrarily set by government or by some legal authority, sometimes by the setting up of a land registry or by some other means.

with respect to such real estate transactions is that the commitments undertaken and rights bestowed can be recognized in the future, for as long as they persist. The existence of documentation ensures this. De Soto demonstrates the importance of documentation in contemporary capitalism where it is not enough that one can ensure security of tenure; it is also important that others, especially potential lenders or future creditors, can satisfy themselves that tenure is indeed secure.

## 6. Conclusion

The difficulty encountered with Searle's account of social and institutional reality as applied to real estate is that, while it is more applicable to informal legal contexts, its claims do not cohere with real estate ownership and transactions in formal legal contexts. An important distinction between these contexts is that, as de Soto points out, the formal property system is diachronic in that it allows outsiders to examine the paper trail of ownership and property rights whereas the informal system is synchronic in that ownership can only be discerned through fieldwork, such as talking to local people, learning about local property arrangements, approaching both extralegal authorities and legal authorities, and so on (2001, 194). This diachronic-synchronic distinction brings out an important point when dealing with institutional facts, which is that not all institutional facts are such that they can immediately come into existence simply because those involved collectively accept the institutional fact in question or collectively intend or accept the imposition of a status function. A problem I see with Searle's account of institutional facts, at least as it is applied to real estate, is that, despite various references he makes to historical developments with respect to certain institutional facts such as the evolution of money from pieces of gold to dollar bills (1995, 41–42), his account of specific institutional facts, such as "Jim owns this land," turns out to be applicable only to largely synchronic contexts because of the elevated role he attributes to collective intentionality in the formation and maintenance of institutional facts. The point about real estate ownership and transfer in diachronic contexts, such as formal legal contexts, is that collective intentionality plays a minor role (and in some instances arguably hardly any role at all) in the form of some sort of vague generalized acceptance of some aspects of the law.

But then, arguably, almost no institutional facts are purely synchronic. By virtue of something being an institution, even a novel one, it must have arisen from something else within a preexisting institutional or social context, and all such contexts involve a history. To return to the real estate context, it is remarkable that even in extralegal contexts, many property owners have some sort of documentation, however limited, to

link themselves to their property. According to de Soto, “Everywhere we have been in the world, most extra-legals have some physical artefact to represent and substantiate their claim to property” (2001, 195). Where there is documentation, there is the possibility of a paper trail and therefore the emergence of some basic diachronic element even within extralegal contexts.

Documentation is important in all economic matters relating to ownership and economic exchange. It allows for longevity in relation to ownership and transactions and the recording of complex transactions. In fact, the invention of the first primitive writing systems, the earliest form of cuneiform script, is now believed to have occurred in response to the economic requirements, specifically to account for payments in the form of goods (Schmandt-Besserat, 1996). But, historically speaking, the most important side effect of documentation, especially in relation to real estate, is that it opened the way for a new kind of economic system, a system based on capital, on being able to capitalize a property by using it as collateral, to lease a property, to buy a share in a property, and so forth. As De Soto puts it,

Capital is born by representing in writing—in a title, a security, a contract and other such records—the most economically and socially useful qualities *about* the asset. This is where potential value is first described and registered. (2001, 48).

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# Real Institutions, and Really Legitimate Institutions

17

*Eric Palmer*

## Introduction

This essay develops a thesis regarding the manner through which social institutions such as property come to be, and a second thesis regarding how such institutions ought to be legitimated. The two theses, outlined below, are in need of explication largely because of the entrenched influence of an erroneous reading of social contract theory concerning the historical origins of the state. In part 1, I introduce that error, which yields a pair of myths:

Myth 1: Government precedes and underwrites both the reality and the legitimacy of all other social institutions,

Myth 2: People's choices alone generate social institutions.

I will argue that both Hernando de Soto and John Searle work effectively to counter the basic error and the first myth, though both remain in thrall to the second. With the error and myths examined, I proceed in parts 2 and 3 to present two central theses about institutions:

Thesis 1: The construction of social institutions can be understood clearly only if that topic is distinguished from the topic of their normative status, or legitimacy.

Thesis 2: The normative status of such institutions can be understood properly only if their legitimacy is distinguished from the legitimacy of government.

With the distinction of Thesis 1 in place, an informative socio-technical account of the construction of institutions can be formulated with little

ado. This allows for clarity concerning how institutions might be legitimated (Thesis 2), and consequently, how legitimation can proceed. Some fundamentals of legitimation from a Kantian perspective are outlined in part 3.

This chapter, then, is philosophy presented in the tradition of clarification of conceptual fuzziness—concerning our mixing of the ideas of the legal and the real in social institutions – and of promoting clear presentation in ethics by disentangling the idea of the legal from the politically legitimate and the ethically legitimate. It is intended for a broad audience as a caution against the tendency to think along the lines of Myth 1, and as a tool for developing clear distinctions between the socially real and the really legitimate. It also offers to philosophers in particular a significant argument in social ontology in its treatment of Myth 2 (see section 2.1).

## 1. Avoiding a Hobbesian Error

Thomas Hobbes conceived of government as composed of and justified by a social contract: an agreement of individuals to live in peace and to form a confederacy of government to improve their “nasty, brutish and short” lives. The familiar fiction he presents is of “a covenant of every man with every man,” each to give up his legitimate right to self-government by handing over his right, and practically also his strength, to a legislative, judicial, and police force that the men form among themselves (Hobbes 1996, 109).

Hobbes mentions a “covenant” of each with all, and the process of generating this covenant is, I think, often envisioned as a first meeting of individuals that ultimately generates the state. It is a meeting that, so far as we know from history, has never taken place, and such a meeting is not clearly suggested by Hobbes, or by Locke.<sup>1</sup> Nevertheless, both agree that some process to erect or recognize the sovereign must somehow take place; and Rousseau would have us convene just such a meeting regularly, in an assembly of all citizens to re-affirm the foundations of government (Rousseau 1997, III sec. 8).

The culturally familiar story about an original covenant, I believe, has been very significant. It has since led to a myth that pervades much political discussion: that government, as the original exit from the state of

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1. Though the precise extent to which Hobbes wished his construction to be treated as representative of history is open to debate, he certainly insisted that the state of nature is a genuine historical possibility which has existed in some places and times, and that the commonwealth can arise only through covenant (65, 89). For Locke similarly, see the *Second Treatise of Civil Government* (1988, sec. 86–90).

nature, is the mother of all other legitimate political institutions. This myth may help to foster another one, more general and almost as prevalent: the view that legitimate political institutions are ultimately grounded in the free choices of existing people, the fundamental “selves” that we have or that we are, prior to politics.

From a historical perspective, these are certainly myths—there is no evidence for their reality—and from a philosophical perspective, the myths cloud more helpful analyses of sovereignty and legitimacy that have been readily available since Kant, as I will argue below. Myths do have sociological and so historical impact, however. The two myths play their parts today: I will consider a few current examples.

Regarding the first myth, a pair of cases from the documents of two U.S. public-interest political concerns is illustrative. The Women’s International League for Peace and Freedom (WILPF) launched the “Challenge Corporate Power, Assert the People’s Rights” campaign in the summer of 2002 (2002a). I take their slogan to suggest a fundamental, and vague, priority of people and their choices. Similarly, the National Lawyers’ Guild (NLG) suggests, “In a democratic society, living human beings are sovereign and are the basis of all government authority” (2003). The latter claim, if concerning *legitimacy* of authority, is, I believe, true. The claim is a misleading formulation, however. It is questionable as a matter of fact (and the Women’s International League [2002b] makes a similar dubious maneuver). The social contract theorists are not the only constituency that argues that sovereignty is surrendered by individuals to government: many legal dictionaries assert the same, as do all governments with an executive branch, including democratic ones (e.g., Martin 1998, “Sovereignty”). The principle of state sovereignty that is reflected in international law similarly suggests otherwise.

Noting such vagueness is not mere pedantry. At this point of the discussion, a brief explanation for the broader audience regarding the purpose in philosophy of conceptual clarification is in order. I find the work of both of these organizations to be worth examination, and particularly, I find the formulation of purpose in the NLG Constitution to be quite clear: “[The NLG is] an organization of lawyers . . . in the service of the people, to the end that human rights shall be regarded as more sacred than property interests. . . .” The errors I have noted are minor, but they are also persistent. They are examples of vagueness in the way people express themselves, and they appear even when writers are at their best, composing carefully drafted documents. Therefore, the errors may reflect a persistent patch of vagueness concerning sovereignty. I suggest that misleading background assumptions about the sources of sovereignty may be responsible for the vagueness. Highlighting those assumptions should serve to make them less prevalent, and that is the general point of this sort of effort in philosophy.

On to Myth 2: William Meyers, David Korten, and many others concerned to change the political landscape frequently write of corporate personhood as a “legal fiction” (Meyers 2000; Korten 1999, 75). But the law plays little role in determining the actual status of some business, and the work of the Institute for Liberty and Democracy provides good evidence regarding the extralegal reality and robustness of business entities. Furthermore, de Soto’s *Mystery of Capital* makes a strong case that we should not expect, or even desire, that institutions related to property and business develop simply and solely through the auspices of legislation and the interpretation of legislation in courts. De Soto argues that the historical development of property in U.S. law did not fit that pattern, and that the government also did not always do an excellent job, for its part, when it did take charge of the development of the property system during the westward expansion. De Soto is persuasive in his suggestion that extralegal dimensions to development have their merits (de Soto 2000, 126–27).

De Soto also discovers an important sociological phenomenon: many of us, and politicians in particular, are unaware of the role and extent of nonlegal but socially real business activity. He analyzes that neglect as partly the result of our inability to recognize how legality has developed historically, and as partly the product of small-mindedness of government officials, who see extralegal development simply as antisocial illegality, and not as necessary problem solving in difficult circumstances (73–75, 88). I would like to suggest that the contractarian story has also played a large cultural role in allowing government officials and others to neglect the extralegal business sector. It is not just that they are unaware of history: I think they have an origins story in their minds, about how legitimate institutions should be set up, that turns the eyes away from history. The social contract story, then, may be the root cause of the symptoms that de Soto points to.

To dispel the myths and more clearly answer the question, “What makes real property real?” we must start by distinguishing between the social reality and constitution of an institution and its political or moral legitimacy, as the U.S. critics noted above have not done. History can tell us much about the social reality of the institutions of politics; what Hobbes was concerned to explain was instead the rational basis of political legitimacy. He turned to a formulation in terms of a “compact” that was easily misread as a historical claim. It was left to Kant to show that there is no reason for linking the ideal of government with the story of its historical generation, if the ideal of legitimacy alone is what is to be understood.<sup>2</sup>

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2. See the discussion of this turn in Kant found in Gierke 1913. Kant is not entirely innocent of the error of unnecessary mythical historicizing. See the vaguely historicist language in Kant, *Toward Perpetual Peace* (1998b, 335).



Kant steers us away from the error of thinking of people as entities somehow prior and institutions as somehow posterior to the political situations enveloping them. Instead, we are pointed to a conceptual division between a world of facts (in which history occurs) and a kingdom of ends. Legitimacy concerns ends, motives, and purposes; historical events are only accidental, or are symptomatic of legitimacy: by themselves, they will always provide us with a faulty analysis of legitimacy.

Part 1 of this chapter has introduced the division between the real world (the world of facts) and the realm of legitimacy (the kingdom of ends). Part 2 considers description of the world of facts in further detail; part 3 concerns that world's relation to the kingdom of ends.

## 2. What Makes a Social Institution Real

Kant has provided us a distinction between facts and ends, and that division allows us to return in clarity to the world of facts. Real social institutions produce irreducible social facts, as Peter French has argued (1984), and are the Y term (the institutional facts) in Searle's (1995) familiar formulation, "X counts as Y in [context] C." But how do real social institutions such as property or corporations come to be constituted?

It should become apparent that for each thing there will be a different historical story, but we can probably speak truly of types of stories for some groups of things. There is an open-ended variety of stories about how land is made into property, and many of the stories are quite obvious. Here are several particularly diverse ones:

**1. Land is made property by fiat.** In the past, kings and other political leaders have claimed lands outright, and would-be kings have made claims to lands, then pursued those claims against others through war. Landed kings have also made claims to other lands, often allowing vassals that subjugate the people of those lands to govern the lands in the kings' names. Minor variants on the same process continue today; see the contribution of David Koepsell to this volume for a particularly unusual one.

**2. Land is made property by enclosure.** This is a particularly vivid case, where land is "staked." This is often accomplished under the fiat of a regime, and sometimes requires document filing or an enclosing fence to establish the boundaries of the stake. Other times, the staking itself plays its role in the creation of the political regime. In such cases, good fences literally *make* good neighbors.

**3. Land is made property by agreement.** Antarctica's territorial division is an especially clear example of this case; war settlement is another.

The point of this rather bland recitation is to illustrate that we can consider how property is made without addressing—without even touching upon—the question of how it is made *legitimate*. The three stories of property creation briefly recounted above are one-sided and limited, of course: they may neglect competing stories concerning the subjugated, the nomadic, and the voiceless, respectively. Those sociological and historical counterstories are likely to also be a part of any reasonably informative account of the construction of social reality.

How property is made is a sociological matter, or more precisely, a socio-technical one, for in the second case, the physical technology of the fence plays its particularly obvious role. If we wish to study how property is made from land, I doubt that we can do better than to follow the lead of Bruno Latour in the sociology of science, or the research work of the Institute for Liberty and Democracy, to study the numerous processes of consolidation of property claims.

### 2.1. *The Social Significance of Technical Structures*

The example of staking property leads me to offer a small criticism of both Searle and de Soto. Both seem to be less impressed than they should be by the significance of physical objects in the construction of social reality, and they show it in different but linked ways: they both promote the contribution of the mind to social reality to the neglect of things material instantiation, such as the surveying stake, that plays a fundamental, functional role in practically all social institutions.

As a warm up, consider the institutional significance of the speed bump, a particularly vivid example of what Bruno Latour dubs “socio-technical” objects.<sup>3</sup> There are at least two obvious ways to turn dangerous speeders into good citizens in the neighborhood of a school zone. One is to spend \$100,000 or so per year on a police officer and the infrastructure necessary to support the officer, in order to solve the problem for an eight-hour day; another is to lay a lump of asphalt for cost and maintenance of, say, \$200 per year. The effects of the two solutions are not exactly the same, of course, yet they both reconfigure social reality in substantial and similar ways; thus, it is no wonder that some English refer to speed bumps as “sleeping policemen.” The physical properties of speed bumps, coupled with the speech acts necessary for their judicious placement, can yield social order: the invented technology refashions social institutions, alters the economy, and so forth.

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3. See Latour 1994. The example of the speed bump is his own, though the elaboration is mine.

Both of these authors, however, greatly downplay the contribution of the material to social institutions. De Soto attributes an importance to written law that generally discounts the significance of technological regimes:

It is law that detaches and fixes the economic potential of assets as a value separate from the material assets themselves and allows humans to discover and realize that potential. It is law that connects assets into financial and investment circuits. And it is the representation of assets fixed in legal property documents that gives them the power to create surplus value.

Lifting the bell jar, then, is principally a legal challenge. . . . (157)

Yet it is law and physical fact *together* that make the speed bump effective. Law allows speed ordinances and the mobilization of city workers' crews, but design and brute substance carry the rest of the burden. Similarly, the things of first importance when we speak of real property should doubtless include stakes and surveyors as well as law, for thousands of years past right to the present. More recent technologies will include the barking dogs that demarc boundaries noted by de Soto (2000, 153) and global positioning systems. These are themselves bound up in law also: a wooden stake is rarely acceptable; humane laws affect the activities of many barking dogs, and so allow them to mark boundaries effectively; and a global positioning system requires a maintenance contract. It may be the case that de Soto, for his part, has found that the problem has been, practically, "a legal challenge." It would be misleading, however, to suggest that such matters are *fundamentally* legal: they are at least as much socio-technical.

Furthermore, the choice among and development of technological regimes is crucial to what law can speak of, particularly with regard to real property. One who treats de Soto's lesson too narrowly may neglect the importance of the appropriate infrastructure of banking, including the willingness of bankers to offer mortgages (see Andrew Frank's chapter in this volume). Technological innovations, such as global information systems, may also play their roles in solving the problem of social order (see Eric Stubkjaer's chapter in this volume). Innovation in both these respects will alter the language that lawyers, courts, and legislature can use in their work, by antecedently altering the real structure of social institutions.

I have similar concerns with John Searle's discounting of the important role of physical objects and technology. He misleads us towards mentalism when he writes: "In a sense there are things that exist only because we believe them to exist. I am thinking of things like money, property, governments, and marriages" (1995, 1). In a sense, of course, Searle is correct, but only in a very loose sense, as he ignores the socio-technical component in these and other "status functions" that are generated in social reality. Money, which is one of Searle's most developed examples,

requires a technology, such as counters, as Searle briefly acknowledges but does not consider carefully. We simply could not get by on our “beliefs” alone here—it could not practically work for the sort of institution that is in place. The same goes for the other institutions in his list, at least in the forms that those institutions take today. One might be able to decide and keep in one’s head who is the leader of a group, but governments of the sort with which we are acquainted require much more socio-technical apparatus, encompassing voting machines as well as supreme courts to override them. Similarly, technologies such as paint and paper, in wedding portraits and parish registers, have served their roles in the development of the institution of marriage.<sup>4</sup>

My suggestion is that, as de Soto was too focused upon law, Searle is similarly too mentalist in his quick adoption of these examples: he gives too little credit to the social significance of *things* within the construction of social reality. A more suitable example to make Searle’s point about the conventional nature of social reality would be a simple verbal promise between friends. This may qualify as a social fact, and perhaps an institution, along the lines that Searle suggests. But it is also an exceptional case that we should not take as the basis for other social institutions, such as government: for such a model of agreement might underwrite the common and troubling historical interpretation of Hobbes’ “covenant of every man with every man.”

Further detail concerning the case of money will show a point that is already implicit in the examples discussed two paragraphs above: that physical technology actually plays a determinative role in setting social function. Searle does allow a place for physical technology: he allows that money uses physical technology, and he states that football touchdowns, for example, are not executed simply by declaration (1995, 55). He also writes of the “agentive functions” in social reality of objects with particular physical properties. He gives credit to the structures of screwdrivers and the “sheer physics” of tall fences, for example (20, 39). Searle passes over any such acknowledgement for the institutions of marriage and government, however, and as social institutions become more enfolded in human cooperation, he is less inclined to note technology’s contribution to the social product. Searle writes, “In the extreme case, the status function may be attached to an entity whose physical structure is only arbitrarily related to the performance of the function,” and he uses money as his example (41).

In the case of money, Searle’s acknowledgement of debt to technical reality is miserly indeed, for he writes: “just about any sort of substance can

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4. See the discussion of the social and legal significance of wedding portraits in Panofsky 1953. Thanks go to Carolyn Butler Palmer for this example.

be money, but money has to exist in some physical form or other. Money can be bits of metal, slips of paper, wampum, or entries in books. . . . Most money is now in the form of magnetic traces on computer disks. It does not matter what the form is as long as it can *function* as money, but money must come in some physical form or other” (1995, 34–35). Here Searle presents a partial analysis of the importance of physical facts to social institutions. But he downgrades the physical matter by suggesting that the form of money hardly matters, and actually becomes arbitrary over the course of institutional development, so long as the stuff “can function as money.” Searle does not allow that what the physical constitution of the counters *is* plays a great role in determining what constitutes the function itself and in shaping social reality.

Money isn’t what it used to be. As everyone is aware, it has become electromagnetic for good, nonarbitrary reasons concerning efficient transfer. But that change has also altered its social role and its function significantly. Particularly, the volumes of currency made available for transfer in electronic form have allowed for a specific importance of currency traders to international economics. Governments of developing countries, in efforts to attract stable foreign investment, have used available funds to artificially stabilize the values of their currencies. Large sales of currencies gained a functional use in traders’ eyes—particularly in Asian currencies in the late 1990s—once the traders recognized that they could exhaust the national reserves dedicated to propping prices. Traders sold borrowed currency, exhausted the government’s prop, subsequently pushed down the value of the currency, and then bought it back at profit (Saludo and Lopez 1997). Collusion among money traders as well as large-scale borrowing and selling done for such functional purposes are now carefully restricted and legislated in international markets by those with opposed purposes. So, the new medium for money had unintended social effects, and it also altered money’s (and law’s) function: once the traders understood those effects, money was functionally different, since it could be used in a new way to draw profits.

The physical structure of money has also been exploited for quite opposed purposes. According to Plutarch, the ruler and social engineer Lycurgus introduced iron, at very high weights per unit, as the exclusive legal currency in Sparta. By this means Lycurgus reduced theft, crippled external trade deliberately, and consequently, attacked luxury among wealthy citizens. Money lost many of its specific functions as a medium of exchange, then, as a consequence of Lycurgus’s choice of physical technology:

The iron money, after all, could not be exported elsewhere in Greece, and was considered a joke there, not an object of value. Consequently it was impossible

to buy any shoddy foreign goods, and no cargo of merchandise would enter the harbours, no teacher of rhetoric trod Laconian soil, no begging seer, no pomp, no maker of gold or silver ornaments—because there was no coined money. Thus gradually cut off from the things that animate and feed it, luxury atrophied of its own accord.<sup>5</sup>

In Searle's analysis of function, it is necessary that the practical effects of the physical technology be recognized by someone for them to actually be functional: functional, as opposed to brute fact (such as, "greenbacks make my wallet this thick . . .") and as opposed to unintended consequence (the unintended devastation that currency traders can wreak). Nevertheless, I conclude: First, these brute facts and unintended consequences have great roles in the construction of social reality, even if they are not functional because they were not intended to arise. Second, regarding function: The mental work of belief and agreement that Searle highlights is one of a pair of components that makes for almost every social institution, but the specific physical technology involved is as important a component for shaping the functional product. Because it so shapes function, it is misleading to view these institutions as existing "only because we believe them to exist." This is as true of money, governments, and marriages as it is of speed bumps.

Searle's view, that it is often a matter of "convention"<sup>6</sup> when we tie technologies to status functions—a view that de Soto's writing about law suggests he might share—is misleading. We cannot choose whatever specific physical technology we like: we choose among those we find to be available or can make available through technological development. A more helpful claim, albeit a metaphorical one, would be that we do not choose technologies; instead, we enlist nature in our causes, and nature also has its say in the construction of social reality. Daniel Dennett's claim that "We learn . . . how to spread our minds out in the world," gets us part way to the realization that many of our institutions fundamentally depend on material instantiation (Dennett 1996, 139). Dennett does not, however, make it obvious that the world will play a further significant role by aiding or frustrating, and altering, our efforts. The technology we use will usually have unintended effects that contribute to social reality, as we have found with voting machines recently, and it will also shape the functions that we can impose with its use, as the money example suggests.

5. Plutarch 1988. Richard Talbert (translator and editor of Plutarch 1988) mentions that Plutarch's reporting in this instance, as elsewhere, is largely, but not perfectly accurate; see 17n1.

6. See Searle 1995, 49, 56, for reiterations of the strong conventionalist position laid out at 41–42.

Consequently, Searle's (2003) recent retreat to the view that credit and electronic cash are each only "representations of money," laying direct weight, presumably, on bills and coin, makes matters worse, and the problem clearer: if the technology plays a role in determining functions, the technology must play its part in constituting what the social institution "money" is.

Section 2.1 has provided a detour into social ontology. It presents the cautionary lesson that physical infrastructure plays a fundamental role in the construction of social reality. Its lesson may be added to the general point of part 2, in which I have attempted to defend the claim that the construction of institutions can be studied without reference to legitimacy. I have argued that the legitimacy of institutions is a matter entirely separate from their construction: we must consider each separately to consider them clearly. I have also gestured at a philosophical distinction that supports this separation: the division between the world of facts and the kingdom of ends, as presented by Kant.<sup>7</sup> Now, what more can I say about legitimacy?

### 3. Real Institutions, and Really Legitimate Institutions

Kant's division between the world of facts and the kingdom of ends remains an extremely useful idea for understanding legitimacy, and I think it is a particularly appropriate one to promote for the concerns of the interdisciplinary conference that spawned this volume. I will elaborate upon its implications to close this chapter, focusing upon Kant's development of the division.

I should briefly note that variant conceptions of justice are also currently on offer, as are discussions that analyze both the concept and the application of the idea of a "kingdom of ends" (on the latter, see Korsgaard 1996). There are well-subscribed contemporary ethical approaches, such as virtue ethics, that do not explicitly countenance the concept, or at least, do not use it as the main tool for determining legitimacy (see, e.g., the writings of Martha Nussbaum). There are others that allow for such treat-

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7. I will stick with Kant's term "kingdom" here, rather than other possible descriptors (community, democracy, discourse community, etc.) because I maintain that each capable individual remains sovereign over his, her, or its ethical choice. Kant's view agrees with this, but adds an extra layer that is not intended here, since he assumed a continuing role for monarchy in the development of ethical progress in a cosmopolitan context (see *Toward Perpetual Peace*). Other authors have modified that extra layer, and in doing so, have unfortunately altered the specific character of individual ethical sovereignty: see, e.g., Christine Korsgaard's (1996) reference to the "legislative citizen" (xii).

ment, but will disagree with Kant as to what in the world qualifies as an end; for example, arguing that we should include some nonhuman animals, and exclude some human animals (e.g., seriously brain-damaged ones; see the writings of Peter Singer). Recent work in the Kantian tradition also digs into analysis of the conditions under which treatment of individuals as ends is appropriate; for example, considering the participatory conditions required for legitimate adjudication among those who are ends (see writing of John Rawls and of Jürgen Habermas).

What in general can we say about the relation of the real to the legitimate, where these are conceived as, respectively, the historical world of facts and the normative kingdom of ends? First, a caveat about what legitimacy is not. It is not a feature that may be gathered from the study of history, but it is reasonable to hold nonetheless that a historical story concerning facts can be told about how one comes to maintain a view concerning what the kingdom of ends is. The historical story might, for example, include intellectual discussion, such as is briefly reviewed in the preceding paragraph. A socio-technical story of the development of any account of legitimacy may also be told, much like the ones briefly mentioned above regarding the constitution of real property.<sup>8</sup> But no such stories will in any way serve as a normative basis for a legitimacy claim. I may write all I like about what Kant and Rawls wrote, and a sociologist might write all he or she likes about the facts and causes of my education. Both of these discussions may bring up ideas for consideration, but neither will move us a step toward explaining what makes a real institution really legitimate in addition.

Legitimacy is distinct from the historical, then, but it is also clear that they have some relation. This suggests a point that is rather basic, but very important for establishing a clear characterization of the relation between the factual and the normative: we can learn about what works from experience, without also committing ourselves to the idea that we can learn what is good from experience. Here is how Kant expresses the relation:

Nor could one give worse advice to morality than by wanting to derive it from examples. For, every example of it represented to me must itself first be appraised in accordance with principles of morality, as to whether it is also worthy to serve as an original example, that is, as a model; it can by no means authoritatively provide the concept of morality. Even the Holy One of the Gospel must first be compared with our ideal of moral perfection before he is cognized as such. . . (Kant 1998b, 63)

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8. The demand that the normative is also historical reflects recent argument, by sociologists of science, that all scientific study must be explainable sociologically, in principle. See Harry Collins 1981.



Few would doubt that history, presented as facts and causes, does provide us with useful evidence that is in some way relevant to consideration regarding legitimacy. Once again, I think it is helpful to simply introduce Kant's succinct treatment of this point: "Imitation has no place at all in matters of morality, and examples serve only for encouragement, that is, they put beyond doubt the practicability of what the law commands and make intuitive what the practical rule expresses more generally, but they can never justify setting aside their true original, which lies in reason, and guiding oneself by examples" (Kant 1998b, 63).

What, then, is the relation between fact and end? In the first section, I loosely referred to the relation as "symptomatic": what has happened, and what will happen in the world of facts, shows the symptoms of what is unseen but relevant in the kingdom of ends. I have brought in Kant's discussions of ideals and examples as a first step toward further precision. A second step is offered by G. E. Moore, in his discussion of the naturalistic fallacy. Because this is a paper addressed to an audience not exclusively of philosophers, a swift introduction to this fallacy may be helpful.

The vexed relation of event to ethical norm was discussed in a particularly clear way by G. E. Moore a century ago. Moore joined with Kant in the view that facts about the world and the basis for ethical norms, including legitimacy, must be distinguished. Moore did not envision a category that might be referred to as a kingdom of ends; rather, here is how he put their relation: "Ethics aims at discovering what are those other properties belonging to all things which are good. But far too many philosophers have thought that when they named those other properties they were actually defining good . . ." (1988, 10). Moore coined the phrase "naturalistic fallacy" to clearly label the mistake of maintaining that norms can simply be other facts about natural objects—that they are a feature of objects in experience. Moore's treatment of the relation is a particularly careful and convincing one: it does not suggest that there is a distinct Platonic Realm of Goodness from which natural objects draw their goodness; rather, some natural objects happen also to have the (nonnatural, ethical) feature of goodness.

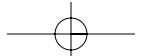
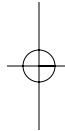
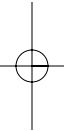
The root division between the historical world of facts and the normative kingdom of ends remains clear, then. This essay has been concerned with characterizing that division clearly, particularly with respect to institutions. It is an essay in conceptual clarification, and has not been concerned with explaining which institutions are in fact legitimate, and why. It is an effort preliminary to that one: we must be clear on the concepts before we can proceed clearly with the substance.

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