

Institutions, Property Rights and their Impact on the Poor

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Institutions are the formal and informal rules that determine economic incentives, and proper incentives increase economic growth.

The set of property rights are the most important institution of a society for economic growth and the ability of the poor to ascend the economic ladder.

A full specification of property rights includes:

- Right to use an asset, provided it does not interfere with the rights of others.
- Right to derive income from the asset, including rental income.
- Right to sell an asset
- Right to bequeath an asset
- Right to exclude others from using the asset
- Can be held privately or collectively or in the semi-commons

This full set of rights typically comes with either formal or informal restrictions. For example, I may have the right to own a gun for the purposes of hunting but I do not have the right to shoot my neighbor. Informal restrictions or norms of behavior abound. For example, in many neighborhoods landowners allow trespass over their land.

Enforcement of Property Rights ¹

Property rights are only useful if they are enforced.

- ? Government – typically defines and enforces formal property rights. Governments specify the rights, obligations and enforcement mechanisms for titles to assets.

In democracies legislative bodies along with the executive specify rights. The judicial branch adjudicates disputes. The police power of the state enforces formal property rights in the event of transgression.

- ? Private Citizens

Private Citizens also take measures to defend their rights, e.g., locks and occupation

- ? Third Party enforcement

Social norms through ostracism also enforce rights. This mechanism works best in homogenous societies.

¹ For the role of the state in specifying and enforcing property rights, see Alston and Mueller (2004).

Why Do Property Rights Matter?

- Incentive to retain value of asset
 - Security of present return from asset
- Incentive to invest
 - Security of future returns from asset
- Ability to invest
 - Collateral
- Ability to sell establishes market prices
 - Resources flow to highest value use

For the poor I want to particularly stress the importance of using assets for collateral. This implies that debt can be a mechanism for improving welfare. The best example is the use of home mortgages. In the absence of a mortgage people would have to wait until they had saved sufficient income to pay cash for their homes. For many this means that they might never own a home. Home ownership not only raises the consumption of the poor but raises the value of the asset because society dispenses with the costly monitoring of landlords.

Private Property Rights, Prices and Trade

- Establish “true” prices
- Prices signal present and future values
- Consumers response to “high” prices: conservation and substitution
- Producers response to “high” prices: new technologies
- Private property rights provide the incentives and trade the mechanism for economic growth

Transparent formal property rights lead to economic growth overall for societies but may disproportionately enhance the livelihood of the lower classes.

Property Rights and the Poor: Enforcement

- Formal (i.e., governmental) enforcement of property rights benefits the poor more than the rich– the problem is that the rights of the poor are not generally enforced as much as the property rights for the rich.
 - Poor face a budget constraint, e.g. they can not hire private police
 - In most countries the government enforces property rights more for the rich than the poor. This is an empirical question. Poor neighborhoods have more burglaries, and murder per capita than rich neighborhoods. Though many poor stand to gain more than the rich from theft, the vast majority of the poor would gain if property rights were better enforced.
 - In developing countries the poor spend a considerable amount of time enforcing their property rights because the enforcement by governments is weak.

- In both rural and urban areas squatters' norms are contingent on the degree of homogeneity of the squatters. Where squatters' rights are secure, enforcement costs are minimal. This is what we found for the Amazon (more on this below) but in urban areas there is more a norm of: “occupy and use it or lose it.”
- If government enforces formal property rights the poor can spend less of their own time enforcing claims. The result is that the poor can spend more time in the labor force, and their children spend more time in school.

Erica Field, found that title reform increased hours of work for the poor by a net 16 hours a week. This is a 17% increase. She based her study on a sample of 2,750 households in eight Peruvian cities in 2000. She argues that areas that had title reform versus those that did not were very similar in terms of poverty, access to electricity and sewage, and literacy. Child labor also fell enabling children to devote more time to school: in neighborhoods where the government introduced title reform children worked 27% less than in neighborhoods without title reform.²

Property Rights and the Poor: Investment in Physical Capital

– property rights give the poor both an incentive and a mechanism (collateral) for investment.

If this is true we should observe that squatters should perceive that otherwise similar land is more valuable. We should also observe squatters exerting effort to strengthen their claims and petition government for formal titles.

Evidence:

In 1992 and 1993 Lee Alston, Gary Libecap and Robert Schneider conducted surveys of smallholders in the Brazilian Amazonian state of Para. Based on 249 surveys the characteristics of the households were³:

Percentage with title: 56%

Percentage with sales receipt indicating the occupant paid cash to another squatter: 12%

Percentage with no documentation: 32%

Average area: 109 hectares

Percentage area cleared of forest: 40%

Percentage in pasture: 38%

Percentage in permanent crops: 7%

Average years of education: 2

Average age: 43

Average time on plot: 8 years

Average number of migrations: 3

Perception of increase value of having a title;

For a subset of our households in the area near Tucuma, we asked “How much is your land worth now?” and “How much would it be worth if you had a definitive title” On average our settlers perceived that having a definitive title compared to a provisional

² For more details see Field (2002)

³ For more elaboration, see Alston, Lee J., Gary D. Libecap and Bernardo Mueller (1999b).

military title, sales receipt or nothing, would increase the value of their land by US\$35 per hectare or 36%.⁴

Given the perceived increase in value we would expect that settlers would exert effort to secure definitive titles. We asked 88 settlers in Tucuma, Nova Alianca and Colonia Reunidas what efforts they undertook regularly to maintain their claims and they reported as follows :

1. Keeping the boundaries clear was the most frequent response. 71 reported that they did so and spent approximately 6 days a year doing so.
2. 8 settlers with sales receipts got them notarized.
3. one settler paid land taxes which is very rare, even for people with definitive title.
4. some settlers hired a topographer to provide a map of their borders
5. some settlers built markers on their boundaries
6. many settlers went to offices of INCRA, the government agency responsible for titling, to petition for titling. These trips cost at least a day's worth of work.
7. in the colony of Nova Allianca the settlers paid for an emissary to travel to Belem, the capital of the state of Para and to Brasilia the federal capital to petition the government to hasten the titling process.

These efforts represent investments. We estimated the dollar value (1992 \$) of the efforts to secure titles of seven settlers in Tucuma. We valued their time at US\$2/per day, this is a low threshold level for unskilled wages at the time. Collectively these seven settlers expended US \$188 to firm their property rights. If they had succeeded in getting a title the perceived collective increase in land value was U.S. \$10,800. Even if it takes years to get a title, which it often does, the payoff is large.

- The rich do not need collateral as much as poor because they can pay cash for assets.
- Formal specification and enforcement of property rights by government enables the poor to invest more and spend less time and money enforcing their own claims.

Evidence:

We used the household responses of 249 settlers to estimate the impact of having a title on investment, (proxied by land devoted to pasture, requiring costly fencing, and permanent crops.) The impacts varied across our sites. Controlling for a host of individual characteristics we can estimate the % of total farmland representing investments for those with and without a title. The results across our sites follow:

⁴ See Alston Libecap and Mueller (1999b): 111-112.

% Acreage devoted to pasture or permanent crops

| | Without a Title | With a title |
|-----------|-----------------|--------------|
| Altamira | 26% | 55% |
| Sao Felix | 7% | 28% |
| Tailandia | 12% | 33% |
| Tucuma | 32% | 80% |

These represent large investments in materials, effort and patience (in the case of tree crops). Of those who had pasture the mean level of fencing was 1,181 meters which represents about an investment of U.S. \$550.

Controlling for investment having a title increased land values over and above the increases investment. Why? Settlers had to expend less time enforcing their own claims and it increases the extent of the market for their land. For example, most investors in Sao Paulo or Rio de Janeiro would only buy titled land. The increased value of a title is greater for land that is closer to a market center. For land at the market center our estimates indicate that a title would increase land values by 189%. For land that is 40 kilometers from the market, land would increase by 72% with a title; and for land 140 kilometers from a market land values would increase by 45%. These estimates make sense because titled land closer to a market should have a greater value due to increased competition for the land.

Property Rights and the Poor: Investment in Human Capital

- mortgage markets for real estate enables investments in human capital
 - Today many parents refinance homes in order to defray costs of education for their children.
- “mortgaging” labor for investment: indentured servant contracts
 - The U.S. got off to a good start in the 18th century in part because of indentured servitude.
 - Close to 70% of free immigrants came to the colonies of Britain as indentured servants.⁵ An indentured servant had the right to sell his future labor in return for a boat trip to the colonies. In the absence of this property right we would have had fewer immigrants who overtime increased the number of middle class farmers in the colonies in North America. The cost of passage was more than the gross

⁵ See Galenson (1981).

salary of low income potential migrants. It would have been impossible for the poor to save enough to migrate and, if they heroically did, by the time they saved enough they would be at an age where the investment would have a much lower return.

- Cost of passage during peacetime – first half of 18th century – about 5 lbs sterling
 - Cost of passage during wartime – second half of 18th century – 8-10 lbs sterling
 - Wages in England: for English servants in husbandry 6-7 lbs⁶
- Result: immigration of the poor to British colonies that allowed indentured contracts greatly exceeded immigration to Portuguese and Spanish colonies where indentured contracts did not exist.

• Restricting Property Rights Hurts the Poor

- In agriculture it was historically the case in the Western world that rental markets were an important way to acquire the physical and human capital required for ownership. Based on a sample of black farmers in Arkansas in 1938, Alston and Ferrie (2005) estimated the percentage of farmers who started as wage workers, sharecroppers or tenants and ended up as owners: 25% ultimately became owners. The characteristics of the sample of Arkansas black farmers are very similar to black farmers in the cotton south. We also have evidence from earlier years indicating the same type of economic ascension up the “Agricultural Ladder.” For example, the 1880 census indicates that about 25% of black farmers in the South owned the farms that they operated. This is remarkable given that freedom was only 15 years prior.
- Historically for developing countries rental markets in agriculture were as prevalent as in North America yet rental markets have declined in importance in most Latin American countries over the past several decades. Evidence follows on the use of rentals in selected countries in the Americas.

Percentage of Agricultural Farmland or Farms Rented for Selected Countries in the Americas⁷

North America

| | |
|---------------|------------------------|
| Canada | 37% of farmland |
| U.S. | 41% of farmland |

Latin America

| | |
|-------------------------|-----------------------|
| Argentina (1988) | 5% of farmland |
| Bolivia (1984) | 2% of farms |

⁶ The figures for cost of passage and wages came from personal correspondence from Professor Farley Grubb at the University of Delaware, a noted expert on indentured servitude.

⁷ Source: de Janvry, Macours and Sadoulet (2002)

| | |
|----------------------------------|-----------------------|
| Brazil (1995) | 12% of farms |
| Chile (1976) | 7% of farms |
| Dominican Republic (1998) | 7% of farms |
| Honduras (1993) | 3% of farmland |
| Mexico (1991) | 1% of farmland |
| Venezuela (1997) | 2% of farmland |

- In much of rural Latin America, it is difficult to evict renters. The result is that landowners are afraid to rent and the number of landless peasants increases. Landowners may be afraid to rent not only because they can not evict but because land reform agencies may see them as a target for expropriation.

- ? In urban areas it is also difficult to evict tenants who are delinquent in their rental payment. Renters in essence pay a litigation risk premium which covers the landlord for those who do not pay. Gustavo Rangel (2000) estimated that the litigation risk premium in Rio de Janeiro is R\$1,800 per year on an apartment valued at R\$50,000. This is a big city premium where landlords have to engage in costly litigation compared to small cities who can use the informal sanctioning of threatening to print the names of those in default in the newspapers.

Land Reform in South America

Experiences in South America

- Peru and Bolivia – Giving land to highland peasants with the proviso that they could not sell their land has led to the disappearance of formal capital markets. Glave (1992) found that the poor had faced high credit costs for seeds, fertilizers and transport to markets because their land could not be used for collateral. Keating (1998) argues convincingly that in Bolivia following the 1953 Agrarian Reform Law landholders reduced capital investments because of insecurity in property rights and poverty increased in regions where land reform took place.

- Land Reform in Brazil

- In the 1980s and 1990s Brazil relied on expropriations for land redistribution

Results:

- 1) Violence over land in an effort to prevent (by landowners) and increase (by landless) expropriations

- 2) Premature deforestation in an effort to demonstrate use in order to prevent expropriation

- Barrantes (1992) also found premature deforestation for the Peruvian Amazon as means to capture property rights.

- 3) Labor effort devoted to redistribution rather than production is harmful for economic growth

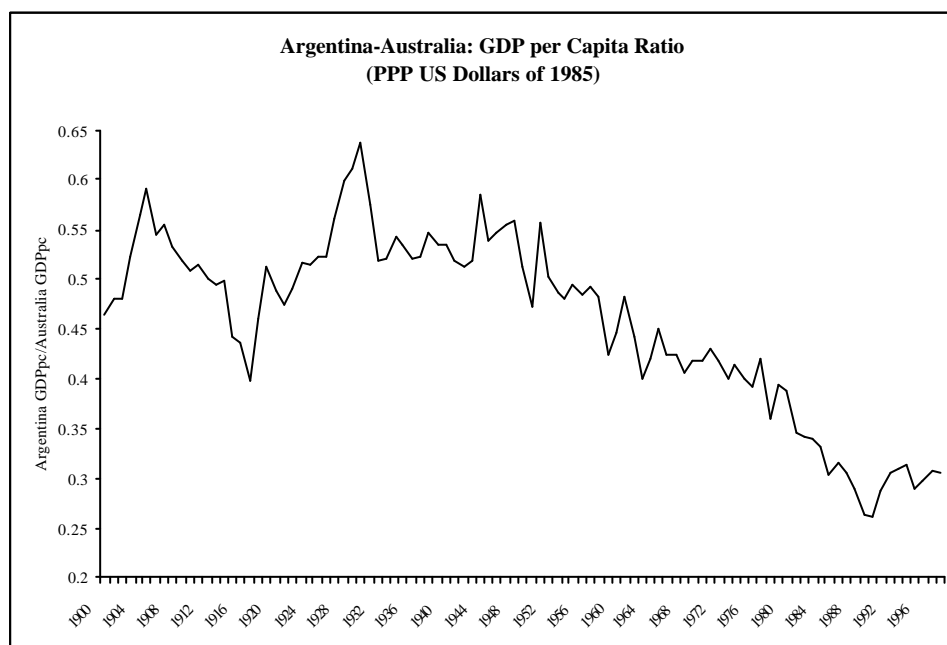
Property Rights and the Poor: Consumption

- The ability to mortgage assets enables the poor to smooth out their consumption stream leading to higher utility
- With a mortgage market the poor would have to wait until they had cash in order to buy a house
- “Owning” a house promotes better stewardship and increases values

The Abridgement of Property Rights in Argentina⁸

- In the early 20th Century Argentina had a per capita standard of living of roughly 60% of Australia which was the world’s richest country per capita at the end of the 19th century. Argentina placed in the top ten in the world in per capita income.
- In both cases growth resulted from agricultural exports
- The administration of Juan Peron in the 1940s put Argentina on a trajectory from which it never recovered. He controlled the prices of wheat and cattle, the major exports, as well as controlled the rents paid by tenants. Agricultural investment declined as did long-run economic growth
- Below is evidence showing the break point between Argentina and Australia in economic growth.

Graph 1



Source: Gallo (2003)

⁸ For further elaboration see Alston and Gallo (December 2005).

? As you can see, the relative income of Argentina to Australia peaked in 1930 which was the date of the first military coup in Argentina. The military coup set in motion an abandonment of the rule of law upholding property rights. The military handed over the control of government to conservatives who stayed in power through fraudulent elections. The decade of fraud eroded a belief in the rule of law which upheld property rights. Instead the population increasing supported populism which brought Peron to power. As President, one of Peron's first measures was to initiate proceedings impeaching all but one of the Supreme Court Justices. Since then, all but two administrations impeached Supreme Court Justices, forced resignations of Justices or added Justices.⁹ The result has been institutional volatility and volatility in economic growth. Again, this should be viewed in comparison to Australia whose endowment was very similar. Abandoning the rule of law that maintained property rights can best account for the difference in the growth trajectories.

Concluding Remarks:

Capitalism rests on a set of institutions that generates economic growth. The most fundamental institutions are the set of property rights in a society. Not only are secure property rights fundamental for economic growth but, as the examples that I have given illustrate, secure property rights defined and enforced by government enable many of the poor to ascend the economic hierarchy.

⁹ In the most recent election of 2003 there was another movement to impeach the court. In a poll from the first week of June over 80% of the respondents wanted all or some of the Supreme Court Justices to resign.

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