Private Rights to Property

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Private Versus Public Property Rights

> Because a market economy tends to generate a spirit of self-reliance rather than dependency, . . . an authoritarian regime will never have more that a tentative and pragmatic commitment to economic freedom.
> Anonymous

Governments expand their powers both by physical force and by undermining private rights to property. In many respects it is easier to constrain government from abusing its powers of physical force than it is to constrain it from usurping property rights. Because use of physical force often is dramatic and sensational, it captures the attention of news media which bring the event into every home for public scrutiny. This acts as an effective deterrent.

The gathering of state power through changes in the structure of property rights is much more difficult to control. Being gradual and piecemeal, each series of events captures the attention of only those directly affected. Because the interests of property owners are diverse and diffused, there is typically no broad-based effort to counteract policies or programs that attenuate the property rights of small groups. Because the ultimate effects of constraining private property rights are often so far removed in time from the actual event, the cause-and-effect relationship is not seen or understood. Indeed, the price of freedom is eternal vigilance.

British historian Paul Johnson says there are basically two ways to transfer property rights from private to public control. The first is by direct assault--nationalization. The second is by "slow starvation"--government regulation, legal harassment or taxation. In democratic societies, nationalization is used only rarely, probably, writes Johnson, because "it allows the public to make comparisons between the performance of the nationalized sector and that of the free sector which is nearly always to the latter's advantage." (See end note #1) It is much more common to accomplish the transfer of resources from private to public use in a gradual, piecemeal fashion--slow starvation of the private sector. This has been the experience in the United States during the past half century and continues to be present-day reality. As evidence, note that in 1929, government (all levels) expenditures as a proportion of national income were only 10 percent. By 1984 this had grown to more than 40 percent.

Examples illustrate how government influences economic behavior and the use of resources by restructuring property rights.

Rent Controls

Controlling housing rental rates is a classic example of the erosion of private property rights. Traditional rent controls specify a maximum rent that property owners legally may charge for use of their dwelling. Further, tenants typically are prohibited from subleasing at rates above the rent ceiling. The effects are diverse and far reaching, and many are unseen by the casual observer. At the most fundamental level, however, rent controls represent a transfer of the rights of property from the property owners to tenants, both present and future.

Throughout the history of the United States, rent controls have been rare. Normally, residential rents have been set by market supply and demand. Controls were first introduced during World War I but lifted quickly after the armistice. They were adopted again during World War II but largely disappeared by 1952. The first major peacetime use of rent controls was during the general wage-price controls of 1971-74. The most notable exception to the history of rent controls is New York City where controls have been in force since World War II.

Inflation in the 1970s revived interest in rent controls. Rising prices for fuel, maintenance, materials and capital and a growing demand for rental housing as home ownership became more expensive raised rents dramatically. Angry tenants, who consider the higher rents unjustified and who view property owners as unscrupulous profiteers, have succeeded in establishing some type of rent controls in more than 200 communities.

Because rent is simply a special name given to the price of housing services, rent control is a special case of price control. It is an attempt to set price without regard for the supply and demand for housing services. Do rent controls help tenants? On this the evidence is clear: in the short run cement tenants benefit at the expense of property owners, but in the long run both tenants and owners are worse off.

Rent controls in effect are a tax on property owners and a subsidy to tenants. Owners receive less than full market value in rents and tenants pay rents below market value. This is a classic case of wealth transfer by government. It is not surprising then to find existing tenants as leading advocates of controls. Over time, however, other developments work to the disadvantage of tenants and especially future would-be tenants. Because controls reduce the rate of return on investment in rental housing, builders are discouraged from constructing new units.

Some recent controls have sought to avoid this problem by exempting newly constructed units from regulation. This can hardly be encouraging to prospective builders. After all, what the government has done to property rights in today's existing housing may be done to property rights in tomorrow's existing housing. Instead of increasing the supply of rental housing to match the increasing demand brought on by inflation, the controls exacerbate the problem by taking away owner wealth and creating uncertainty among would-be suppliers of rental housing. As evidence of the power of controls to stifle supply, note that in France there was almost no new residential construction under controls from 1914 to 1948.

Even the current supply of rental housing is affected by controls. If rents cannot keep pace with operating costs, maintenance will be curtailed. While nominal rents may be kept constant by controls, effective rents rise as quality declines. Eventually the quality of rental housing will be brought in line with the controlled price. As experience reveals, if owners are unable to cover their direct operating costs, units will be allowed to deteriorate to the point of being uninhabitable and eventually abandoned. In New York City an estimated 30,000 units are abandoned annually.

Controlling rents also results in inefficient use of existing units. Because controls favor existing tenants, they are reluctant to move and occupy other units as their space needs change. For example, couples whose children grow up and move out may continue to occupy larger units than they would otherwise, while younger, growing families are crowded into smaller units.

Controls have other effects on tenants, even in the short run. Controls promote black-market transactions and discrimination. People who value rental housing highly but who are unable to find it will seek methods to induce owners to rent to them instead of others. These methods may involve cash bribes, but probably they will take the form of prepayment of rent, large unrefundable damage deposits or an agreement to purchase the owner's furniture at exorbitant prices. Because price no longer serves to allocate space among competing tenants, owners rely more heavily on nonmonetary devices for choosing tenants. They naturally can be expected to favor those who appeal to their own prejudices and to discriminate against those whose characteristics they regard as undesirable. The undesirables typically include members of minorities, families with children or pets, unmarried couples and students. The effect is to accentuate the importance of an individual's undesirable (from the viewpoint of the owner) characteristics.

Clearly rent control is a poor way to cope with rising rents and a perverse way to induce more housing. If the objective is to subsidize low income families to assure access to adequate housing, the problem is income, not housing, and the solution is to raise their incomes. This is a problem for society at large, not one that should be shouldered by housing owners alone through the conscription of property and the transfer of wealth. On the other hand, if the problem is an inadequate supply of rental housing, the solution is to induce more, not less, existing housing space to be rented and to induce more, not less, construction of new units.

Proponents of rent controls often argue that controls are necessary to ensure that human rights prevail over property rights. But property has no rights. Only people have rights. The dispute is not between the building and the tenants, it is between the building's owner and the tenants. The issue is over whether owners will be allowed to use their property as they wish or whether the tenants will be able to use someone else's property as they wish.

Private Versus Public Lands

Although the institution of private property plays a central role in the American economy, that is not to suggest that government owns no property. Indeed, the federal government is the largest single property owner in the world. Of all its property holdings perhaps most startling and controversial is its ownership of land--one-third (760 million acres) of the nation's total land mass. On a state-by-state basis its ownership is even more pronounced--more than 90 percent in Alaska, 88 percent in Nevada and more than 60 percent in Utah and Idaho. Overall, the federal government owns nearly 50 percent of the western states. In contrast, only 4 percent of land in the northeast and north central states is owned by the federal government.

Opinion is sharply divided over whether the government owns too little or too much land. On one side are the environmental and conservation groups who argue for expanded governmental ownership and control in the belief that it will put the land to better use. On the other side are those who believe that much of this land should be sold to private owners or at least made available to private industry for purposes of putting it to its best use by developing energy and mineral resources or whatever market values dictate.

The former groups claim that it would be unconscionable to place these lands in the care of greedy business people, for they would rape and plunder the landscape for profit just as they did our rivers, lakes and air. The resulting despoliation of the environment and the degradation of the wilderness must not be allowed. The protection of our national heritage demands expanded government ownership to keep these lands in public trust for the public interest.

Those who advocate the divestiture of public lands counter that environmental groups ignore the costs to society from government mismanagement and from not allowing development of the rich resources embodied in these lands. These costs include less employment in communities near the resources, higher prices for energy and mineral resources, less economic growth, lower tax revenues, lower profits, greater dependence on foreign sources for strategic materials and outright waste of the resources.

Because of the context of this dispute, it may seem to be an unusual problem that requires a special solution. Stripped of its emotions, however, the dispute is no more than the everyday problem of resolving how to allocate scarce resources among competing uses. When resources are scarce and different people want to use the same resources simultaneously for different purposes, choices must be made. Fundamentally, this problem is the same as deciding how much land should be used for commercial purposes, how much for residential purposes and how much for agriculture. It is no different from deciding how much of the nation's steel is to be used to produce automobiles, buildings, airplanes and refrigerators or how timber resources are to be allocated among housing, furniture and paper.

What would be the probable outcome if title to western lands were transferred to private owners? Our discussion about the connection between the structure of property rights and economic behavior is helpful in thinking about this. Suppose that the federal government declared that at noon tomorrow all public lands in the western states will be transferred to private owners by a lottery in which all U.S. citizens age 18 or older have an equal probability of their name being drawn. Each new owner will have fee simple title and all the rights to use, enjoy and transfer these lands that accompany such title. Because it is not important to this mental exercise, we are not concerned about the number or size of the land parcels to be given away. Neither is it significant that this transfer will represent a windfall gain to some citizens without compensation to the treasury. Our concern is only with the probable uses of these lands and whether or not the worst fears of the public-lands advocates may be realized.

So as not to leave to chance whether the interests of environmental and conservation groups are represented among the new landowners, let us further suppose that before any land is given away to the general public, qualified groups such as the Sierra Club and the Wilderness Society first will be allowed to select any 25 percent of these lands to which they will be given title. (See end noted #2)

Now that ownership is in the hands of private citizens, what reasonably can be expected to happen to these lands? To answer this, let us put ourselves in the shoes of the new owner-environmentalists. It seems reasonable to assume that these people are not much different from others. Their preferences about how natural resources should be used may be a bit more intense in one direction than another, but they can be expected to respond to incentives, and they now face a different set of incentives than before.

Prior to ownership of these lands, environmentalists could advocate that additional lands be designated wilderness areas without having to be concerned about the costs that others incur as a result of precluding any other uses of this land. In other words, the incentive structure was such that if one million acres of wilderness could have produced several million barrels of oil or board feet of lumber, the cost of this sacrifice (lower oil or lumber prices, more employment, foregone profits) is borne almost entirely by others. Only benefits from additional wilderness needed to be considered under the old system of incentives.

Now, however, with ownership of these lands in the hands of environmental groups, they face a very different set of incentives. If their lands include valuable mineral deposits, they will have to bear the costs of non-development. Income sacrificed by non-development will represent a real cost in terms of other objectives that such income might have made possible. Among such objectives might be the acquisition of additional lands for wilderness purposes. Environmentalists will be forced to consider both costs and benefits of their land-use decisions. They will use their land only in ways that allow their perceived benefits (however defined) to exceed their perceived costs. Because these lands are now freely transferable among all citizens, the environmental groups will be compelled to include in their own calculation of cost the values that others place upon their lands. These lands will be held and used by the environmentalists only if the value in its current use is greater than its value to others. If the land is more valuable to others, environmentalists will be better off by selling the land.

Will the development of mineral resources mean a desecration of the landscape? There is no question that the extraction of mineral resources will involve some changes in the landscape. This is inevitable just because of the nature of the activity. But is it likely that it will be a careless raping as some would have us believe? To answer this question, imagine yourself to be one of the lucky new owners of a mineral-rich piece of wilderness. What will guide your decisions as to how this land will be used? Even if you hate the wilderness, despise camping and hiking and are allergic to pine trees, will it be rational for you to ignore the fact that others have great love for the wilderness and place a high value upon it? Of course not. Still, if mineral resource developers are bidding for access to your lands, you must weigh the value of your land in these alternative uses. You recognize that once the minerals are extracted the miners will leave and then the next best use of the land may be in its wilderness state. What do you do? We cannot know for sure, but we can be confident that you will be concerned about the long-as well as the short-run value of your land. A not unlikely outcome is that you will allow some of the minerals to be extracted, but you will require that extraction methods minimize damage to the landscape. If would-be extractors want access to your land, they will have a vested interest in finding production methods that are not only cost-effective but also environmentally protective.

We probably will find that the alleged incompatibility between resource development and environmental considerations is greatly exaggerated. In fact, several examples suggest this. One illustration of compatibility exists at the Audubon Society's Rainey Wildlife Sanctuary in Louisiana. Here oil and gas wells reside harmoniously with migrating geese, nutria, mink, armadillo and alligators. Part of the land is leased to private interests for cattle grazing. Audubon openly acknowledges the potential of damage from pollution, yet explains that "experience in the past few decades indicates that oil can be extracted without measurable damage to the marsh. Extra precautions to prevent pollution have proven effective." (See end note #3) The Society collects nearly $1 million per year in royalties from the three oil companies operating the wells. Baden and Stroup conclude:

Under these circumstances, as opposed to public ownership, the wilderness groups [are] forced by self-interest to consider the opportunity cost of total non-development. Further, rather than resolutely opposing the extraction of any commercially valuable resources from the land, they focus on obtaining these resources while maintaining to the optimal degree the wilderness character of the area. (See end note #4)

Of course, it should not be claimed that the free-market, private property economy will allocate resources perfectly. Likewise, it is not realistic to expect that the management of resources by government will yield optimal results. We must ask: Which system is most likely to manage resources most efficiently or, alternatively, least inefficiently? We cannot provide a definitive answer here, but because people are continually bombarded with examples of alleged market failures, we would be remiss if we did not correct this bias by drawing attention to government failure in managing natural resources. Richard Stroup, former director of the Office of Policy Analysis of the Department of the Interior and long-time scholar of public management of natural resources, says there is now abundant data on the experiment in "land resource socialism," and the evidence reveals conclusively that there is no shortage of bad management. His studies reveal that range conditions on Bureau of Land Management land are much worse than on comparable private lands. Environmental atrocities in forests and water resources under federal management are common. Moreover, retarded productivity and high management costs are the norm. (See end note #5)

Close examination of the management of public resources does not provide much corroborative evidence for the position that the public interest is best served by public guardians. This should not be a surprise because results are determined by incentives, and the structure of incentives within which bureaucrats work is perverse. They encourage public servants to behave counterproductively.

The solution to public mismanagement is not better public managers. Public officials are not basically different from other citizens. They respond to the incentives they face, and, like the polluting citizen, if they do not bear the costs of their actions, then we can expect behavior that is contrary to the efficient management of resources. We can confidently predict that their self-interests will override broader economic and environmental interests. The solution is to correct the faulty incentive structure. The transfer of public lands to the control of private citizens could help and is an option that should receive careful study.

Expectations about Future Property Rights

The influence of property rights on economic behavior and the use of resources depends not so much on the present structure of rights but more importantly on expectations about future property rights. In other words, how we use resources today depends on our forecast of the future. The world abounds with examples verifying this proposition. Here we consider three diverse cases involving urban development, Hong Kong and Organization of Petroleum Exporting Counties (OPEC).

Urban Development

Because the purchase of any property is fundamentally the purchase of a bundle of rights to the property, the value of a tract of land depends on the attendant rights. If these rights are altered, the value of the property is altered accordingly. What one is willing to pay today and how one plans to use land tomorrow depends critically on an individual's forecast of future governmental regulations and restrictions on personal property. The greater the uncertainty about the extent and nature of future governmental restrictions, the lower the price offered.

An urban-development project, whether residential or commercial, is a major undertaking requiring substantial up-front expenditures for land acquisition, engineering tests, planning, platting, designing, permits and other costs. It is not uncommon for projects to be multiphase and multiyear. Planners of such projects necessarily must give careful consideration to expected future governmental restrictions on the subject property. If regulations are expected to remain stable, or if future changes can be predicted with reasonable certainty, then development decisions will depend on projected costs of financing and construction and estimates of market demand. However, if there is great uncertainty about the future of governmental restrictions, if others have been hurt by changing regulations, developers' decisions will reflect this.

An environment of unpredictable future property rights will have several effects. One result will be fewer and smaller development projects. Developers will minimize their exposure to regulatory change by avoiding long-term projects. Because investors must be compensated for incurring greater risks, this will be reflected in higher costs to the developer and higher prices or rents to property occupants. Even the communities at large will suffer from regulatory uncertainty, for they surely will be subjected to considerable litigation expense over the legality of their changes; the rate of growth of the tax base will slow, and erratic growth may jeopardize the orderly development of the city.

Uncertainty about future property rights is a real problem and has become more significant during the past decade. Today there are more than 1,000 lawsuits challenging changes in land-use controls. Most of these suits are filed because property owners allege that changes in controls resulted in a loss of value and, therefore, a loss of wealth. Even if a government does not actually take away the property per se, by taking away some of the owner's rights to the land, the economic effect may be the same. If owners are not compensated for the loss of property rights, they will have lost some wealth that will have been transferred to the city.

Hong Kong

Under the governance of Britain for 140 years, Hong Kong's laissez faire economy has flourished. Today it is the world's third largest financial center and the focal point of Western trade with Asia and the Far East. Britain's lease of Hong Kong from China expires in 1997. During the summer of 1982 China vowed to regain sovereignty over Hong Kong and to make it a special administrative zone thereafter. During the months following this announcement, the Hong Kong stock market declined 25 percent, property values slid nearly 40 percent from their 1981 peak and the normally robust Hong Kong dollar plunged to new lows in the foreign-exchange market.

Is there any doubt as to the underlying cause of these changes in property values? Clearly, expectations about future rights to property have changed. In spite of British assurances that there is no cause for alarm, in spite of the fact that the Chinese government has a vested interest in a strong Hong Kong economy, the experience of China's takeover of Shanghai in 1949 and the instability of China's own policies during recent decades is hardly reassuring to those whose lives and livelihood depend on a free economy. The prospect of nationalization, restrictions on prices, wages, employment, foreign trade, currency, communication, travel and other economic activities is seen by many as the beginning of the end of the Hong Kong miracle. Whether or not confidence in the future will be restored to pre-1982 levels remains to be seen, but we can be confident that as long as there is uncertainty about the future stability of private property rights, the economy will be sluggish and property values will remain depressed.

Organization of Petroleum Exporting Countries

In the last few years, OPEC has been plagued with an oil surplus. This resulted, in part, from a decline in oil demand, an increase in non-OPEC production and an apparent increase in OPEC oil production above agreed upon quotas. The latter is a problem common to cartels. Members make formal agreements to restrict output so that they can receive higher prices than they would if production is not coordinated. But in private members are tempted to cheat on the agreement by producing more than their quota because of the prospect of realizing above-quota profits. Of course, if cheating occurs, total supply is increased and the coordinated market price cannot be maintained. The tendency to cheat on the agreement by expanding output and selling at discount prices often is cited as the reason for the inevitable failure of cartels.

While this inherent weakness is certainly real, the expectation of changes in future property rights may be working also (at least in some countries) to expand oil production. If, for some reason, current owners of a resource believe that their future rights to this resource are threatened, they have an incentive to exploit the resource now and to convert their wealth into another form over which their future rights appear to be more secure. This reasoning applies to all members of OPEC and doubtless enters into their decisions about future production levels. Of course, the weight given to this argument varies among nations depending on local circumstances. While there are no data to prove or disprove this theory as it relates to OPEC, it is hard to imagine that the ruling families of Saudi Arabia, for example, have not been so influenced, especially during the recent war between Iran and Iraq. Given the bellicosity of Iran and the probability of the war spreading to Saudi Arabia, the temptation to convert oil deposits into Swiss bank deposits must be great indeed.

Controlling Corporations

If awards were given for the world's most maligned institution, the corporation would stand head and shoulders above all other nominees. Part of its notoriety is self-inflicted by the behavior of its own practitioners, but much more results from a fundamental and pervasive misconception of what a corporation is. For generations, writers have portrayed the corporation as a monolithic, inhumane organism, existing only to serve insatiable greed by taking advantage of consumers and workers alike. History books, movies, television, newspapers and prominent personalities all contribute to this stereotype.

Many citizens view the corporation as a physical, inanimate and impersonal object without human content or feeling. As such, the corporation is regarded as a thing or a piece of property incapable of understanding, let alone responding to, social needs. Corporations must be controlled by society for the collective welfare of the people. Critics with this perspective commonly ignore the fact that corporations are owned by people -- ordinary citizens. Indeed, American corporations are owned directly by approximately 30 million people and indirectly by many times more through insurance companies, employee pension funds, mutual funds and credit unions. Not recognizing this fact, people are easily misled by the charge that the corporation promotes property rights at the expense of human rights. Attacks and constraints on corporations are not attacks and constraints on property per se but on the owners of the corporation --people -- and their wealth.

Public confusion about the real nature of the corporation and its ownership makes it an easy target for well meaning but misguided social reformers as well as not-so-well-meaning enemies who clearly understand the nature of the corporation but intend to use the power of government under the guise of public interest to transfer corporate wealth for their own purposes.

It should not be surprising that the corporation has been subjected to an increasing array of controls if one considers the public's perception of the corporation; its increasing demand for environmental quality, entitlements and protection from risk; the fact that real personal incomes have been rising slowly; and the deep recessions of 1974 and 1982. Regulations for purposes of occupational safety, consumer safety, environmental quality, energy conservation, affirmative action, land use and wage and price stability are daily realities for corporate managers.

A new regulation known as plant-closing laws has been proposed recently. While it has not yet achieved much legislative success, its proponents nevertheless are working tenaciously for its enactment at both state and federal levels. If passed and implemented, this new regulation will represent a fundamental change in the structure of property rights. The purpose of the legislation is to inhibit by means of restrictions and penalties the closing or relocation of plants. (See end note #6) Promoted primarily in northern industrial states, sponsors claim that such laws are necessary to avoid the pain and social costs of plant closings. Prominent among their objectives is the maintenance of employment and a growing tax base.

Of course, such legislation treats only a symptom and not the disease. To prohibit a plant from closing does nothing to correct the underlying reason for its impending failure or retarded performance relative to other locations. More importantly such laws would have perverse effects in the long run.

Descriptions of the free-enterprise system emphasize the right to open a new business and, if it does well in satisfying consumer desires, to have the opportunity to earn handsome profits. Not so frequently noted, but just as important, is that this system also provides the right to close a business if it is not doing well. If the right to earn a profit is to have any incentive for would-be entrepreneurs, it must also mean the right to minimize losses.

Denying individuals the right to close on their own terms and schedule is a basic change in property rights that will evoke a corresponding change in economic behavior. Wealth-generating investments in new business ventures will be retarded. While some current employees may benefit from such laws, their gain will be short lived. Unforeseen, but nevertheless real, will be the subsequent reduction in incomes from new businesses that otherwise would have opened but for such restraint on their property rights.

Even more important, but again not well understood by the lay public, the laws inhibiting business closures inhibit the movement of resources to their highest valued uses. As demands change, as technologies evolve, some businesses fail, but their demise is more than offset by the birth of new businesses. Such is the nature of an adaptable economic system that allows, indeed, encourages change and growth, and this has been the history of the American economy. To deny the free movement of either human or physical resources is to retard economic growth and to promote, even though unintentionally, social discord. While the free-market, private-property system is not perfect, and although the changes in demand and techniques it permits may at times cause real hardships for some whose services are less demanded, this must be weighed against the alternative. The costs attendant with the alternative, although often hidden, are real. The evidence of history speaks loudly and clearly: where societies organize themselves according to the principles of private property and free markets, their citizens not only live better, but also they live more freely and more harmoniously. Those who disregard the past are condemned to repeat it." Let us be informed about our economic order, for if we are not, "the enemy is us."