

Private Rights to Property
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Property Rights and Economic Behavior

What is common to many is taken care of, for all men have greater regard for what is their own than for what they possess in common with other.

Aristotle (See end note 1)

The structure of property rights refers to the prevailing set of laws, regulations and customs that govern the use and transfer of resources. Because the structure of property rights also establishes incentives, a change in this structure changes both the incentive system and economic behavior.

The traditional set of private property rights includes the right to decide the use of property, to gain the benefits yielded by property and to transfer (sell) property to others. When we sell something, we actually are transferring a bundle of rights to that asset. Property rights are neither lost nor gained during transfer, that is, we convey only the property rights that we have and no more. The value of an asset depends on the bundle of rights attached to that asset. If the bundle is somehow altered, the value of the bundle, and therefore the value of the property, also, is altered.

For example, suppose that after some negotiation a person agrees to purchase your automobile for \$5,000 and that the exchange will take place at noon tomorrow. This agreement is based on the perceptions of both buyer and seller of the value of the automobile. The price is influenced in large part by the buyer's perception of the current structure of property rights and the probability of this structure remaining intact for the foreseeable future. Suppose that at 8:00 a.m. tomorrow, a governmental decree announces that henceforth all automobiles are public (communal) property. Anyone can use any automobile that is not currently in use. Once the driver leaves the automobile he or she can no longer be assured that it will be available for future use. The bundle of property rights to automobiles has been altered, and the value of rights to the automobile also has been diffused and changed. Indeed, the exchange value of that automobile to any particular person has fallen because no one has any reason to give up cash for an asset that an individual can no longer control.

While this is a hypothetical example wherein private rights to the property were extinguished, it illustrates that the value of an asset depends upon the structure of the rights to property. Property rights need not be completely removed for an asset's value to be affected.

Suppose instead the decree had restricted present and future automobile ownership to married males age 35 or older. Whether or not your buyer qualified for ownership, the value of your automobile would have declined because the market supply of used autos has increased (as non-qualified owners offer their autos for sale), while the demand has decreased because the number of qualified owners has decreased. If someone qualified for ownership and was informed about the decree, we can confidently predict that the buyer would not voluntarily complete the noon transaction at the previously agreed price. If the transaction takes place at all, it would be at a lower price.

If the decree had set a maximum legal speed or specified the minimum number of passengers or constrained the hours of the day during which it could be operated or prohibited travel outside some set boundaries, the rights to the property would have been altered, and the value of the automobile would have been changed.

The structure of property rights also influences our care of property. Consider again the example of automobiles declared common property. Under these circumstances what incentive is there for anyone to be concerned about the auto's maintenance? Who would bother to replace a broken windshield or repair a flat tire? No one because no one could be certain to capture the benefits from such an expenditure. It would be an investment for which the return would be low if not zero. In other words, there is little incentive to maintain this asset. Indeed, it would be irrational to behave otherwise. It takes no great imagination to forecast what would happen to the average quality of the nation's stock of automobiles. Without a program for public maintenance, the roadsides would soon become more crowded than the roads themselves.

People do not treat their own autos this way because their autos are part of their wealth. A person's wealth depends importantly on personal management of assets. This means that people will defend their property from abuse by others. We lock our cars and our homes to deter theft of our property. We do not throw garbage into our yards, write on our bathroom walls, place gum under our own tables or crush out cigarettes on our floors. Indeed, we would not tolerate others coming into our homes and doing these things because their harmful effects are borne entirely by ourselves through a reduction in our personal wealth.

Not only does the existence and enforcement of property rights cause us to defend our property from abuse by others, it also induces us to take account of the social costs (the negative effects or harm to others) of our actions. We are careful not to damage other's property, for if we do, we will have to compensate them for their losses at the expense of our own wealth.

Also, when property rights are transferable, this causes people to take into consideration the interests that others have in the property. Property use depends on its value. But this value reflects the value that others place on the property in alternative uses. Wealth-seeking people will retain or use the property for their own purposes only if it is worth as much to them as it is to others. Otherwise, owners would enhance their wealth by selling or leasing their property to others who value it more highly. Thus the transferability of property rights compels all owners to act in accord with the values that all other would-be users place on the property.

Communal Rights to Property

How is economic behavior affected when property rights are communal instead of private? By communal we mean property is available to all on a first-come, first-served basis. Such properties are either controlled by government (roads, parks, seashore, forests) or by no one (open sea, atmosphere, moving waters). Whereas an owner of private property may exclude all others, no one can exclude others from using communal property except by prior and continued use of the property. The first person to enter a highway or occupy a campsite holds that right as long as that person uses the property. Subsequent users may follow the first but cannot displace or exclude the first user. (See end note 2)

When property rights are communal, people tend to ignore the social costs of their actions. By social costs we mean the negative effects (costs) that their actions have on others. For example, when a rancher's cattle consume grass on public land, there is less grass for another rancher's cattle. Although the grass may be expected to grow and replenish, if the extent of grazing is not managed, overgrazing can lead to wind and water soil erosion and eventual depletion of the grazing-land resource. Under private ownership of land, we can be confident that ranchers will have incentives to manage the grazing of their herds to avoid depletion. Under common property arrangements, however, there is no benefit for a single rancher to refrain from grazing. To do so only benefits others who continue to graze the commons. Each person has an incentive to use the resource because that person benefits only by exercising the communal right. Because the cost of using the resource is borne almost totally by others, people ignore this cost. The result is overgrazing, or more generally, overuse (depletion) of the common resource.

Communal wildlife must be killed to establish private rights to, or to benefit from, this resource. Because hunters (as other people) tend to ignore the social costs of their hunting and consider only their private benefits, it should be apparent why the American buffalo was near extinction around 1900 and why over fishing is threatening several species of whales. Chronic overgrazing in the West from the late 1880s to the 1930s has been traced to insecure land ownership on the western rangelands and is another example of the tragedy of the commons. (See end note 3)

Pollution

Environmental pollution can be explained also as a consequence of common property. To appreciate the problem, let us examine a specific case where nearly everyone pollutes the atmosphere. While we use our automobiles carefully, we do not use the environment with equal care. When driving our autos, we vent exhausts into the atmosphere even though this contributes to a polluted environment. So here are people who

are by and large responsible citizens, who use their own autos carefully and who desire a high quality environment but who nevertheless knowingly pollute the environment.

Are we observing Jekyll-and-Hyde behavior? Not really. In fact, people are behaving in a manner consistent with their drive for greater wealth and as expected when property rights are communal. Because no one has any clearly defined and enforceable rights to the environment, it is available for all to use first-come, first-served. In deciding whether or how to use any resource, private or communal, people assess the benefits and costs of its use. Here they weigh the benefits against the costs of polluting. The benefit from polluting (using vehicles) is viewed as the utility received from not walking or biking. However, they view their cost of polluting as virtually zero. This is because individuals have no private property rights to the air and therefore they have no legal recourse to collect from the polluter for damages to the quality of their air. The cost of using the common resource (polluting) is borne almost entirely by others. And if the cost of polluting is effectively zero, as long as the benefit from polluting is positive, even well meaning citizens with the purest intentions can be expected to pollute. This is because individuals respond to personal costs and benefits as perceived by themselves.

Is the case of industrial pollution any different? Does such pollution take place because business people are more sinister than the average automobile owner? Not really. The source of the problem is the same. If the cost to the firm of installing smoke scrubbers or disposing of solid waste by other than dumping in the river is more than the benefit, it will pollute. As long as the costs of pollution are borne largely by others, as long as people are not held accountable for the costs their actions impose on others, pollution will continue. Without well defined and enforced private property rights to air and water, people are not compelled to consider the interests that others have in the air and water. They are not constrained by the negative effects (costs) they impose on others. But if people did own clearly specified rights to air and water, others could use these resources for waste disposal only with the permission of the owners. Under these circumstances we can be confident that environmental pollution would be less than now exists. But we can be certain also that it would not disappear completely, for it will be economical for the environment to be used at least to some extent for waste disposal.

Market vs. Government Failure

People often point to environmental pollution as an example of market failure. This is a mistake. It is more accurate to say that pollution occurs because of the failure to have a market in pollution rights. Still, it is pollution that people typically cite when seeking to rationalize additional governmental controls over the market system. Even champions of private property and free markets recognize this failure and claim that government can play a useful role. What is the proper role of government? One common prescription is extensive and detailed regulations of would-be polluters, consumers and industrialists. Many, however, do not have so much faith in the effectiveness of governmental controls. They recognize that, like the market system, even governmental agencies fail to manage resources effectively, and indeed, often make matters worse. An alternate approach is for government to assign private property rights to common resources. Or, if it is not possible to assign rights to the property per se, it could assign a fixed quantity of user rights to the common resource and let the market allocate these rights among would-be users in accordance with their respective values. (See end note 4)

Graffiti and Litter

The problem of common property explains why our highways and parks are badly littered, why graffiti on public washroom walls is the norm rather than the exception and why school facilities are unsightly and deteriorate rapidly under the abuse of their occupants. How do we explain the fact that this behavior is not restricted to public property? We observe similar treatment of private property that attracts the public for commercial purposes: retail stores, theaters, restaurants, gasoline stations and shopping malls, for example. Don't the owners of these facilities have a vested interest in protecting their property from such abuse? Certainly, and they do in fact commit some of their resources to reduce patron abuse, but property rights are effective in this instance only if the costs of enforcing these rights are less than the benefits received from

enforcement. It is economical to make some expenditures for enforcement purposes (closed circuit TV-scanners for security, restroom designs that make abuse difficult but easy to correct and roving uniformed security guards), but it is not economical to commit sufficient resources to completely eliminate patron abuse because the cost is too high. Therefore, some abuse will always be observed in such facilities because the abusers bear almost none of the costs of their own behavior.

Moreover, because the harmful effects of property abuse, both public and private, are not directly borne by non-owners, few observers believe it is their responsibility or in their interest to police or correct the abusers' behavior. Observation of mistreatment is typically ignored or simply deplored with a shrug. Where property rights are either non-existent or not well enforced, we can expect such property to deteriorate both in quality and value.

Shirking and Economic Growth

The problem of communal property also extends to work incentives. If the fruits of individual labor are not captured by the worker as private property but instead are assigned to the community for distribution among its citizens according to criteria unrelated to productivity, voluntary work efforts will decline. Each worker will have an incentive to shirk, to stand aside and to let others work. Practicing the motto "from each according to his ability, to each according to his need" will result in a smaller economic pie. While such practice often is motivated by the desire for a more equally divided pie, experience shows that even this goal is unlikely to be realized.

That private rights to the fruits of a person's labor is a powerful incentive to be productive is dramatically evident in the Soviet Union. New York Times' Hedrick Smith, one-time resident and keen observer of Russian life, reports that in the Soviet Union families living on collective farms are permitted to cultivate a small plot of land for their private benefit. It should be no surprise to learn that the farmers husband their private plots much more carefully than the collective plots. Confirming evidence of this can be inferred from Soviet data which report that in 1973, private plots, which represented only 1 percent of the farmland, produced 27 percent of the nation's total agricultural product. (See end note 5)

In a broader context, many historians view the emergence of the institution of private property rights in Europe during the Middle Ages as an important factor in the rise of the western world and its escape from perpetual poverty and famine. (See end note 6) Of course, the structure of property rights continues to be an important determinant of economic growth. The structure of property rights is always changing, sometimes dramatically through war and revolution, but more often it is a slow and gradual process. Stability in property rights and consistent enforcement of these rights are important ingredients in a healthy economy. If the structure changes too frequently or capriciously, this reduces our ability to forecast the future and inhibits our willingness to invest because of greater uncertainty about recovering our investment and capturing the benefits from the investment. Because economic growth depends critically on a sustained flow of investment in new capital goods, permanence and stability in the structure of property rights are essential to economic growth and prosperity.