CHAPTER 1

Prologue: What Is Trust?

Of Indian Real Estate and Title Insurance

Property Ownership in Hyderabad

The dusty streets of Hyderabad in Andhra Pradesh, a state in the southern region of India, are usually bustling at midday with motorbikes veering in and out of traffic, colorful auto rickshaws sputtering smog, dabbawallas delivering lunch pails with homecooked food, and clusters of meandering buffalo. If you drive down these roads long enough, you begin to notice that many of the walls that line the road are painted. As the dust from the construction settles a bit, you make out block letters, "PROPERTY OF K. RAO" on one wall, "THIS PROPERTY BELONGS TO A. GOEL" on another. Most streets seem to have one or more of these prominent inscriptions.

This painted lettering is the most visible symbol of the challenges of undertaking property-related transactions in India. Property ownership and transfer here is subject to an elaborate set of rules governed by local authorities, which may at times be bent by those same local authorities at their discretion. Without rigorously enforced formalized standards, a well-painted sign can bolster a claim to a plot of land, or throw a prior claim into dispute. Lawsuits can last for years, during which time the property sits in limbo. In some cases, properties are sold that are not actually owned by the seller or sold twice to different unsuspecting buyers. Everyone in Hyderabad has a heartbreaking story of the real estate market that happened to them, a family member, or friend.

Given these concerns about title security, threat of long contentious litigation and associated red tape, prospective buyers would be justified in hesitating before embarking on this uncertain venture. According to Doing Business 2010, a project of the World Bank, India ranks 93rd out of 183 economies in ease of property registration. It ranks almost at the very bottom in contract enforcement, 182nd out of 183, with the average dispute taking nearly four years to be resolved. China, in comparison, ranks 32nd in ease of property registration and 18th in contract enforcement.

Despite a growth rate in the first decade of this century that would be envied by most developed nations, studies suggest a dampening effect on India's economic development caused by the current mixed bag of governance mechanisms. At one Aspen Institute seminar in February 2010, a number of senior business leaders cited unpredictability in business dealings as the greatest deterrent to investing in India. Many preferred the predictable backroom negotiations in China to the unpredictable official channels of India. Though rules governing real estate in India are slowly changing, with some states like Karnataka building urban property databases, these issues are likely to persist for some time.

Defining Trust

Why do we raise these issues at all? The challenges in the Indian property market, at their core, are really about trust or lack thereof. When people think about trust, their first thought is usually of a dynamic embedded in a personal relationship, perhaps with a loved one, a dynamic that has a moral basis and is analogous to faith. Our view of trust, however, is broader and more akin to the Oxford English Dictionary definition of trust. It describes trust as "confidence in or reliance on some quality or attribute of a person or thing." This characterization puts emphasis on a certain kind of opinion, whether you want to call it confidence or reliance, that allows you to impute behavior and can mitigate some degree of risk. Since the term *trust* is at the very heart of this book, we will take the liberty of rewriting this excellent definition in the interests of clarity (though probably at the risk of also being tedious and dry). We define trust for our purposes here as the *probabilistic extrapolation of future behavior based on a body of evidence.*

What does this long-winded definition mean? Nothing too complicated, really. Essentially, we see trust as about taking what you know (a body of evidence) and using it to *expect* (probabilistic extrapolation of future behavior). We all live with expectations, whether we are aware of them or not. We expect the sun to rise each morning, cars to drive on the correct side of the road, our technology to function the way it has in the past, and certain people to treat us a certain way. There are patterns we identify through the daily business of living, patterns which we use to build expectations that guide our own decisions and behaviors. Every day, we learn a bit more about the people in our lives and the world around us. Sometimes we have data such as credit scores to guide our decisions. Other times, we simply have patterns of behavior we have collected over time from people who happen to have shared quirks and characteristics. We have noticed that people who cannot look us in the eye are often lying to us. We might infer from this, when we run across someone in the future who cannot look us in the eye, that the probability that they are lying to us is higher than average.

Obviously, the "body of evidence" can vary widely in reliability and size. It might be as tenuous as a superficial resemblance to a familiar person or situation. For a naïve teenager with less experience, the body of evidence is probably going to be smaller. Even so, there is almost always some basic grounding for trust. We use what we have even if we do not have much to work with. We never come with nothing in our heads. Trust therefore sits in contrast to faith, which requires a leap across a chasm almost by definition.

Trust in Organizations and Systems

In light of this definition, we have the capacity to trust more than just individuals; we can also trust organizations and systems (that is, if they merit the trust). As with individuals, high trust in organizations and systems requires a relatively high level of predictability. In India, the pattern of property transactions often lacked a high degree of predictability, which in turn hampered the development of robust systemic trust. Like people, organizations and systems have nonrandom patterns of behavior derived from some intrinsic basis, whether you want to call it DNA, values, culture, ethos, beliefs or structure[1]. If there is no intrinsic basis, such as the flipping of an even coin, there is no grounding for trust. It makes no sense to extrapolate future behavior based on a random body of evidence. We should note, however, that while we maintain this to be true at the conceptual level, in practice people do this all the time, frequently at the roulette wheel in Las Vegas.

We exhibit trust in organizations and systems every day. When we inquire about a piece of property in the United States, we expect the relevant government office's determination of title ownership to be decisive and behave

[1] Note that while our definition of trust is broader, we focus on people-oriented groupings - individuals, organizations and systems – excluding patterns based on physical laws for the purposes of this discussion.

accordingly. We base this expectation on our experience with the government, concluding – not always consciously - that, whatever its deficiencies, the government can probably be relied on in this context.

If this was not the case, we might turn to alternative modes of action. Organized crime is typically viewed as a cultural phenomenon, but it is an economic one as well. Criminal organizations arise to fulfill needs, such as protection, enforcement, and supplying illicit commodities. They are the supply side of an economic equation, and often ordinary people represent the demand side. In India, one of main modes of recourse for people seeking to acquire undisputed property title is through somewhat unsavory brokers whose toolkit might include physical violence. These local real estate dons offer predictable, if not always legal, outcomes, leveraging their own fearsome reputations to ensure that titles once awarded never fall into question. Many of these people would prefer a standard, legal process but good alternatives are not always available. Unfortunately, trust and legality do not always go hand in hand.

Effective governments earn their legitimacy and achieve low levels of organized crime by instilling trust in constituents that their rights and property will be secured. In the United States, we fortunately do not require hired thugs and prominent signage to lay claim to real estate. Transfer of property here happens smoothly and relatively quickly, with the signing of scraps of paper. We rarely end up in court or are asked to pay bribes.

However, this was not always the case. Once upon a time, we faced some of the same issues that India does today. The first title insurance company in the United States was created in the late 1800's in response to nonstandard land records-keeping, deficient laws, and self-interested officials that together opened the door to property scams. The first title insurance companies had to develop their own "title plant" or paper storehouses of deeds, mortgages and other official documents. They faced persistent obstruction by officials and parts of the legal profession whose interests were aligned with the large fees received for the former laborious search method. Then, in 1888, before use of title insurance became widespread, two cases gained wide notoriety. One involved James S. Bedell, a trusted mortgage clerk at a prominent New York law firm who used his position to extract $296,880 from unsuspecting buyers using forged mortgage documents. In a similar case soon thereafter, William R. Foster, Jr., a former attorney for the New York Produce Exchange, was found to have forged $168,000 in mortgage registration certificates over a period of five years and absconded before he could be arrested. Even in today's dollars, these frauds pale in comparison to Bernie Madoff's $65 billion Ponzi scheme. However, at the time, according to the *New York Times*, "news of the forgeries spread with rapidity throughout the business part of the city and carried a feeling of alarm to every financial institution in town."

This widespread insecurity helped promote the use of title insurance until it became the standard it is today. It is now the quiet backbone of the American real estate market, despite the fact that it, by and large, no longer serves the original insuring function. Because of the high quality of title plants today, insurers undertake a relatively low level of actuarial risk, with most premiums spent on financing title research and maintaining the plants rather than paying insured losses. However, as an institution that promotes trust among market actors, title insurance creates significant societal value by lowering risk, reducing real and perceived transaction costs, and generally lubricating transactions. Similar to FDIC insurance and contract law, its value lies mainly in its *presence* rather than its *use*. It has become part of the body of evidence that actors in the real estate market use to determine whether they can trust counterparties in transactions.

Bridging the Past and Future

Trust can be thought of as our best attempt to line up what we believe about the future behavior of people, organizations and systems with the information we have today, amassed over time. It bridges the relationship between the past and the future. We trust our mothers mostly because they have established a long pattern of extraordinarily benevolent behavior towards us. Though there may be some genetic predisposition to trust our family members, we probably would not trust a solely biological mother we had never met as much as one that had raised us all our lives. As the broker between our past and future, trust helps us navigate our present.

The most controversial part of our earlier definition is the "body of evidence." Some people will ask: Is it really trust if there is proof? Our response is that, if you agree with us that reality is mostly subjective and the future is deeply uncertain, real proof of future behavior is not to be had. This is especially true when you are dealing in the realm of people who possess the quality that psychologists and sociologists call "agency," which essentially means capacity to *act*. I can write a letter to my congressman. Or I can put on a funny hat and dance in the street in front of my congressman's house. Or I can put on a vest made of explosives and blow up his house. With the growing power of non-state actors, the uncertainty of our future seems to be increasing rather than the reverse.

It is important to remember that, the future being uncertain, trust is not a yes-no question. It is a probabilistic assessment along a continuum (or many continua, as we shall discuss later), with "confidence" being a matter of degree. Patterns related to human behavior are rarely perfect and often broken. The question to be asked is: How likely is this outcome, or conversely, how surprised will I be if things do not unfold as expected?

This view may seem quite cold and calculating at first glance. A mother's love, after all, cannot be broken down into mechanical parts. We should be clear. We are well aware of the complexities of human relationships, social interactions and emotional responses, not being sociopaths ourselves. We do not ascribe to the economist's stereotyped view of people as completely rational and selfish beings, the classic *homo economicus*. However, we believe that if we limit the conversation to the level of morality, emotions and poetry, we do disservice to the search for truth.

Rather than exclude "the soft stuff," however, we believe that emotions and how people experience their lives are vital to the way they absorb information and negotiate their lives. Indeed, the motivation for this book was our growing fascination with the nature of trust and its everywhere-ness. We found relevance in a dizzying array of disciplines, including neuroscience, genetics, history, anthropology, economics, management science, sociology and psychology. There exists a wealth of supporting literature which would be virtually impossible to present in a comprehensive manner given the breadth.

We embarked on this venture to help ourselves and others come to a better understanding of what makes us all tick and suggest strategies for the future. Today the world in which we live is characterized by change and uncertainty, much of which is driven by accelerating improvements in the digital infrastructure (e.g. broadband speeds, memory, processors, applications). We believe that trust presents one likely strategy for navigating this environment of high risk and deep uncertainty.

However, we do not have all the answers, though we suspect, given the surprisingly broad relevance of the topic, that there is something here of importance. We present here some of the most interesting findings in the literature, in our opinion, as a series of thematic and perspective-driven essays. Even if you do not agree with our perspectives, we hope you at least find them engaging.