Economic Growth and the Property Rights Regime

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> It is often nearer the truth to say that capital is created in the process of economic development than that development is a function of capital accumulation.
>
> —P. T. Bauer[1]

Introduction

To those who depended on the assumption that capital accumulation *is* the cause of economic development—Marxists, social engineers, elitists of every ilk, and others—Peter Bauer's words would appear challenging. Indeed the statement is only an example of Bauer's consistent view of economic development. If economic development means anything, it means that the parameters are changing; and the parameters are all those institutional benchmarks that many economists and other social scientists have chosen to hold constant—or at least to let vary with assured prescience (Bauer 1971, pp. 281–82). The real issue involves how capital is selected and how it is subsequently managed. The selection of inappropriate capital and its subsequent mismanagement contributes nothing to development.

There are other and more fundamental forces at work than capital accumulation alone. But those other forces are usually omitted from development models, because if, as Peter Bauer has argued, they are indeed the source of economic progress, we have been on the wrong track in most of the Third World for the past 40 years.

Peter Bauer had to be dismissed as an irrelevant crank because he argued that a free and competitive market with minimal government

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[1]In Bauer and Yamey (1957, p. 127).

participation would outperform a planned and centrally controlled one. If he were correct—as we now know he was—the role of planners and those who supported interventionist policies would have been sharply diminished. The credibility and prestige of the intellectual establishment of the day also would have been thrown into doubt.

Unquestionably the chivying interventionists were wrong. Cultural and ethnic differences do matter. We cannot ignore the economic success of the overseas Chinese and other immigrant groups. Why is there a taboo against investigating the reasons for their success? Why have they been persecuted, discriminated against, and dispossessed by their host governments?[2] Conspiracies and ethnic factors have only been excuses for their persecution. Could it be that the success of immigrant groups is due instead to a sense of personal responsibility and a consequent high level of entrepreneurial activity?

Are cultural differences fixed? There is too much evidence to the contrary. Rather than using such differences as a reason for further intervention into and manipulation of the economy, we should seek to discover why some groups are so energetic and perform so constructively. This article offers the hypothesis that an important reason for group success can be found in the pattern of ownership and responsibility.

If, within some domestic minority, individual ownership rights predominate, with consequent personal responsibility for success or failure, intervention to restrain the success of that minority is not an appropriate government policy. The appropriate response—insofar as one is required—is to generalize the pattern of ownership rights that made success possible, and to take advantage of its "demonstration effect" to accelerate development for society as a whole. The foregoing argument contains the essence of Peter Bauer's recognition that individuals are the key players in the process of economic development. Individuals, not circumstances, create development.

Before examining the role of the property rights regime in the process of economic growth, it is instructive to consider the meaning of economic success and failure. The fundamental role of ownership and property rights in determining success or failure can then be fruitfully examined.

[2]Would it be indecent also to ask why the World Bank and other agencies have funded expatriates to replace or fill the positions of the domestic Chinese minority in countries such as Malaysia? This is nothing but complicity in the very racism they frequently denounce.

Economic Success and Failure

It is not enough to ask if individuals in a nation are better off now than they were several decades ago; that should be taken for granted. The past four decades have, after all, seen enormous preoccupation with economic development. Foreign aid and foreign advice have poured into the Third World. There has been an obsessive interest in developing ways to accelerate economic progress. Given these circumstances, it is much more relevant to ask why the less successful nations have not performed better. To raise such a question requires a comparison with an operating alternative and not some abstract ideal. A comparison of South Korea with Sri Lanka is useful.

Twenty-five years ago South Korea was thought to have few recognizable resources, and its capital stock had been destroyed by war. Its per capita income was comparable to that of India, Burma, Sri Lanka, and similar nations, and its Confucian culture was thought unlikely to adapt to modern competitive individualist business methods. Moreover, Korea itself had been sundered some 15 years earlier and the traditional industrial heartland had gone to the communists in the North. Large amounts of foreign aid to South Korea stopped in the 1960s.

Despite these unfavorable circumstances, South Korea has achieved sustained economic growth and is now a middle-income nation. Even with high population density and rapid population growth, it has flourished. The per capita gross national product is now almost eight times that of India, and more than eleven times that of Burma. Life expectancy is now 12 years longer than in either India or Burma.

Sri Lanka and South Korea received their independence at approximately the same time. Sri Lanka inherited from Ceylon a stable administrative structure, established communications and transportation systems, and well-developed educational institutions. Ethnic and religious differences do exist in Sri Lanka, but the fact that almost a third of the people in nominally Confucian Korea were active Christians should not be ignored either.

In 1950 South Korea's gross domestic product per capita was just under 82 percent of Sri Lanka's, in 1963 it was just over 97 percent, and by 1973 it was over 186 percent (Kindleberger and Herrick 1977, p. 17, Table 1–2). By 1983 South Korea's gross national product per capita was over 600 percent of Sri Lanka's (World Bank 1985, pp. 6–9). This incredible divergence cannot be explained by war or external conflict because the victim of such disasters was the country that grew successfully. Foreign aid might be an explanatory factor since Sri Lanka continued to receive increasing amounts of foreign aid

throughout the whole period, while Korea's receipts declined sharply in the late 1960s (USAID 1982). By this reasoning, however, foreign aid could only be said to have had a pernicious effect on the recipient. It would seem that the examples of nations that have been split into two parts and then operated with radically different economic systems would be the focus of numerous case studies in economic development. This, however, has not been done for North and South Korea, or for East and West Germany. Casual observation, as well as the few statistics from North Korea that can be checked from third sources, leads to the inevitable conclusion that by material and other standards South Korea has far outdistanced its socialist neighbor.

Keith Marsden (1985) has looked at "Why Asia Boomed and Africa Busted." His comparison of the two continents highlighted the fact that countries starting from quite similar circumstances, but following distinctly different policies, have performed very differently in terms of the major development indicators. By the standard of South Korea, most of the Third World has failed.

An impressive range of hypotheses has been offered to explain relative economic failure: vicious cycles of poverty, population density or rapid population growth, cultural factors such as religion, the choice of economic structure, and, always, a lack of capital. Conspiracy theories by structuralists and others abound but do not warrant serious consideration. Foreign aid was, and often still is, the eternal anodyne for every successive failure. By and large, external and exogenous factors have been the principal excuses. Flagrant misgovernment, faulty economic policies, and meddling intervention have only recently begun to be taken seriously as possible sources of economic failure. "A country, whatever its stage of development, can be well or poorly governed. . . . But with the Third World, the notion of responsibility for bad results disappears completely," notes Jean-Francois Revel (1981).

So many elegant technical explanations for failure have turned out to be nothing more than intellectual curiosa. Consider the example of immiserizing growth that once absorbed so much intellectual interest in trade circles, but which, as a practical matter, contributed nothing. There is the unavoidable feeling that many technical arguments about economic progress were similar to the debate about neoclassical growth models and capital theory between the two Cambridges in the 1960s and 1970s—one side trying to destroy capitalism and the other trying to demonstrate its own mathematical virtuosity.

A Return to the Market Mechanism

Ultimately, the best explanation of any phenomenon must be in accord with observed outcomes. The theories that underpinned eco-

nomic development planning and the role of government as entrepreneur have now had their run. Every success cannot be a special case; every failure cannot be due to random and external events. Economies in the Third World can be grouped into those that are market oriented and those that are more regulated and centrally controlled. The more market-driven economies have consistently outperformed the others.

Markets are back in vogue. There is talk in the Third World, for example, of freeing prices to signal scarcities and surpluses and to allocate rewards. There is even talk of competition as a goad to action in lethargic societies. Privatization is now proclaimed as a viable purgation by governments with distended portfolios seeking relief by eliminating their less defensible activities. We may even yet discover that disguised unemployment can and does exist, but only in the government sector. Finally, James Buchanan (1983) and the public choice school have countered the paradigm of market failure with that of government failure within a democratic setting, pointing out that even imperfect markets may outperform "well-intentioned" government planners. It is now quite usual to see international agencies agreeing with such research conclusions as: "The study finds that rapid economic growth depends on policies, not circumstances" (IMF 1985, p. 61).

The implication of the emerging enthusiasm for markets, however, has not been fully recognized—namely, that the beneficial results of competition and price signals cannot be achieved unless effective ownership rights are established. As Armen Alchian (1967, p. 6) pointed out two decades ago:

> [E]very question of pricing is a question of property rights. . . . [T]he existing system of property rights establishes the system of price determination for the exchange or allocation of scarce resources. Many apparently diverse questions come down to the same element—the structure of property rights over scarce resources. In essence, economics is the study of property rights.

Property Rights

What are property rights and how do they influence economic growth? Property rights are the rights of human beings to control and dispose of property as they see fit. Property rights are human rights over property, as against state ownership and hence detailed rights over humans. Property rights are what people are entitled to do with things they control: who will be allowed to claim the rewards of wise decisions and who will bear the costs of misfortune or irresponsibility.

To fulfill their role effectively, property rights must be exclusive, transferable, partitionable, and perceived to be permanent. They should be exclusive; the definition of property rights should be clear as to whom the owner may or may not exclude. Exclusion is seldom, if ever, complete. The owner of an automobile may be able to exclude others from using the car without his consent under normal circumstances. In times of war the government may be quite entitled to requisition the vehicle.

Unless property rights are transferable we cannot shift resources from lower- to higher-valued uses. Property rights should be partitionable; it should be possible to divide up the collection of rights that goes with any particular element of property. In this way property may be used economically for a wide range of different purposes under differing circumstances. Rights to mineral resources are the simplest example. The owner of a piece of land may wish to use it for cultivation. At the same time he may wish to allow someone else to pay for the right to search for minerals under the land. This is possible because property rights in the land are partitionable.

Property rights must be perceived to be permanent while belonging to any individual. As Roland McKean has noted: If individuals cannot capture the net benefits they could produce, they cannot be expected to produce those incremental benefits. Or, consider Richard Posner's ([1972] 1975, p. 12) example:

> Imagine a society in which all property rights have been abolished. A farmer plants corn, fertilizes it, and erects scarecrows, but when the corn is ripe his neighbor reaps and sells it. The farmer has no legal remedy against his neighbor's conduct since he owns neither the land that he sowed nor the crop. After a few such incidents the cultivation of land will be abandoned and the society will shift to methods of subsistence (such as hunting) which involve less preparatory investment.

It must be clear that ownership refers to the rights to use assets and resources, and that all such rights are inevitably circumscribed in some way. The right to use one's own mind and body for certain activities is restricted by law. Similarly, the ownership of resources does not carry the right to inflict the results of their use on a neighbor. That also is restricted by law. Nevertheless, the broader the range of rights that are embodied in ownership and the broader the range of opportunities open to the owner, the more valuable the owned resource will be (Alchian and Demsetz 1973).

Because the bundles of ownership rights determine the value of any type of property, it matters little how the property is classified in traditional terms. Property may be tangible or intangible; for exam-

ple, physical assets or things such as the accumulated goodwill that go with a particular firm or product. It does, however, matter greatly whether property yields pecuniary rewards (money), or nonpecuniary rewards that may have to be consumed in the form of services and other goods.

To capture pecuniary rights the owner of property must be able to sell the stream of services it generates or to capitalize the stream by selling the property itself. Where the rights to sell or capitalize are constrained, by law or by other institutional arrangement, the property value will decline. For example, a government official is delegated the right (and duty) to distribute valuable property such as licenses to buy foreign exchange. The licenses are limited in number as a means to ration scarce foreign exchange. They are, therefore, worth more to the chosen buyers than they cost. Under these circumstances the official has no ownership rights and cannot sell the licenses to the highest bidder (therefore assuring that they go to those who value them most highly). He can, however, transfer part of the value of the licenses to himself in nonpecuniary and inefficient ways—such as distributing licenses to a particular category of people in a manner that would reflect favorably on him within his own social circle. There are many other ways he could accomplish the same end without resorting to legally corrupt behavior. Due to the nature of the property rights that go with the licenses, the official's estimate of their value will be below that estimated by the purchaser. This wedge between the value that the two parties put on the thing being transferred may lead not only to the transfer of nonpecuniary rewards to the official, but also to the possibility of outright corruption.[3]

Another example of the attenuation of property rights can be found in the universal response to rent controls. Where apartment owners are not allowed to charge occupants the full value of their apartments, there has been visible change in the owners' patterns of behavior. Maintenance declines and the number of apartments available for the public is reduced as owners rent to relatives and friends and as they convert their apartments to business or other uncontrolled uses. The effect of rent controls is a partial transfer of property rights from the owners of the buildings to the present group of tenants—with slums being the ultimate result (Furubotn and Pejovich 1972).

[3]The distinction between pecuniary and nonpecuniary rewards stands on the microeconomic argument that pecuniary rewards (money) will always be preferred to nonpecuniary rewards of the same value because money is fungible and tastes differ (Sanchez and Waters 1974).

Property Rights and Incentives

The pattern of property rights and the cost of marketing those rights will determine what is possible and profitable. If economic growth is the goal, then the structure of property rights should induce people to do those things that lead to economic growth. Economic growth is a long-term process and is more likely to be sustained if people have a strong stake in the future. The way in which ownership is defined determines the expected future income stream from particular kinds of property and thus determines people's vision of the future.

Assurances about future property rights determine both the quantity and kind of wealth people will accumulate. The relative success of South Korea when compared with Sri Lanka may be in large part attributed to the way successive Sri Lankan governments have avowed that their policy was to reduce private property rights in the name of socialism. Until 1977 Sri Lanka's various governments pursued policies that centralized economic power, intervened widely in markets, and moved the country toward a stated goal of complete socialism. Private property was threatened and confiscated, creating an atmosphere of uncertainty about the future. Since few people wanted to acquire or create assets with a low probability of yielding a return in the future, the value of productive assets declined. In the process there occurred a shift from saving to current consumption and a consequent reduction in the overall rate of economic growth. Since 1977, however, Sri Lanka has reversed its economic policies and undertaken a free market approach. Nevertheless, great harm must be undone before Sri Lanka and other such countries become recognizably market-driven, but they have begun (Subasinghe 1986).

Private property rights permit the holder to transfer the results of his efforts to future generations of his choice. This reinforces the family as a social unit. On the other hand, the absence of such well-defined private property rights diminishes the economic importance of the family and reduces the incentive to make provision for the future. In all this is a self-fulfilling prophecy: if the state attenuates private property rights, people will reduce their time horizon and their savings, in turn paving the way for the state to step in with forced saving and government-determined investment.

One way the state can attenuate private property rights is through the tax system. Consider the case of Jamaica. The Jamaican government has chosen an economic system in which people receive free food and other services if they make $1,200 per year. At $1,300 per year they move into an escalating tax structure that reaches a marginal

rate of almost 58 percent at an income of only $2,500 (Reynolds 1985). Understandably, under this structure the returns on productive activity are very low, and the benefits from remaining in poverty are very high. What kind of wealth could one acquire under these circumstances? As McKean (1964, p. 243) has noted, "[T]he higher the cost of pursuing one objective, the less of it one will try to achieve." We would then anticipate that not only current activities but also the creation of future wealth would take the form of untaxed activities. We might expect, for example, to see emigration as a means to increase the return on intellectual capital in various forms. The net return on illegal activities—after discounting for the risk involved—would increase, and there would be less respect for the law. We might expect to find existing capital poorly cared for and maintained. All of this can be seen in Jamaica, and the effect on economic progress is obvious.

Economic growth means constant and pervasive change. Economic change results in continual re-evaluation of assets in which some people gain and some lose. A strong system of private property rights permits individuals to diversify the inevitable time-related risks by holding a variety of assets. This risk-reducing aspect of property rights can be particularly significant in societies where shifting risks to the government has become an accepted doctrine. Risk is inevitable in economic growth; learning to accept and plan for risk is another key to economic progress. Policies that discourage the emergence of various forms of insurance or the growth of futures markets will retard economic growth.

Restricted ownership of real property—as with land in many less developed countries—will cause a shift to investment in human capital. Schooling and certification will replace other productive activity. However, human capital has several disadvantages in this situation. Human capital normally has a finite life; it deteriorates in later years. It can only be passed on to others at a relatively high cost. If investment in human capital is undertaken voluntarily because the returns are higher than for any other form of property, the outcome will be to the benefit of the individual and society. If, however, people invest in human capital because they are not allowed to invest in other assets, or because the government has subsidized human capital, the benefits to both the individual and society are likely to be overestimated.

It must also be stated that foreign aid has no effect on the structure of property rights and is therefore largely irrelevant from the standpoint of economic growth. Foreign aid may, however, be used to sustain patterns of property rights inimical to economic growth. In

such cases aid can do substantial harm, as, for example, when it is used to keep alive otherwise failing cooperatives, government farms, and state production and credit institutions.[4] In this respect the World Bank and the international aid donors bear a heavy responsibility for various agricultural credit banks and marketing boards created for the administrative convenience of the lender or donor. World Bank loans to bus companies in Bombay and Tunis, for example, were required to be filtered through additional government institutions when they could have been made directly to the borrower.

Property Rights and Individual Responsibility

Outsiders—both domestic and foreign—have tended to concentrate on the role of positive incentives in the economic growth process. In several less successful societies it is clear, albeit surprising, that almost nobody is personally responsible for anything that goes wrong. Some collective entity is always at fault, and as a result little can be done to correct the situation. Since outside forces caused the problem, the usual recourse is to ask outside forces for help. In more successful societies, on the other hand, there is a sense of personal responsibility. No individual is responsible for every failure that occurs, but people are certainly responsible for those things that they own or have certain rights to use. Herein lies a fundamental aspect of economic growth.

Economists have long ignored the role of negative incentives and penalties in the overall economic learning process. Nevertheless, much of the discussion about capturing externalities is necessarily about the assignment of personal responsibility. Well-defined property rights tie people to the way assets are used. Ownership is an important factor in making people responsible for the outcome of their action or inaction. Furthermore, private ownership ensures in a way like nothing else can that people bear the costs of their actions.

People who own their assets—their intellectual skills or their land—will themselves have to bear the cost of their behavior in terms of the reduced value and productivity of their assets (Shlapentokh 1986). In this sense, with the erosion of the concept of property rights as a natural right, we have lost a great deal. With no personal ownership there is little personal responsibility for what happens, and even less incentive to cooperate with others for mutual benefit. This is the

[4]Peter Bauer's comments on the axiomatic support for subsidized cooperatives are peculiarly appropriate. The cooperative is nothing more than another form of enterprise in which ownership is structured in a way that people seldom choose voluntarily (Bauer 1968).

basis of the enigma so often observed by foreign visitors to the United States: social cohesion and cooperation among individuals is greater in societies based on individualism than in others based on collectivism. The urge to cooperate is seen formally in the formation of mutual insurance and futures markets. It is more easily seen in the multitude of mutual aid organizations, churches, and social clubs. The tendency to seek shared responsibility and joint protection from risk is important for economic growth, and it is not to be found on the same scale in North Korea or East Germany where ownership (and, therefore, responsibility) lies with the distant and impersonal state.

A free market economy in its operating form is not atomistic or anarchic. There are substantial incentives to cooperation in defining and enforcing limits to the use of private property and to sharing mutual risk. Externalities do exist, but they can frequently be internalized or eliminated through trade and mutually beneficial negotiation among property owners. Since such action would increase the value of each individual's property or it would not be undertaken, people will form cooperative arrangements for various purposes in protection of their property rights.

With private property, be it personal, intellectual, or business, there is a unity of purpose not existing with collective ownership. Self-interest and the profit motive are clear goals. Under these circumstances management is more effective than where property is collectively owned, and there may be a range of often conflicting objectives (Bryce 1960, p. 52). Effective private property rights do not only apply to large blocks of obvious property. The smallest entrepreneur—such as the shoeshine boy on the street in Nairobi—makes economic calculations at the margin and relies for his livelihood on a simple set of property rights and contracts (Elkan, Ryan, and Mukui 1982). It is reasonable to argue that secure private property rights are more valuable to the person who seeks to create wealth than to the existing rich—assuming the marginal unit of wealth is worth more to the person having less to start with. Ownership of trading licenses, permits, and other permissions to operate may be of vital significance to the small trader, as may access to a preferred spot in the marketplace. The way such assets are created and allocated has significant implications for economic growth.

Competition thrives where well-defined property rights exist. These might facilitate trade and create a wider range of owned assets with which to compete. Competition is the engine of economic growth and change for several reasons. It provides clearer criteria for the use of existing resources and drives the continuing search for new

resources. It propels the search for new and appropriate technologies and ways to do both complex and simple tasks. Finally, it rewards applied research and product development that are patently lacking in less developed countries. Competition also plays a beneficial social role. Since there is no wedge between seller and buyer, competition generates courtesy to and respect for customers and potential customers. In a competitive situation, customers have an alternative, in dealing with government they do not.

The Role of Failure in Economic Progress

I have already argued that private property rights define personal responsibility. Put another way, private property rights specify who may reap the rewards and who must bear the cost of failure. The cost of failure due to misfortune or irresponsible behavior cannot be shifted if property rights are well defined.

The entrepreneur has reemerged as the central figure in economic growth. We still have to overcome the widely held view that entrepreneurs are born with a special talent that cannot be learned or improved upon later. The image is, of course, false. Entrepreneurs learn their skill by interaction with their competitors and with their environment.

Few entrepreneurs succeed at the first attempt. They frequently assert that they have learned more from past failures than from any subsequent success. This message should not be lost on those who seek rapid economic growth. Failure is a necessary part of change, and it is a powerful teacher. Furthermore, there must be failures if an economy is growing and new activities are being introduced. It may be said of the less developed countries that they have avoided many small failures at the cost of some truly national ones. Their rulers do not seem to grasp that failure is a part of success. Nor do they appear to have noticed that a high proportion of all new businesses started in any given year in the United States, for example, will fail.

Given a well-defined system of private property rights, there is little to fear from failure. With sound and flexible bankruptcy laws, administered with due haste and at low cost, failure can be used to great advantage. Bankruptcy does not destroy assets; it releases them from one firm for use in another, and potentially more profitable, venture. Thus, bankruptcy eliminates mistakes quickly and allows new entrants to the business world a chance to seek success. It is in this sense that failure is the basis for ultimate success.

Because private property rights are partitionable and therefore can be widely held, business failures may appear dramatic; but their collective effect will be offset by their benefits to society. It is the lack of bankruptcy and business failure in the government sectors of the less developed nations that should be of greater concern. The cost to the economy of assets retained in less productive activities may be a luxury that a rich nation can afford; it may be disastrous to a poor country.

Business failures create flexibility for the introduction of new technologies and new institutional arrangements. The financial community can discover a whole new range of potential markets for its services in the process of failure and reconstruction. The lack of this mutual learning experience may be one of the factors causing the slow emergence of organized financial markets in less developed nations.

The Evolution of Property Rights

Much of modern development economics is devoid of institutional content. This is not true, however, of Peter Bauer's work, which is full of forthright demands that attention be paid to the institutional framework. Adam Smith carefully examined the alternatives of public and private ownership under various institutional arrangements (Clarkson 1975). The key to economic growth in this respect is that the institutional arrangements should be easily rearranged so that those that most readily capture new gains and exclude new losses will survive. Private property rights offer the greatest flexibility in this respect.

There is no conflict between the idea of assured ownership rights and flexibility as long as such rights can be freely divided, combined, exchanged, and traded. One of the most important functions for any government is the establishment and monitoring of an evolving legal system that facilitates trade in property rights. On one hand, technology continually changes the nature of property, making some assets more valuable and others less so. On the other hand, technology continually improves the ability to measure and control property so that it may be more effectively traded at lower cost. There is little of this process of evolution in the public sector and even less in those countries committed to socialist ownership (Demsetz 1967).

Additionally, demographic changes are inevitable during economic growth. Private property rights are a more effective adjustment mechanism than any administered scheme for redistribution of wealth. Widespread distribution of tradeable assets permits more flexible

provision for retirement by individuals than do fixed-age pension schemes. Both the United Kingdom and Chile have recently moved to provide private alternatives to a state monopoly of social security (Goodman 1983). There is every logical reason why this pattern should spread. It would reduce the burden on younger generations who support government pension schemes with their taxes. Also, as the role of women in society changes, a flexible system of private property rights is able to accommodate the acquisition and creation of wealth by new entrants better than any assurance of "public employment." Finally, where property rights have led to the establishment of active markets, there is greater pressure and opportunity for old elites to dispose of their assets and hence make way for new groups in society.

Creating a New Pattern of Property Rights

No nation starts with a clean slate. There is an existing pattern of property rights that is recognized as unsatisfactory by the very search for an alternative. The change from a collective or public ownership to private property rights can be undertaken in two ways. First, all new enterprises must be created on the basis of free and tradeable property rights. Second, the existing system of state enterprises and state ownership must be at least partially dismantled.

At the heart of the process of change must be a reform of the legal system. For economic success, there must be a judiciary that is responsive and evenhanded in adjudicating disputes over matters of contract law. The process of registration, licensing, and other forms of regulation must be streamlined so that all parties can be assured of quick decisions at the lowest possible cost. The appalling cost of overregulation and turgid legal systems is seldom realized. Outsiders rarely come into contact with the full scope of the regulatory and legal systems of Third World nations; the local people are accustomed to their environment and frequently do not realize that it could be improved. The work of Hernando De Soto in Peru, for example, revealed that it can take the equivalent of 289 work days, 81 meters of forms, and 8 overt bribes to legally establish a small clothing factory (O'Shaughnessy 1985). How much further need we go to find a key reason for economic stagnation? The governments of the Third World must undertake legal and regulatory reforms (Bauer and Yamey 1972).

Dismantling the present structure of collective ownership requires an active policy of privatization. Governments are currently producing and distributing goods and services that the private sector could handle more economically if allowed to compete. There is a growing

body of literature on privatization, and there are numerous historical examples of success.[5]

Privatization can take the form of donation to some existing group such as employees, or sale to the same group or the public. Whatever the method chosen, there will have to be considerable research and substantial involvement of the private sector in every case. Those who control the U.S. Agency for International Development must be given every credit and support for their newly announced policy of specific privatization goals. Their action is eagerly anticipated. This is, perhaps, another indication of the degree to which Peter Bauer's free market principles have prevailed in policy circles.

Conclusion

Private property rights focus individual responsibility for action or inaction. Furthermore, well-defined private property rights permit flexibility in the development process and allow for the rapid emergence of failures as they occur. Finally, private property rights increase the flexibility with which resources can be channeled into more productive activities and to new groups in society. Effective private property rights are essential to long-run economic growth.

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[5]Japan underwent a massive privatization phase during the reconstruction of its economy in the face of financial collapse during the late 1870s (Reishauer 1981, pp. 129ff). Modern examples from the United Kingdom and the United States abound (Pirie 1985; Roth 1985).

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THE ROLE OF PROPERTY RIGHTS IN DEVELOPMENT

Gabriel Roth

Alan Rufus Waters (1987) has written a perceptive paper on the importance of property rights in development, a subject ignored by many development economists, though never by Peter Bauer. One result of the neglect of this subject is the naive belief held by some economists that "administrated" prices (that is, prices equated to social costs as determined by the central planners) would enable socialist regimes to work and developing countries to develop. This approach may lead to an improvement in the allocation of existing resources—especially if the alternative is allocation by administrative edict—but, in the absence of clear property rights, is unlikely to stimulate the investment or economic growth found in those societies in which these rights are respected.

The importance of clear property rights may readily be illustrated by the effects of rent controls that reduce the rights of landlords to dispose of their properties in accordance with their own interests. Without exception (so far as I am aware), in every locality in which rent controls have been introduced the result has been the destruction of the market in rented property, with the resulting losses causing particular hardship to low-income landlords and would-be tenants. It is likely that the unavailability of rental housing in Europe inhibits labor mobility and is thus a significant factor in the high unemployment levels prevailing there.

As is to be expected, many blatant examples of losses associated with the lack of property rights are to be found where scarce resources are managed by government agencies. Examples of "government failure" associated with the mismanagement of public utilities abound,

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and not only in developing countries: residents of the Washington, D.C., area need go no further than National Airport to find a plum specimen. But the most widespread example is probably urban traffic congestion, which is generally regarded a "disease of civilization" but which also may be understood as a manifestation of the absence of property rights in urban road space.

Students of economics are taught that traffic congestion is an example of an "externality," whereby each user of the congested facility imposes costs on others for which no direct charge is made. They are also taught that the appropriate remedy is to charge each user the congestion costs imposed on others. Recent developments in solid state electronics now make it technically possible to impose and collect such charges, and the required equipment was recently tested in a pilot study in Hong Kong. But students are rarely taught that private ownership of roads could, at least in theory, bring about a similar result, if competitive road owners were allowed to charge road users profit-maximizing rents for the use of scarce road space. And, while the imposition of such charges could involve considerable technical difficulties, there are no such difficulties to prevent city authorities charging market-clearing rents for the use of parking meter spaces. I know of no city, however, where street parking is charged for at rates designed to ensure that casual parkers are able to find vacant spaces readily at all times in all areas. If the right to charge for street parking were privately owned, it is likely that the turnover at the meters would be maximized, and that society would be better off as a result.

The value of private property is, of course, closely related to the security of its ownership. Few farmers would bother to sow their crops if others had the power to reap them. Therefore, economic development may be expected to be closely related to the existence of "law and order" to protect property rights and thus permit long-term investment. It follows that governments that concentrate on providing goods and services instead of physical security penalize their citizenry not only by misdirecting economic resources through their own agents but also by failing to allow investment to be carried out by those most likely to do it successfully.

The significance of property rights does not appear to be fully appreciated even in the World Bank, which is considered by many to be at the "cutting edge" of development economics. For example, when its officials are asked why the bank does not do more to explore the role of the private sector in development, they respond that the Bank's concern is with "efficiency" and not with "ownership." It must be remembered that a significant number of the Bank's member

governments—including some of those in greatest need of aid—have yet to be convinced about the desirability of the private ownership of the means of production, distribution, and exchange, and of the best ways to move in that direction.

While it is understandable that World Bank staff like to assist any member government that requests help, some of us doubt the idea that "efficiency" in economic development can be usefully pursued without regard to property rights. Most will agree with Waters that the incentives associated with private ownership of productive capacity will tend to reduce costs and increase output. If a privately owned bus breaks down, the driver is likely to be out of pocket; if a publicly owned one breaks down, the driver may well get a holiday with pay. Which bus is likely to get the better maintenance?

But the more subtle point is that the very meaning of the word "efficiency" becomes unclear outside the context of a market economy, except when used in a mechanical and superficial sense. For example, transportation experts, who rarely use buses, will often tell you that buses are more efficient than cars for transporting people in cities, and that big buses are more efficient than small ones. Yet, in view of the revealed preference of many travelers for the high door-to-door speeds that are usually associated with small vehicles, it may be questioned whether it is possible to assess urban transportation efficiency unless both vehicles and road space are allocated in accordance with market principles. Or, to use another transportation example, some might consider it efficient that minibuses in Kuala Lumpur are so full that they carry standing passengers and make huge profits. But if this capacity shortage is due to the refusal of the authorities to allow additional buses to be provided, maybe it is a misuse of the word to regard the situation as "efficient."

There is a least one staff member of the World Bank who is on record as supporting the role of the private sector in development and as pointing out that this subject is probably the least discussed of all major development issues. I refer, of course, to the Bank's president, A. W. Clausen, and to his speech in London in February 1985. Yet much more remains to be done; rhetoric alone is not sufficient. I am delighted that the U.S. Agency for International Development is doing so much to articulate private sector policies and to present them to the world, as, for example, at the splendid privatization conference held in Washington, D.C., in February 1986.

The Cato Institute is to be congratulated on responding to Clausen's challenge, and Alan Rufus Waters's paper is an illuminating element of this response. I hope that the Bank's new president will use his influence to ensure that more light is shed on this subject,

and that the World Bank will not only explore the ways in which property rights can spur economic development, but that it also will use its capabilities in information dissemination to make the results of this work readily accessible to officials in all countries.

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