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Property rights are accepted as central to economic development. But Maitreesh Ghatak shows that property reforms alone cannot solve the problems of the poor who do not have any assets at all. He highlights the importance of financial sector reforms to make property rights effective, rather than nominal

Poor Man's Capitalism

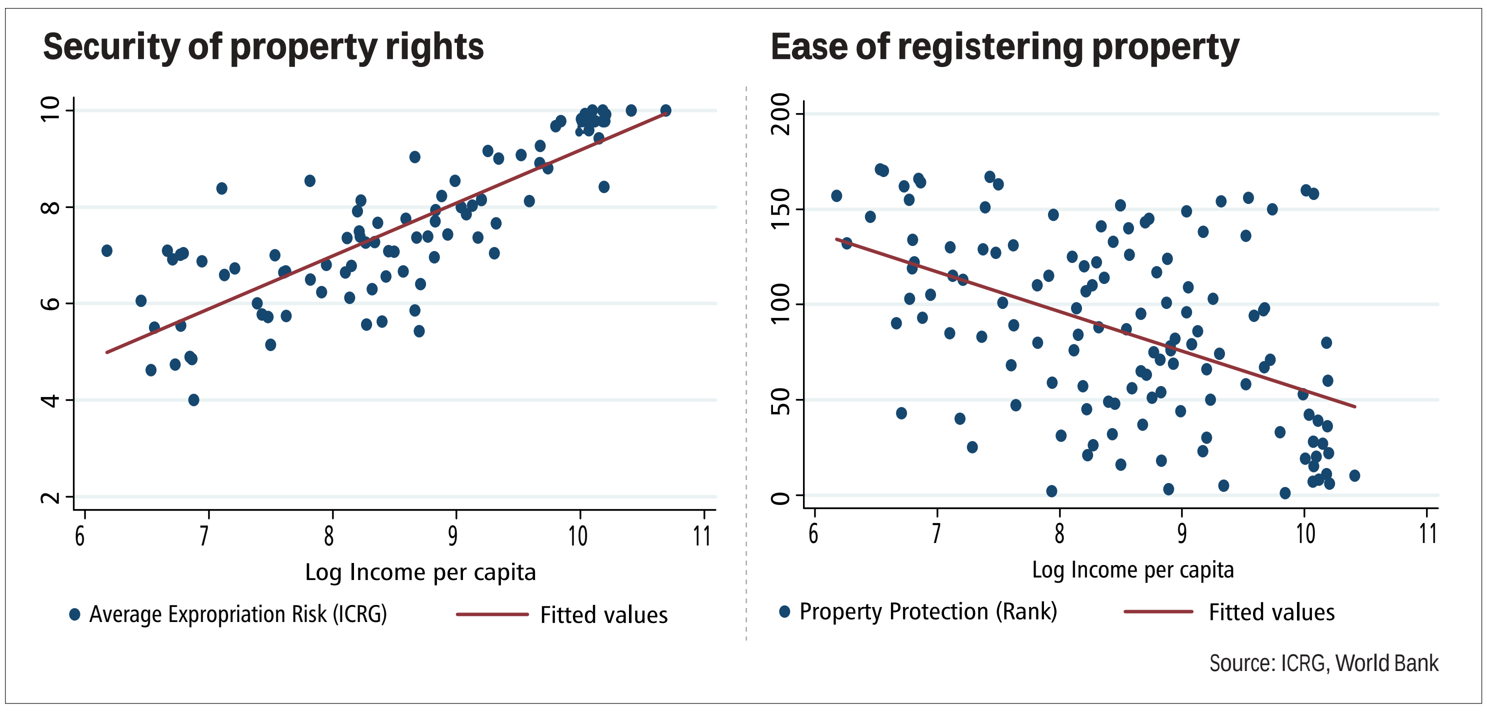
MAITREESH GHATAK

WHETHER they thought private property was *sine qua non* of a free society or organised theft, classical economists, from Adam Smith to Karl Marx, accorded a central position to the role of property rights or relations of production in the process of economic development. However, it is only recently that mainstream economics has come around to this point of view. The cheerful view of economists about the efficiency of competitive markets assumes that property rights are well-defined and well-enforced. Given this presumption, no wonder for a long time economists focused on savings and capital accumulation as keys to economic development.

There is no doubt that savings and capital accumulation are important for economic development. But there is no point telling a typhoid patient that eating vegetables and exercise are the keys to good health. Where property titles are ill-defined, where legal disputes takes decades to settle, where poor farmers or small businessmen face eviction threats, it is difficult to imagine how they can behave like textbook economic agents, namely, taking a long-run view, saving, investing, and climbing their ways out of poverty. Security of property rights therefore is of utmost importance.

The term property right refers to an owner's right to use a good or asset for consumption and/or income generation (referred to as "use rights"). This can also include the right to transfer it to another party, in the form of a sale, gift or bequest (referred to as "transfer rights"). A property right also typically conveys the right to contract with other parties by renting, pledging, or mortgaging a good or asset, or by allowing other parties to use it, for example, in an employment relationship.

By property rights, economists typically refer to private property rights, a key feature of which is being able to legally exclude others from using a good or asset. This affects resource allocation by shaping the incentives of individuals to carry out productive activities involving the use of the good or asset, undertake investments that maintain or enhance its value, and also, to trade or lease it for other uses.



A recent influential advocate of the importance of the link between property rights and economic efficiency is the Peruvian economist Hernando de Soto. According to him, what the poor lack is easy access to the property mechanisms that could legally fix the economic potential of their assets so that they could be used to produce, secure, or guarantee greater value in the expanded market. Therefore, even when they have some assets, it is "dead" not "live" capital.

Economists have emphasised four main aspects of how property rights affect economic activity. The first is expropriation risk—insecure property rights imply that individuals may fail to realise the fruits of their investment and efforts. Second, insecure property rights lead to costs that individuals have to incur to defend their property that, from the economic point of view, is unproductive. The third is failure to facilitate gains from trade—a productive economy requires that assets are used by those who can do so most productively and improvements in property rights facilitate this. In other words, they enable an asset's mobility as a factor of production (e.g., via a rental market). The fourth is the use of property in supporting other transactions. Modern market economies rely on collateral to support a variety of financial market transactions and improving property rights may increase productivity by enhancing such possibilities.

It is possible to take a bird's eye view of the quality of property rights using cross-country data. To illustrate, we take two measures of property rights regimes using standard sources. The first is a measure of the security of property rights from the International Country Risk Guide (ICRG). It is measured on a scale between 0 and 10. A higher score corresponds to better protection of property rights. Figure 1 shows that this score is positively correlated with income per capita in the year 2000. In other words, countries with a higher risk of expropriation have lower levels of income per capita.

The second measure comes from the World Bank's Doing Business project (www.doingbusiness.org). We focus on a measure of the ease with which individuals can register their property, specifically the country's rank on this measure for 172 countries. This is a purely administrative dimension to property rights and follows the logic of the de Soto argument. Figure 2 shows that this too is strongly negatively correlated with income per capita in 2000. Thus, this more administrative dimension of property rights is weaker in low-income countries.

Together these figures illustrate the central proposition that improving property rights is associated with economic development. However, they say nothing about the direction of causation. It is possible that economic development induces a switch to improved property rights as opposed to property rights facilitating economic development.

There are several micro-level studies that look directly at the question of whether secure property rights improve investment incentives, thereby facilitating income growth. Harvard economist Erica Field finds that property-titles issued in Peru starting in the mid-nineties led to a significant increase in labor supply by urban slum dwellers. She finds that residential investment also went up significantly.* In a related study with Maximo Torero, she looks at whether loan applicants are requested to provide collateral before and after titling. Their results indicate that property titles are associated with an increase in approval rates on public sector loans by as much as 12% when titles are requested by lenders.

In a related study, Sebastian Galiani and Ernesto Schargrodsky have looked at the collateral effect of property rights reform.** They look at a group of squatters who occupied an area of wasteland in the outskirts of Buenos Aires more than 20 years before the time of the study. The area was composed of different tracts of land, each with a different legal owner. An expropriation law was subsequently passed, ordering the transfer of the land from the original owners to the state in exchange for monetary compensation, with the purpose of entitling it to the squatters. They find significant effects on housing investment, household size, and child education. The quality of the houses is substantially higher in the titled parcels.

Galiani and Schargrodsky too only find modest effects on access to credit markets as a result of entitlement. Their conjecture is that this small effect could be driven by difficulty of foreclosure on default. Also, in most developing countries even the middle-level propertied classes do not find it easy to receive credit. Therefore, it is not surprising that the urban squatters did not experience a huge increase in credit supply. This underscores the importance of complementary reforms in the financial sector as well as legal reforms that make property rights effective, as opposed to purely nominal.

Interestingly, in a related study Galiani, Schargrodsky, and Rafael Di Tella studied the formation of beliefs using the same data set and find that lucky squatters who end up with legal titles report beliefs closer to those that favour the workings of a free market. To the extent these beliefs encourage effort and enterprise, this could be an additional channel through which property rights might affect productivity.

The upshot is measures to improve property rights are likely to help in the process of economic development through several channels. The attraction of this view is it's very decentralised: it relies on the enterprise of the poor and views them as dynamic entrepreneurs as opposed to passive recipients of government subsidies. However, many of the poor do not have any assets at all. For them, without some direct redistribution of assets, it is hard to see how property rights reform alone will solve any problems. The available evidence suggests that there should not be a "one size fits all" formula for reforming property rights, nor a blind faith that this is a magic bullet that will cure all economic ill.

* *"Entitled to Work: Urban Tenure Security and Labor Supply in Peru." Quarterly Journal of Economics, November, 2007*

** *"Property Rights for the Poor: Effects of Land Titling", Working Paper, University of Washington, St. Louis*

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DATA FROM The Economist

Overview

- There was more gloomy news on **industrial production:** in the year to the fourth quarter it fell by 10.3% in Hong Kong; in the year to January it was down by 19.2% in Germany, 16.7% in Italy and 11.1% in Mexico; and in the year to February it dropped by 11.2% in America and 13.2% in Russia.
- The **Federal Reserve** said it would buy up to $300 billion of longer-dated government bonds to help spur economic recovery. The yield on ten-year Treasuries soon dropped to 2.5%, having been above 3% a day earlier.
- Consumer prices in **America** rose by 0.5% in February. The annual inflation rate ticked up from zero to 0.2%. The core measure went up by 0.2% to be 1.8% higher than a year earlier.
- There were, however, signs that America's **construction** bust has bottomed out. New housing starts jumped by 22.2% in February. The number of permits to build new private homes also rose.
- America's **current-account deficit** narrowed to $132.8 billion (3.7% of GDP) in the fourth quarter, helped by cheaper oil imports.
- **Britain's** unemployment rate rose to 6.5% in the three months to January, up from 6% in the previous three months. The number of claims for unemployment benefits rose by 138,400 in February, the biggest monthly climb since records began in 1971.

The Economist commodity-price index

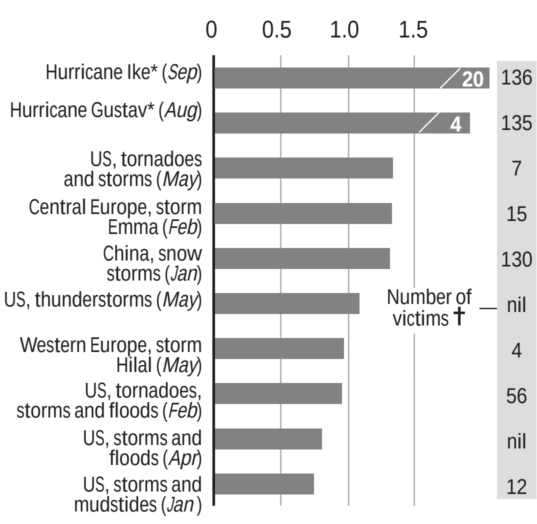
2000=100

	Mar 10rd	Mar 17th*	% change on one month	% change on one year
Dollar index				
All items	153.3	157.7	+1.6	-39.5
Food	178.7	184.4	+0.3	-29.3
Industrials				
All	120.6	123.2	+4.3	-52.6
Nfat†	104.9	107.1	-3.3	-43.9
Metals	129.1	132.0	+8.0	-55.7
Sterling index				
All items	168.0	170.6	+3.3	-12.7
Euro index				
All items	111.2	112.4	-1.5	-26.3
Gold				
$ per oz	894.20	916.80	-5.5	-8.8
West Texas Intermediate				
$ per barrel	45.71	48.97	+40.1	-55.2

*Provisional †Non-food agriculturals

Natural disasters

Biggest insurance losses, 2008, $bn (start date)

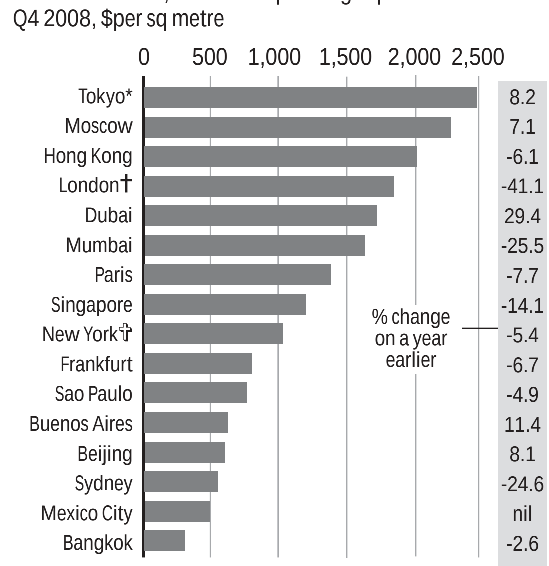


* United States, Caribbean, Gulf of Mexico, Haiti et al
†dead or missing
Source :Swiss Re

More than 240,000 people lost their lives to natural and man-made catastrophes last year, according to Swiss Re. The insurance firm puts the total cost of damages at $269 billion, less than a fifth of which was covered by insurance. Much of the $52 billion paid out by insurers was accounted for by the devastation caused by Ike and Gustav, two hurricanes that struck the Gulf of Mexico in August and September. Another two of the big insurance losses were for storms in Europe, but these claimed fewer lives than those in America. China's earthquake in May left almost 88,000 people dead or missing. The worst catastrophe was tropical cyclone Nargis in Myanmar, which claimed 140,000 victims.

Office rents

Total annual rent, taxes and operating expenses
Q4 2008, $per sq metre



* Inner Central † West End ‡Midtown
Source :CB Richard Ellis

Office rents in London, measured in dollars, fell by 41% in the year to the fourth quarter of 2008, according to CB Richard Ellis, a property firm. Around half of that drop reflects lower local charges for office space. The rest was down to a fall in sterling against the dollar. Almost all of Sydney's 25% decline in rents was because of a weaker Australian dollar. Rents in other rich cities, such as Frankfurt, New York and Paris, dropped by less. These places are already cheaper than Moscow. The rise in Tokyo rents makes it the most expensive city in the survey. All and more of the rise in charges was because of the yen's appreciation. Rents in Beijing were barely changed in yuan, but cost 8% more than a year earlier in dollars.

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn		Current-account balance latest 12 months, $bn		Current-account balance % of GDP 2008†	Currency units, per $ Mar 18th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-797.1	Jan	-673.3	Q4	-3.3	-	-	-13.7	0.37	2.53
Japan	+28.5	Jan	+143.3	Jan	+2.0	98.1	99.3	-5.6	0.56	1.31
China	+311.5	Feb	+400.7	Q2	+6.1	6.83	7.06	-3.6	1.24	3.21
Britain	-167.7	Jan	-45.6	Q3	-2.0	0.72	0.50	-11.3	1.90	3.11
Canada	+41.6	Jan	+11.3	Q4	-1.1	1.27	1.00	-2.4	0.42	2.86
Euro area	-46.4	Dec	-89.6	Dec	-0.8	0.76	0.64	-4.6	1.60	3.22
Austria	-2.4	Dec	+16.8	Q3	+1.6	0.76	0.64	-3.4	1.60	4.29
Belgium	+7.1	Dec	-8.2	Sep	+0.7	0.76	0.64	-3.6	1.62	4.14
France	-80.6	Jan	-56.8	Jan	-2.2	0.76	0.64	-5.4	1.60	3.77
Germany	+250.7	Jan	+224.3	Jan	+5.3	0.76	0.64	-3.9	1.60	3.22
Greece	-65.0	Dec	-51.2	Dec	-12.2	0.76	0.64	-4.8	1.60	5.73
Italy	-18.4	Jan	-72.9	Dec	-2.0	0.76	0.64	-4.3	1.60	4.53
Netherlands	+51.7	Jan	+67.6	Q3	+6.2	0.76	0.64	-1.3	1.60	3.79
Spain	-139.3	Dec	-154.5	Dec	-7.8	0.76	0.64	-7.4	1.60	4.01
Czech Republic	+3.8	Jan	-7.3	Jan	-2.3	20.6	16.3	-3.0	2.50	5.38
Denmark	+5.6	Dec	+6.8	Jan	+1.0	5.68	4.77	-2.0	3.24	3.86
Hungary	-0.4	Jan	-11.3	Q3	-3.7	231	164	-2.7	9.54	11.50
Norway	+73.7	Feb	+83.4	Q4	+10.9	6.73	5.15	10.6	3.27	4.02
Poland	-23.1	jan	-28.1	Jan	-4.9	3.49	2.26	-2.2	4.27	6.24
Russia	+170.8	Jan	+98.9	Q4	-3.3	34.5	23.6	-6.1	13.00	11.86
Sweden	+15.7	Jan	+40.3	Q4	+6.7	8.38	6.01	-3.3	0.30	2.96
Switzerland	+18.4	Feb	+40.3	Q3	+8.7	1.17	1.00	-1.7	0.41	1.88
Turkey	-65.7	Jan	-37.2	Jan	-3.4	1.72	1.23	-4.2	12.09	8.56‡
Australia	-1.0	Jan	-44.1	Q4	-5.3	1.52	1.09	-3.1	3.04	4.37
Hong Kong	-24.1	Jan	+26.4	Q3	+9.1	7.75	7.77	-4.5	0.92	1.97
India	-111.2	Jan	-28.5	Q3	-3.7	51.3	40.4	-7.2	4.57	7.25
Indonesia	+8.0	Jan	+0.6	Q4	+0.2	11,970	9,185	-2.9	9.38	1028‡
Malaysia	+42.2	Jan	+38.3	Q3	+7.8	3.68	3.18	-6.6	2.09	3.59‡
Pakistan	-19.7	Jan	-15.6	Q3	-5.8	80.5	62.9	-6.4	12.10	21.98‡
Singapore	+16.1	Jan	+27.1	Q4	+15.4	1.53	1.38	-4.1	0.65	2.10
South Korea	-8.5	Feb	-5.0	Jan	+1.2	1,421	1,009	-3.5	2.42	4.81
Taiwan	+6.3	Feb	+25.0	Q4	+7.9	34.1	30.7	-5.0	0.90	1.34
Thailand	+1.7	Jan	-1.3	Jan	+1.4	35.8	31.2	-4.7	1.82	2.94
Argentina	+12.8	Jan	+9.0	Q3	-0.5	3.65	3.15	-0.8	14.50	na
Brazil	+24.2	Feb	-27.0	Jan	-2.2	2.30	1.70	-1.5	11.16	6.16‡
Chile	+7.6	Feb	-3.4	Q4	-3.4	592	439	-3.5	3.36	3.79‡
Colombia	+2.1	Feb	-5.3	Q3	-4.0	2,389	1,823	-3.3	8.34	7.03‡
Mexico	-16.6	Jan	-2.4	Q4	-3.4	14.1	10.7	-3.2	7.18	8.37
Venezuela	+39.2	Q4	+39.2	Q4	+0.2	6.14	4.20§	-5.2	17.01	6.55‡
Egypt	-25.2	Q3	+0.1	Q3	-1.0	5.63	5.48	-7.1	10.52	4.16‡
Israel	-12.8	Feb	+2.6	Q3	+1.9	4.14	3.38	-5.0	0.55	3.53
Saudi Arabia	+150.8	2007	+95.0	2007	+7.9	3.75	3.75	-8.0	1.15	na
South Africa	-8.7	Jan	-23.2	Q3	-7.0	9.94	8.00	-3.3	9.15	8.22

*Merchandise trade only. ‡Dollar-denominated bonds. § Unofficial exchange rate.