Property Rights and Development

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Abstract

There is a strong consensus that secure property rights are critical for economic development, but tricky issues about the direction of causation and measurement have made it difficult to demonstrate this relationship empirically. In recent years, scholars have made progress on these issues. In the future, scholars can profitably turn their attention to four issues: (i) why privatization is so unpopular, (ii) how politics shapes property rights, (iii) the distributional consequences of property rights, and (iv) the impact of violence on property rights and economic development.

INTRODUCTION

There is a strong consensus that secure property rights are critical for economic development because they provide incentives for right holders to put their assets to their most productive use. Where property rights are unclear, poorly defined, or subject to arbitrary trespass by the state or other claimants, right holders will have little incentive to use the asset productively and economic growth will suffer. Yet, if secure property rights are so beneficial to society to economic growth, then why are they so rare? Why do property rights take such different forms across countries and societies?

Property rights are typically treated as a bundle of rights, including the right to use an asset, to earn income from an asset, and to transfer an asset (Barzel, 1989). Property rights may be held by individuals, groups, or the state. Property rights are never inviolable and use, income, and transfer rights may be circumscribed in a variety of ways. States often put restrictions on the use of property to protect broader social interests. Speed limits curtail the use rights of car owners. Similarly, social norms may discourage right holders from exercising certain rights.

Economic systems allocate property rights in a variety of ways. De jure definitions of property rights seek to specify the use, income, and transfer rights of assets precisely, but these formal legal depictions are never complete because the costs of specifying fully all the different dimensions of property

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rights for every possible contingency are simply too great (Grossman & Helpman, 1986). De facto practices and social norms often fill this legal void, but these informal means may be limited precisely because they lack formal legal authority backed by the state. In addition, informal definitions of property rights may be at odds with formal definitions, a contradiction which only further erodes the clarity of property rights.

To give some idea of the complexity of property rights, consider Goldstein and Udry's (2008, p. 5) discussion of land tenure in Southern Ghana. They note that "land is 'owned' by a paramount chief and is allocated [to individual farmers] locally through the matrilineage leadership … but land rights are multifaceted. The act of cultivating a given plot may—or may not—also be associated with the right to produce trees on the land, the right to lend the plot to a family member, the right to rent out the land, the right to make improvements, or the right to pass cultivation to one's heirs … and these many dimensions of lend tenure are ambiguous and negotiable." Not surprisingly conflicts over land are common.

Property rights influence economic development through at least four channels (Besley & Ghatak, 2010). First, secure property rights allow individuals to reap the fruits of their investment and efforts. Because much economic activity requires upfront investments of time, capital, and effort for benefits that accrue in the future, right holders are vulnerable to arbitrary or unexpected changes in policy or laws. Where the holders of property rights expect the government to change the tax rates after they incur the sunk cost of investment, they will be reluctant to invest. This "commitment problem" robs the investor of a potentially lucrative investment, but it also robs the state of potential tax revenue.

Second, weak property rights compel economic agents to devote significant resources to defending their property rights rather than putting those assets to more productive uses. Each additional worker hired to protect property—be it a lawyer or a security guard—is a worker not hired to produce.

Third, secure property rights can promote development by making it easier to trade. Economic efficiency occurs when rights are assigned to those who can use the asset most efficiently, but weak property rights may prevent this beneficial outcome by deterring right holders from selling or renting their assets to more productive agents. Landowners who have surplus land to sell may be reluctant to do so absent confidence in the enforcement of contracts with buyers. Fourth, where property rights are weak, the holders of property rights cannot use their property as collateral and this can cripple the development of markets for credit and land.[1]

1. By some accounts, strong private property rights have also played a central role in protecting democracy (Lindblom, 1977).

FOUNDATIONAL WORK

Modern economics has enshrined strong property rights as a fundamental tenet. Indeed, the core results of neoclassical economics rely on the assumption that property rights are perfectly defined and enforced without any cost. This seemingly innocuous assumption led many economists to take property rights for granted. This changed with Coase (1960), whose insights eventually led to the current resurgence of scholarly interest in property rights. In "The problem of social cost," Coase begins by arguing that if property rights were perfectly defined and costless to enforce, then the initial distribution of property rights would not matter for social welfare because owners would simply exchange property rights until they reached an equilibrium outcome that left everyone satisfied. Those able to obtain a higher economic gain from exercising a property right could compensate parties injured by the owners' exercise of that property right. For example, if bargaining was costless, then steel producers could compensate those harmed by the pollution the steel plant produces while still exercising its right to produce as much steel as was profitable. This arrangement would leave both parties better off. Coase's argument marked a departure from prevailing thought, which argued that government action was always needed to assign penalties to polluters in order to make injured parties whole. More generally, Coase argued that in the absence of transaction costs, market participants have many means to organize their transactions efficiently without state regulation.

However, Coase went on to argue that because, in reality, the cost of exercising property rights is never zero, the allocation of property rights is critical. The costs to the steel producers of identifying all those harmed by its pollution, measuring their losses, and paying compensation could easily exceed the gains from exercising the right to produce steel, thereby leading to social welfare losses. Indeed, many mutually beneficial exchanges of property rights go unmade precisely because of the costs of transacting outweigh the gains from exercising the right.[2] Coase suggested that when the transaction costs of exercising property rights were low, market-based solutions involving negotiations between parties were likely most efficient. However, when these costs were high, government regulation was likely the best response. More generally, this insight laid the conceptual foundations for scholars to examine how a broad range of institutions from legal and political systems to social ties and ethnicity shape the security and distribution of property rights.

One central cost of transacting is enforcing property rights between economic agents engaged in trade. Intertemporal trade raises the possibility of buyers cheating sellers or vice versa. Absent confidence that sellers will

2. See Glaeser, Johnson, and Shleifer (2001) for a discussion and application of Coase.

deliver the good tomorrow, buyers are reluctant to part with their cash today. One large strand of research explores the great variety of institutional solutions that economic agents have devised to promote trade. Milgrom, North, and Weingast (1990) demonstrate how itinerant traders created a system of private courts that allowed buyers and sellers from all over medieval Europe to exchange goods at the annual Champagne Fairs without a central state. These private courts resolved disputes, shared information about traders' reputations for honesty, and barred traders who refused to abide by court decisions from entering the Fair. Yet, scholars have also documented frequent failures to create reliable institutions to protect property rights and promote the mutually beneficial exchange even where it would make both parties better off (Bates, 1984, 1989).

To increase the security of property rights, many scholars point to the state. Thanks to its economies of scope and scale in the provision of public goods, such as justice, and its monopoly on the legitimate use of violence, the state is better suited than other organizations to protect property rights in many instances. But state protection of property rights raises another problem: states strong enough to protect property rights are also strong enough to take property away. Similarly, states too disorganized to control their agents are also hardly in a position to commit to protect property rights through time (Frye & Shleifer, 1997; Shleifer & Vishny, 1993).

Another strand of literature on property rights focuses on the commitment problem. That is, how can the owners of property be convinced that state agents will not expropriate them after they invest or lend? North and Weingast (1989) traced the great expansion in credit to the Crown to the institutional constraints placed on the King by the Parliament following the Glorious Revolution of 1688. In their telling, the English Crown paid high interest rates before the Glorious Revolution because the Crown retained the power to renege on loans at will. Anticipating default by the Crown, lenders charged high rates or refused to loan. However, the institutional checks on Royal fiscal policy placed on the Crown by Parliament after the Glorious Revolution raised the costs to the Crown of reneging on its loans and led to lower interest rates and a greater willingness to lend. Thus, the institutional constraints created more secure property rights for lenders and allowed the Crown to raise revenue far more efficiently. Other institutional solutions to the commitment problem involve increasing the number of groups needed to approve changes in policy, and the delegation of decision-making authority to bureaucrats more insulated from political pressure, such as central banks and courts (Stasavage, 2002).

CUTTING-EDGE WORK

Much recent work on property rights has focused on identifying the causal effects of property rights on economic development (Fenske, 2011). This is difficult because property rights, just like many institutions, are rarely randomly assigned in the real world. If, say, private and state property rights were randomly assigned to firms, then we could compare the average performance of firms to determine whether state or private property rights were associated with better performance. However, property rights are often assigned in ways that are correlated with firm performance. For example, if private property rights are granted to better performing firms in the first place, then it is difficult to identify whether private property or some other feature of firm is driving better performance. More directly, politically powerful firms may have stronger property rights and better performance, which makes it difficult to know whether political power or stronger property rights is shaping economic performance. The key is to find some way of identifying the impact of property rights absent.

Scholars have made some progress in mitigating this problem. For example, Acemoglu & Robinson (2001) find an instrument for good institutions: the death rates of colonial settlers in the nineteenth century. Where the disease environment for colonizers was benign, as in the United States, Canada, and Australia, colonizers settled the lands and installed good institutions, such as secure property rights, strong courts, and clear land titles. However, where the disease environment prevented settlement by colonizers, as in the Congo and Zaire, colonizers set up extractive institutions that allowed the colonizers to engage in economic predation on a large scale. The institutions protecting property rights were put in place for reasons not directly related to the quality of institutions and because these institutions persisted over time, they ultimately led to rapid growth in the former and slow growth in the latter. The key point is that the disease environment and subsequent settler mortality rates are correlated with the quality of institutions, but not with subsequent levels of economic development. Instrumenting for the quality of institutions with the mortality of rates of settlers, they find that the quality of institutions has a significant and substantially large impact on economic growth.[3] Others have created instrumental variables for the quality of institutions based on geography, population height, latitude, and exposure to natural disasters (c.f., Hall & Jones, 1999; Hidalgo, Naidu, Nichter, & Richardson, 2010).

3. Glaeser, Laporta, Lopez-de-Silanes, and Shleifer (2004) criticize this strategy because the settlers not only brought their institutions with them but also their human capital. They attribute the high growth rates of countries with low settler mortality rates at the time of colonization to the education and skill level of the settlers.

While these instrumental variables can be helpful, they are often difficult to come by.

NATURAL EXPERIMENTS

Still other scholars have identified "natural experiments" in which property rights are assigned "as if" randomly to right holders. Di Tella, Galiani and Shargrodsky (2007) study how creating title to property shapes economic behavior by studying squatters who were occupying an urban wasteland in Argentina. In 1983, a law was passed assigning property rights to the squatters. Some, but not all, of the original owners of the land contested this decision in court and a lengthy legal process ensued. As a result, some squatters received title to the land immediately, while those occupying land involved in the court case did not. Di Tella, Galiani and Schargrodsky then demonstrated the importance of secure titles by finding that the group of squatters with titles invested in their homes and their children's education at higher rates and also felt greater efficacy. Crucially, they find that groups with and without titles are basically identical in all other respects, save for the possession of legal title. This allows them to identify the causal impact of legal title on economic behavior.

Similarly, Field (2007) studied the efficiency gains from a massive project that assigned property titles to 1.2 million Peruvians between 1996 and 2003. Taking advantage of the staggered introduction of the program across neighborhoods, she finds that squatter households who had no legal claim to their plot spent more than 13 hours per week defending their property. Squatter households with legal titles worked 16 hours more per week than those without, demonstrating the importance of property rights. Related research finds that squatter households with titles also had lower fertility rates and were more likely to have invested in their residences (Field, 2004). Contra de Soto (2000), they do not appear to increase access to credit.

Frye and Yakovlev (2014) explore how elections shapes property rights in Russia by comparing the responses of businesspeople surveyed just before and after the parliamentary elections of December 2011. Fortunately, those interviewed before and after a parliamentary election were remarkably similar on factors that might shape property rights, such as size, sector, financial condition, and personal characteristics of the managers. The "as if random" timing of the interviews allows for a cleaner estimation of the impact of the election on property rights.

Fisman (2001) examines how shocks to the health of President Sukarno in Indonesia influenced the share price of companies with and without close ties to the regime. Firms with Sukarno family members on their corporate boards experienced significant declines in their share price in the wake of news about the deterioration of the President's health, thereby demonstrating the impact of political connections on property rights. Researchers relying on a natural experiment take advantage of unusual circumstances to isolate the impact of property rights on economic behavior, but these opportunities are relatively rare and leave analysts at the mercy of unexpected events and historical quirks.

Field Experiments on Property Rights

Field experiments involving randomized controlled trials have become increasingly common in development economics and some scholars have usefully applied this method to identify the causal impact of property rights. By randomly assigning property rights to users, this approach introduces an exogenous source of variation in property rights that can allow for stronger causal inference (c.f., Blattman, Hartman, & Blair, 2014). However, many aspects of property rights are not readily amenable to analysis via field experiments because property rights are often an extension of political power and are designed to deliver economic benefits to privileged groups (c.f., Bates 1989; Engerman & Sokoloff, 2002). Reassigning property rights raises deep political issues as right holders are likely to resist. Given the tight link between property rights and political power, it is a special challenge to design large-scale field experiments with random assignment of property rights.

Measurement Issues

One of the central challenges to the study of property rights is measurement. Property rights arrangements include formal and informal components and capturing these different dimensions is often quite difficult. Formal changes to property rights may bear weak resemblances to practices on the ground (Ellickson, 1991). Using behavioral measures of the security of property rights is another option. For example, some argue that investment is a proxy for secure property rights. However, Besley (1995) notes that investment itself may influence the security of property rights in some settings. Using data from Ghana, he finds that planting trees raised the costs of expropriation of land and thereby made property more secure. Others have noted that profitable investments themselves may lead to conflict with economic rivals, family members, or state agents (Place, 2009). These causal identification and measurement challenges have been primary reasons for the lack of progress in demonstrating the causal impact of property rights on development (Fenske, 2011).

FUTURE AREAS OF RESEARCH POLITICS OF PROPERTY RIGHTS

Public Opinion and Property Rights

Efforts to measure and identify the causal effects of property rights will remain a topic of interest, but several other areas of research will also likely dominate future studies of property rights. One puzzle is why privatization—the transfer of rights from state agents to private agents—is so unpopular. Even where privatization produces gains for society, it remains deeply unpopular (World Bank, 2005). Surveys in 28 postcommunist countries conducted in 2006, found that a majority of respondents in each country wanted to revise the status of industrial firms privatized after the fall of communism. Moreover, only 20% of respondents favored the current status quo (Denisova, Eller, Frye, & Zhuravskaya, 2012). At the same time, only 30% of respondents favored returning these privatized firms to state hands. Privatization is no more popular in Latin American where 60% of respondents view privatization unfavorably (Panizza & Yanez, 2006).

Why popular opposition to privatization is so great is an open question. Citizens may oppose the legitimacy of the process by which assets were privatized or they dislike the distribution of property after privatization. Finally, they may simply prefer state property to private property. Denisova *et al*. (2012) explore this issue in a postcommunist setting and find that low human capital shapes support for revising privatization via a preference for state property, but those who experience economic hardship oppose privatization primarily on the grounds of the legitimacy of the process.

Other works have begun to probe public attitudes toward privatization and private property. In the wake of the privatization and subsequent nationalization of water in Buenos Aires, Di Tella, Galiani, and Shargrodsky (2012) find that those who gained access to water via privatization had a more favorable view of water privatization than those who did not, but that priming subjects with anti-privatization information from the government nullified this effect, suggesting the importance of both material interests and political information. Yet, we do not know how widespread opposition to particular forms of property rights can influence investment decisions. Expropriations of property rights by populist leaders have been remarkably common over the past 40 years, yet widespread opposition to privatization does not always translate into expropriation (Guriev, Kolotilin, & Sonin, 2011).

Politics and Property Rights

The empirical study of property rights began with simple forms of property rights in which the state and politics played little role (Demsetz, 1957; Umbeck, 1981). Yet, recent studies have tried to incorporate how politics influences the distribution and impact of property rights on economic behavior. At a macro-level, Acemoglu and Robinson (2012) identify how state institutions have increased the security of property rights and promoted economic development through time. Others have studied the politics of property rights on a micro-level. Goldstein and Udry (2008) study more than 500 small plots of land in Eastern Ghana over 2 years and find that politically connected farmers are far less likely to have their land expropriated when it is fallow and have far higher yield rates than those with weaker connections. Similarly, women rarely risk keeping their land fallow out of fear that it will be expropriated, and therefore achieve far lower yields than man. Goldstein and Udry (2008, p. 26) note: "Rights over a particular plot of land are political: they depend on the farmer's ability to mobilize support for their right over the spot." Kwaja and Mian (2005) find that borrowers in Pakistan who had run for office received loans on far more favorable terms than those without political connections and were significantly more likely to fail to repay their loans than their less politically connected rivals. Where politics allocates property rights toward the most politically valuable rather than the most efficient, economic development will suffer. A key issue for policymakers and scholars is to develop a better understanding of how political incentives shape property rights.

Autocratic countries exhibit particularly great variation in the security of property rights, a topic that scholars are beginning to probe. Autocratic countries face particularly strong commitment problems given the much weaker constraints on leaders compared to democratic countries. But autocrats vary in their level of constraint. For example, Gehlbach and Keefer (2011) find that one-party regimes such as China provide stronger institutional checks on autocratic predation on property rights when compared to autocratic regimes led by the military or by single individuals.[4]

Haber, Razo, and Maurer (2003) find that autocratic rulers in Mexico in the early twentieth century mitigated the commitment problem in the oil sector by creating a coalition of interests with foreign owners. Autocratic rulers who had property rights over oil but not the technology to develop the resource, formed a coalition with foreign companies who had the technology, but not the access to the oil. In this trade of secure property rights for oil revenue, successive autocrats had good reason to protect the property rights of foreign oil companies and foreign companies profited from this arrangement by gaining access to oil. Indeed, it took the political revolution of 1938 and the installation of the PRI government to break this coalition.

4. China offers a rich area for research given its variation in property types across regions and over time (Lin, 1992).

Secure Property Rights, But for Whom?

As in other areas of political economy, scholars of property rights have become less confident in large "*n*" cross national research in part due to the difficulty of measuring property rights at the national level, and have turned to studies that document how property rights have differential effects on right holders. Some studies focus on why some groups have stronger property rights than others. The standard argument is that the wealthy prefer strong property rights that protect the political and economic status quo (Engerman & Sokoloff, 2002). However, Sonin (2003) argues that where the wealthy can park their assets in safe havens abroad, they may prefer weak property rights at home because they will likely be taxed to pay for strong property rights in their place of residence.

Lawson–Remer (2011) probes the paradox that the creation of secure property rights often involves the expropriation of politically vulnerable groups. From the enclosure movement in Britain, to the imposition of colonial rule in Africa, to the dispossession of the native population in the United States, secure property rights are built upon and often coexist with weak property rights for marginalized groups. Lawson–Remer finds that traditional measures of secure property rights typically capture the property rights of business people rather than those of politically marginal groups. Using a clever measure, she finds little correlation between the strength of property rights for business owners and for politically vulnerable groups. Her econometric analysis finds that strong property rights for businesspeople are associated with economic growth, but that the strength of property rights of politically marginal groups are not correlated with economic growth. This raises the normatively troubling question of whether the secure property rights of the businesspeople come at the expense of politically marginal groups.

Why do some individuals and groups have stronger de facto property rights when de jure property rights are identical? Under what conditions do state officials allocate property rights based on political or economic considerations?

Violence and Property Rights

At their core, property rights are about exclusion. Clear property rights define who can use and gain income from assets and who cannot. Even where changes in property rights may produce greater efficiency, they also inevitably entail redistribution between groups and hence, conflict. North, Wallis, and Weingast (2009) raise this issue most forcefully in their reinterpretation of the rise of modern states. They focus explicitly on how the limits and controls on wielders of influence shape long-run economic development and the nature of social orders. In their view, the failure of societies to control the wielders of violence is a primary cause of why countries fail to achieve their economic potential.

Contemporary Russia provides an excellent example. Volkov (2004) describes the rise of "violent entrepreneurs" in his study of the evolution of the market for private protection in Russia. With the collapse of the Soviet state, private protection rackets thrived in Russia in the 1990s, but the advent of higher oil prices and a natural advantage in scope and scale allowed state protectors, such as the police and security forces, to outcompete private protection rackets. In time, the police became monopolists in the sale of protection which they provided primarily as a private good to those who could pay. Recent years have seen a related phenomenon of hostile takeovers (literally) undertaken in cooperation with the security forces (Gans-Morse, 2012; Markus, 2012). Kapeliushnikov, Kuznetsov, Demina, and Kuznetsova (2013) find that firm owners in Russia who believe that their firm is more likely to be the target of a hostile takeover invest at significantly lower rates. Certainly, Russia is far from the only countries in which firms with a comparative advantage in the use of violence play prominent roles in the economy.

But access to violence also shapes economic outcomes on the micro-level. Hidalgo *et al*. (2010) focus on land seizures by squatters across municipalities in Brazil from 1988 to 2004. They find that negative economic shocks not only lead to more land invasions but also that these effects are especially pronounced in municipalities with high income inequality. While other works have identified the direct effect of economic shocks on property rights, this work also identifies how the local social structure conditions this effect, thereby offering a more subtle and nuanced analysis. How to curtail the wielders of violence is a central question for academics and policymakers going forward.

CONCLUSION

Coase's insights on property rights have made an enormous contribution to economic thought; and over the past half century, scholars have produced a remarkable body of work on the relationship between property rights and economic development. Yet, from an academic perspective, there is still much to be learned. Moreover, the substantive importance of the study of property rights is equally important. Understanding how different distributions of property rights, and different institutional arrangements shape economic and political behavior is surely an important means promote growth and reduce poverty.

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