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Property Rights

Armen A. Alchian

One of the most fundamental requirements of a capitalist economic system—and one of the most misunderstood concepts—is a strong system of property rights. For decades social critics in the United States and throughout the Western world have complained that "property" rights too often take precedence over "human" rights, with the result that people are treated unequally and have unequal opportunities. Inequality exists in any society. But the purported conflict between property rights and human rights is a mirage. Property rights are human rights.

The definition, allocation, and protection of property rights comprise one of the most complex and difficult sets of issues that any society has to resolve, but one that must be resolved in some fashion. For the most part, social critics of "property" rights do not want to abolish those rights. Rather, they want to transfer them from private ownership to government ownership. Some transfers to public ownership (or control, which is similar) make an economy more effective. Others make it less effective. The worst outcome by far occurs when property rights really are abolished (see TRAGEDY OF THE COMMONS).

A property right is the exclusive authority to determine how a resource is used, whether that resource is owned by government or by individuals. Society approves the uses selected by the holder of the property right with governmental administered force and with social ostracism. If the resource is owned by the government, the agent who determines its use has to operate under a set of rules determined, in the United States, by Congress or by executive agencies it has charged with that role.

Private property rights have two other attributes in addition to determining the use of a resource. One is the exclusive right to the services of the resource. Thus, for example, the owner of an apartment with complete property rights to the apartment has the right to determine whether to rent it out and, if so, which tenant to rent to; to live in it himself; or to use it in any other peaceful way. That is the right to determine the use. If the owner rents out the apartment, he also has the right to all the rental income from the property. That is the right to the services of the resources (the rent).

Finally, a private property right includes the right to delegate, rent, or sell any portion of the rights by exchange or gift at whatever price the owner determines (provided someone is willing to pay that price). If I am not allowed to buy some rights from you and you therefore are not allowed to sell rights to me, private property rights are reduced. Thus, the three basic elements of private property are (1) exclusivity of rights to choose the use of a resource, (2) exclusivity of rights to the services of a resource, and (3) rights to exchange the resource at mutually agreeable terms.

The U.S. Supreme Court has vacillated about this third aspect of property rights. But no matter what words the justices use to rationalize such decisions, the fact is that such limitations as price controls and restrictions on the right to sell at mutually agreeable terms are reductions of private property rights. Many economists (myself included) believe that most such restrictions on property rights are detrimental to society. Here are some of the reasons why.

Under a private property system the market values of property reflect the preferences and demands of the rest of society. No matter who the owner is, the use of the resource is influenced by what the rest of the public thinks is the most valuable use. The reason is that an owner who chooses some other use must forsake that highest-valued use—and the price others would pay him for the resource or for the use of it. This creates an interesting paradox: although property is called "private," private decisions are based on public, or social, evaluation.

The fundamental purpose of property rights, and their fundamental accomplishment, is that they eliminate destructive competition for control of economic resources. Well-defined and well-protected property rights replace competition by violence with competition by peaceful means.

The extent and degree of private property rights fundamentally affect the ways people compete for control of resources. With more complete private property rights, market exchange values become more influential. The personal status and personal attributes of people competing for a resource matter less because their influence can be offset by adjusting the price. In other words, more complete property rights make DISCRIMINATION more costly. Consider the case of a black woman who wants to rent an apartment from a white landlord. She is better able to do so when the landlord has the right to set the rent at whatever level he wants. Even if the landlord would prefer a white tenant, the black woman can offset her disadvantage by offering a higher rent. A landlord who takes the white tenant at a lower rent anyway pays for discriminating.

But if the government imposes rent controls that keep the rent below the free-market level, the price the landlord pays to discriminate falls, possibly to zero. The rent control does not magically reduce the demand for apartments. Instead, it reduces every potential tenant's ability to compete by offering more money. The landlord, now unable to receive the full money price, will discriminate in favor of tenants whose personal characteristics—such as age, sex, ethnicity, and religion—he favors. Now the black woman seeking an apartment cannot offset the disadvantage of her skin color by offering to pay a higher rent.

Competition for apartments is not eliminated by rent controls. What changes is the "coinage" of competition. The restriction on private property rights reduces competition based on monetary exchanges for goods and services and increases competition based on personal characteristics. More generally, weakening private property rights increases the role of personal characteristics in inducing sellers to discriminate among competing buyers and buyers to discriminate among sellers.

The two extremes in weakened private property rights are socialism and "commonly owned" resources. Under socialism, government agents—those whom the government assigns—exercise control over resources. The rights of these agents to make decisions about the property they control are highly restricted. People who think they can put the resources to more valuable uses cannot do so by purchasing the rights because the rights are not for sale at any price. Because socialist managers do not gain when the values of the resources they manage increase, and do not lose when the values fall, they have little incentive to heed changes in market-revealed values. The uses of resources are therefore more influenced by the personal characteristics and features of the officials who control them. Consider the socialist manager of a collective farm under the old Soviet communist system. By working every night for one week, he could have made, say, one million rubles of additional profit for the farm by arranging to transport the farm's wheat to Moscow before it rotted. But because neither the manager nor those who worked on the farm were entitled to keep even a portion of this additional profit, the manager was more likely than the manager of a capitalist farm to go home early and let the crops rot.

Similarly, common ownership of resources—whether in the former Soviet Union or in the United States—gives no one a strong incentive to preserve the resource. A fishery that no one owns, for example, will be overfished. The reason is that a fisherman who throws back small fish to wait until they grow is unlikely to get any benefit from his waiting. Instead, some other fisherman will catch the fish. The same holds true for other common resources whether they be herds of buffalo, oil in the ground, or clean air. All will be overused.

Indeed, a main reason for the spectacular failure of the 1980s and early 1990s economic reforms in the former Soviet Union is that resources were shifted from ownership by government to de facto common ownership. How? By making the Soviet government's revenues de facto into a common resource. Harvard economist Jeffrey Sachs, who advised the Soviet government, once pointed out that when Soviet managers of socialist enterprises were allowed to open their own businesses but still were left as managers of the government's businesses, they siphoned out the profits of the government's business into their private corporations. Thousands of managers doing this caused a large budget deficit for the Soviet government. In this case the resource that no manager had an incentive to conserve was the Soviet government's revenues. Similarly, improperly set premiums for U.S. deposit insurance gave banks and S&Ls (see SAVINGS AND LOAN CRISIS) an incentive to make excessively risky loans and to treat the deposit insurance fund as a "common" resource.

Private property rights to a resource need not be held by a single person. They can be shared, with each person sharing in a specified fraction of the market value while decisions about uses are made in whatever process the sharing group deems desirable. A major example of such shared property rights is the corporation. In a limited liability corporation, shares are specified and the rights to decide how to use the corporation's resources are delegated to its management. Each shareholder has the unrestrained right to sell his or her share. Limited liability insulates each shareholder's wealth from the liabilities of other shareholders, and thereby facilitates anonymous sale and purchase of shares.

In other types of enterprises, especially where each member's wealth will become uniquely dependent on each other member's behavior, property rights in the group endeavor are usually salable only if existing members approve of the buyer. This is typical for what are often called joint ventures, "mutuals," and partnerships.

While more complete property rights are preferable to less complete rights, any system of property rights entails considerable complexity and many issues that are difficult to resolve. If I operate a factory that emits smoke, foul smells, or airborne acids over your land, am I using your land without your permission? This is difficult to answer.

The cost of establishing private property rights—so that I could pay you a mutually agreeable price to pollute your air—may be too high. Air, underground water, and electromagnetic radiation, for example, are expensive to monitor and control. Therefore, a person does not effectively have enforceable private property rights to the quality and condition of some parcel of air. The inability to cost-effectively monitor and police uses of your resources means "your" property rights over "your" land are not as extensive and strong as they are over some other resources such as furniture, shoes, or automobiles. When private property

Property Rights for "Sesame Street"

Janet Beales Kaidantzis

Ever seen two children quarreling over a toy? Such squabbles had been commonplace in Katherine Hussman Klemp's household. But in the *Sesame Street Parent's Guide* she tells how she created peace in her family of eight children by assigning property rights to toys.

As a young mother, Klemp often brought home games and toys from garage sales. "I rarely matched a particular item with a particular child," she says. "Upon reflection, I could see how the fuzziness of ownership easily led to arguments. If everything belonged to everyone, then each child felt he had a right to use anything."

To solve the problem, Klemp introduced two simple rules: First, never bring anything into the house without assigning clear ownership to one child. The owner has ultimate authority over the use of the property. Second, the owner is not required to share. Before the rules were in place, Klemp recalls, "I suspected that much of the drama often centered less on who got the item in dispute and more on whom Mom would side with." Now, property rights, not parents, settle the arguments.

Instead of teaching selfishness, the introduction of property rights actually promoted sharing. The children were secure in their ownership and knew they could always get their toys back. Adds Klemp, "'Sharing' raised their self-esteem to see themselves as generous persons."

Not only do her children value their own property rights, but also they extend that respect to the property of others. "Rarely do our children use each other's things without asking first, and they respect a 'No' when they get one. Best of all, when someone who has every right to say 'No' to a request says 'Yes,' the borrower sees the gift for what it is and says 'Thanks' more often than not," says Klemp.

rights are unavailable or too costly to establish and enforce, substitute means of control are sought. Government authority, expressed by government agents, is one very common such means. Hence the creation of environmental laws.

Depending on circumstances, certain actions may be considered invasions of privacy, trespass, or torts. If I seek refuge and safety for my boat at your dock during a sudden severe storm on a lake, have I invaded "your" property rights, or do your rights not include the right to prevent that use? The complexities and varieties of circumstances render impossible a bright-line definition of a person's set of property rights with respect to resources.

Similarly, the set of resources over which property rights may be held is not well defined and demarcated. Ideas, melodies, and procedures, for example, are almost costless to replicate explicitly (near-zero cost of production) and implicitly (no forsaken other uses of the inputs). As a result, they typically are not protected as private property except for a fixed term of years under a patent or copyright.

Private property rights are not absolute. The rule against the "dead hand," or perpetuities, is an example. I cannot specify how resources that I own will be used in the indefinitely distant future. Under our legal system, I can specify the use only for a limited number of years after my death or the deaths of currently living people. I cannot insulate a resource's use from the influence of market values of all future generations. Society recognizes market prices as measures of the relative desirability of resource uses. Only to the extent that rights are salable are those values most fully revealed.

Accompanying and conflicting with the desire to secure private property rights for oneself is the desire to acquire more wealth by "taking" from others. This is done by military conquest and by forcible reallocation of rights to resources (also known as stealing). But such coercion is antithetical to—rather than characteristic of—a system of private property rights. Forcible reallocation means that the existing rights have not been adequately protected.

Private property rights do not conflict with human rights. They are human rights. Private property rights are the rights of humans to use specified goods and to exchange them. Any restraint on private property rights shifts the balance of power from impersonal attributes toward personal attributes and toward behavior that political authorities approve. That is a fundamental reason for preference of a system of strong private property rights: private property rights protect individual liberty.

About the Author

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Further Reading

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Protectionism

Jagdish Bhagwati

The fact that trade protection hurts the economy of the country that imposes it is one of the oldest but still most startling insights economics has to offer. The idea dates back to the origin of economic science itself. Adam Smith's *The Wealth of Nations*, which gave birth to economics, already contained the argument for free trade: by specializing in production instead of producing everything, each nation would profit from free trade. In international economics, it is the direct counterpart to the proposition that people within a national economy will all be better off if they specialize at what they do best instead of trying to be self-sufficient.

It is important to distinguish between the case for free trade for oneself and the case for free trade for all. The former is an argument for free trade to improve one nation's own welfare (the so-called national-efficiency argument). The latter is an argument for free trade to improve every trading country's welfare (the so-called cosmopolitan-efficiency argument).

Underlying both cases is the assumption that free markets determine prices and that there are no market failures. But market failures can occur. A market failure arises, for example, when polluters do not have to pay for the pollution they produce (see EXTERNALITIES). But such market failures or "distortions" can arise from governmental action as well. Thus, governments may distort market prices by, for example, subsidizing production, as European governments have done in aerospace, as many other governments have done in electronics and steel, and as all wealthy countries' governments do in agriculture. Or governments may protect intellectual property inadequately, leading to underproduction of new knowledge; they may also overprotect it. In such cases, production and trade, guided by distorted prices, will not be efficient.

The cosmopolitan-efficiency case for free trade is relevant to issues such as the design of international trade regimes. For example, the General Agreement on Tariffs and Trade (GATT), incorporated into the World Trade Organization (WTO) in 1995, oversees world trade among member nations, just as the International Monetary Fund oversees international macroeconomics and exchange rates. The national-efficiency case for free trade concerns national trade policies; it is, in fact, Adam Smith's case for free trade. Economists typically have the national-efficiency case in mind when they discuss the advantage of free trade and the folly of protectionism.

This case, as refined greatly by economists in the postwar period, admits two main theoretical possibilities in which protection could improve a nation's economic well-being. First, as Adam Smith himself noted, a country might be able to use the threat of protection to get other countries to reduce their protection against its exports. Thus, threatened protection could be a tool to pry open foreign markets, like oysters, with "a strong clasp knife," as Lord Randolph Churchill put it in the late nineteenth century. If the protectionist threat worked, then the country using it would gain doubly: from its own free trade and from its trading partners' free trade. However, both Smith and later economists in Britain feared that such threats would not work. They feared that the protection imposed as a threat would be permanent and that the threat would not lower the other countries' trade barriers.

U.S. trade policy today is premised on a different assessment: that U.S. markets can, and should, be closed as a means of opening new markets abroad. This premise underlies sections 301–310 of the 1988 Omnibus Trade and Competitiveness Act, which permit, and sometimes even require, the U.S. government to force other countries to accept new trade obligations by threatening tariff retaliation if they do not. But those "trade obligations" do not always entail freer trade. They can, for instance, take the form of voluntary quotas on exports of certain goods to the United States. Thus, they may simply force weak nations to redirect their trade in ways that strong nations desire, cutting away at the principle that trade should be guided by market prices.

The second exception in which protection could improve a nation's economic well-being is when a country has monopoly power over a good. Since the time of Robert Torrens and John Stuart Mill—that is, since the mid-1800s—economists have argued that a country that produces a large percentage of the world's output of a good can use an "optimum" tariff to take advantage of its latent monopoly power, and thus gain more from trade. This is, of course, the same as saying that a monopolist will maximize his profits by raising his price and reducing his output.

Two objections to this second argument immediately