

CHAPTER ONE

What Are Property Rights?

PROPERTY RIGHTS: The right to life is the source of all rights—and the right to property is their only implementation. Without property rights, no other rights are possible. Since man has to sustain his life by his own effort, the man who has no right to the product of his effort has no means to sustain his life. The man who produces while others dispose of his product is a slave.

Ayn Rand, *The Virtue of Selfishness*

ANYONE WHO has observed children quarreling knows that disputes occur when the rules are not clear. They may be fighting over who has the right to a toy; how much time must be given to hide in a game of hide-and-seek; or who will call a foul in a basketball game. Experienced adults address these disputes by defining the rules of the game—who has the right to do what and when.

Just as children need rights resolution for harmonious play, so is rights resolution a necessary condition for life in a civil society. Imagine a world wherein nobody can identify who owns what and the rules that govern property vary from person to

person (DeSoto 2000, 15). Chaos far worse than children quarreling would ensue. As philosopher Thomas Hobbes stated, life in a world of anarchy without rules and property rights would be “nasty, brutish, and short” (Leviathan 1985, 186).

To avoid anarchy, citizens create order by agreeing on rules that specify who can do what, who reaps the benefits from productive activity, and who bears the costs of disruptive activity. These rules are the essence of property rights. Property refers to much more than just real estate. Property rights determine who may cultivate a field, who can park in which slot in a parking lot, who is responsible for pollution, and who can profit from the sale of music. If property rights are clearly defined and enforced, cooperation replaces conflict as property owners bargain with one another and share in gains from trade.

This primer explores what property rights are, how they encourage civility and economic progress, how they evolve and devolve, how they can be taken by others, how barriers can help protect them, and whether they will be preserved in the future.

Who Can Do What?

Property rights are the rules of the game that determine who gets to do what and who must compensate whom if damages occur. Return to the scene of the children quarreling. Disputes over toys result when ownership is unclear and are resolved by clarifying which child has the right to the toy. Children can play a peaceful game of hide-and-seek as long as it is clear who hides and who seeks, where hiding can occur, how much time must be allotted for hiding, and so on. Similarly, when property lines between land parcels are clear, disputes are far fewer, hence the familiar adage “Good fences make good neighbors.” Patents and copyrights make clear who profits from intellectual capital. Trespass and

What Are Property Rights?

3

nuisance laws hold responsible those who encroach on another's property.

Property rights may be established as formally as filing a deed with a court or as informally as acknowledging a first come, first served rule for allocating seats at a movie theater. They govern access to tangible assets, such as cars and parcels of land, but they also apply to less tangible assets, such as patents and copyrights.

Whether they are formal or informal, whether they apply to tangible or intangible assets, property rights consist of multiple characteristics often referred to by lawyers as a bundle of sticks, each of which represents a different aspect of property ownership. These ownership characteristics include the right to use (and so to profit from) an asset, the right to exclude others from using the asset, and the right to transfer the asset to others. In its most complete form, ownership of property grants the owner control of all the sticks as long as use does not infringe on the rights of others. The owner of a car, for example, has the right to carry friends and family in the car, as long as he or she drives it in a manner that does not endanger other drivers. Property rights allow the owner to determine the uses of the asset and to derive value from the asset. They also ensure the owner of the rights to physically transform and even destroy the asset.

Property rights also come in less complete packages, allowing an owner to derive only partial value from an asset, to exclude only some users, or to transfer only certain uses for only a specified time period. Returning to the case of a car, an owner is often restricted from using it as a taxi unless licensed to do so. In the case of land, zoning regulations may limit the uses of specified parcels no matter what the landowner might want.

Even if property rights are defined, they must be enforced if they are to be effective. Consider the importance of clearly specified and enforced rules in a basketball game. During the game, property rights to space on the court belong to the first player to

occupy it, and those rights cannot be invaded. If they are, a foul has occurred. However, interpreting whether the space was already occupied before it was entered by another requires a referee to make the judgment calls and enforce the rights.

Similarly, property rights rules that govern civil interaction must be defined and enforced. Boundary disputes between landowners can arise because survey lines are not clear. If a tree branch grows across a boundary line, does the invasion of space above the ground constitute a violation of property rights? If music from a stereo or smoke from a chimney crosses a neighbor's property line, does this violate the neighbor's property rights? Answering such questions requires institutions of adjudication, such as courts, that serve the same purpose as the referee—defining and enforcing property rights. Before further expanding the definition of property rights, it is important to look back to what people thought of property rights in the past and to touch on how these thoughts were implemented in everyday life.

Philosophical Evolution

On a philosophical level, property rights have interested scholars at least since the time of Plato and Aristotle. Plato's *Republic* presents his vision of the ideal society, one devoid of belongings. Plato argued that property should be communal both in ownership and use. He believed that the rulers of a city should not own property so that they would not tear the city in pieces by differing over "mine" and "not mine" (Pipes 1999, 6).

Aristotle's *Politics* challenged Plato's vision, posing the question, "What should be our arrangements about property: should the citizens of the perfect state have their possessions in common or not?" He concludes that property should be owned privately because "that which is common to the greatest number has the least care bestowed upon it" (Aristotle *Politics* 1. 8–11).

What Are Property Rights?

5

Early Catholic church theorists followed Aristotle's lead. Thomas Aquinas established the church's definitive position in his *Summa Theologica*, arguing that private property rights were legitimate within a grander system of natural law—orderly principles that govern the functioning of nature. He argued that common ownership promoted neither efficiency nor harmony, instead causing costly discord. He believed that, for humans to perfect themselves spiritually, they need the security provided by ownership.

With the rise of Protestantism, enlightenment scholars such as John Locke continued to examine the boundaries of property rights. In *The Second Treatise on Government* (1690), Locke argued that property rights existed prior to (and thus with or without) government and that these rights were derived from natural rights, such as the right to one's own life and liberty. According to Locke, if a man owns his own labor, he should also own the fruits of that labor. By Locke's definition, ownership of a thing must include the right to use that thing and retain gains from its use. The protection of these natural rights is the primary justification for the existence of government. As Locke stated, "The great and chief end therefore of men uniting into commonwealths, and putting themselves under government, is the preservation of property." Locke also argued that if a ruler violates any of his subjects' property rights he is "at war" with them, and therefore the ruler may be disobeyed (Bethell 1998, 16).

Locke's perspective influenced Adam Smith's work, especially *The Wealth of Nations* (1776), a century later. Smith built on Locke's view that property existed within a larger system of natural rights and that the institutions of property and government were self-reinforcing. Private property, according to Smith, created a role for government in defending property, and the exis-

tence of government created the security to stimulate the creation of new property.

Smith built on the relationship between property and government to justify government's role in providing national defense and in administering justice. National defense seeks to protect property from external threats, while the administration of justice ensures the integrity of property rights in the face of internal disputes. He argued that these two functions are critical to the sanctity of private ownership and ultimately to determining the wealth of nations.

Property Rights Through History

Practical consideration of the benefits of property rights doubtlessly preceded the scholarly inquiries, and lessons regarding the centrality of private ownership in establishing orderly and efficient societies are still being learned today. Studies of primitive cultures conclude that property rights were a central part of people's existence. In fact, there is no record in anthropological studies of societies that were unaware of property rights (Pipes 1999, 116).

The existence of property rights from primitive times to the present is best explained by a human desire for order, or perhaps for the benefits that order conferred. In a seminal article describing the problems that arise when resources are not privately owned, but are common to all, H. Scott Gordon (1954) concluded:

Stable primitive cultures appear to have discovered the dangers of common property tenure and to have developed measures to protect their resources. Or if a more Darwinian explanation be preferred, we may say that only those primitive cultures have survived which succeeded in developing such institutions. (134–35)

For much of human history, when hunting and gathering were

What Are Property Rights?

7

the principal forms of economic activity, claims of tribal ownership applied to control of territory, while individual property claims included weapons, tools, and other personal belongings (Pipes 1999, 12). Pre- and post-Columbian Indians understood the importance of property rights and designed institutions that clarified who had rights to land, hunting territories, and personal property. Because agricultural lands had to be improved through the investment of time and effort, they were often privately owned. The Mahican Indians, for example, possessed hereditary rights to use well-defined tracts of fertile land along rivers. The Hopi tribes marked off territory by boundary stones engraved with symbols of the clan (Anderson 1996, 6). Personal items such as the teepee, which were costly to produce, were privately owned as well (Anderson 1995).

The importance of property rights increased as societies shifted from a hunter-gatherer existence to an agrarian lifestyle, in which economic activity focused on territory and soil cultivation. One of the earliest examples of property rights attached to agricultural lands comes from ancient Greece. Farmers who labored for themselves were exempt from paying tribute to aristocrats. This economic independence became a guarantee of freedom, so Greeks were motivated to acquire property. They were further motivated to protect their acquisition because if a Greek lost his land, he also lost his rights of citizenship (Pipes 1996, 100).

With population growth came competition for territory and other natural resources. Individuals sought confirmation that they would be rewarded for investing in the land; they wanted the security that someone else could not confiscate the wealth they created. As a result, pressures on the state to guarantee the security of ownership increased. In 1215, King John of England agreed to the demands of his barons and authorized the Magna Carta. This influential charter protected property owners against the powers of central government. David Hume in his *History of*

England wrote that the Magna Carta provided for the equal distribution of justice and the free enjoyment of property. Both provisions were “the great objects for which political society was at first founded by men, which the people have a perpetual and unalienable right to recall, and which not time, nor precedent, nor statute, nor positive institution, ought to deter them from keeping ever upmost in their thoughts and attention” (1778, 445).

By the sixteenth century, it was clear that the crown’s authority stopped where private property began. The ideas of individual sovereignty and individual proprietorship became entrenched in the common law of Britain and subsequently in the Constitution of the United States.

Just as hunting and gathering gave way to settled agriculture, settled agriculture gave way to the industrial revolution. That transition required secure property rights to capital assets in order to guarantee private investors a return on their investments. The rise of contractual arrangements such as the modern corporation and the growth of impersonal markets depended on protection of capital from governments by constitutions and from fellow men by civil laws (Pipes 1999, 44).

The authors of the U.S. Declaration of Independence and Constitution shared Locke’s and Smith’s beliefs in the importance of private ownership. The Founding Fathers firmly believed that the human right to private property had to be protected in law as the basis for individual liberty, a free society, and a free economy. The Fifth Amendment to the Constitution, for example, was aimed at protecting private property from governmental takings. Because the rule of law and constitutions guaranteed the sanctity of property in England and the United States during the eighteenth and nineteenth centuries, trade and commerce flourished and economies grew.

During that time period, however, increasing numbers of people called for state regulation and the abolition of property. Critics

What Are Property Rights?

9

of capitalism argued that it was destroying social equality. In the *Communist Manifesto* (1848), for example, Friederick Engels and Karl Marx denounced private property as exclusively a product of capitalism. Accordingly, they claimed that “the theory of the communist may be summed up in a single sentence: abolition of private property.”

If ever there was a dramatic example of the importance of private ownership of labor, land, and capital, it was the economic performance of communist regimes. Lacking the incentives inherent in private ownership, the Soviet Union and its satellites stagnated or declined to the point that they had no choice but to reform their economic systems.

By the time the Berlin Wall fell and communism collapsed, it was obvious to most observers that private property rights and their definition and enforcement by the rule of law were necessary ingredients for economic growth. Since the 1980s, many countries have transferred assets and rights from the public sector to private ownership in an attempt to improve efficiency. Industries undergoing privatization around the world include transportation, telecommunications, airlines, banking, mining, natural gas, and electric power (see Megginson, Nash, van Randenborgh 1996, 115).

An Economic Perspective

As the economic scales were tipping in favor of private ownership and away from communism, law and economics scholars were refining their explanations of how property rights work to encourage productivity and of the consequences of abrogating property rights. The work of Nobel laureate Ronald Coase and other economists such as Harold Demsetz and Armen Alchian have provided a more general approach to why property rights have emerged. These theories, according to Alan Ryan, suggest that “property comes into existence under the impulse of pressures

towards efficiency through a process parallel to that of natural selection” (Pipes 1999, 63). Nobel laureate Douglass North argues that economic growth occurs when secure property rights exist to make it worthwhile to invest in socially productive activity. He relies on historical examples to demonstrate that societies built on private ownership and the rule of law are more likely to experience economic development.

The economics of property rights focuses on individuals as the basic unit of analysis (for a complete discussion, see Anderson and McChesney 2003). Accordingly, a group or society is an aggregation of individual preferences and procedures. Building on the individual as the unit of analysis, four basic tenets guide the economics of property rights.

First, individuals make choices under conditions of scarcity. The choices people make are constrained because resources are limited. In a world of scarcity, one use of an asset precludes another. For example, water used for irrigation cannot provide a free-flowing stream in which fish can spawn. Land used for subdivisions cannot provide wilderness amenities, and so on.

Second, individuals act rationally to pursue their self-interests by adjusting to the benefits and costs of their actions. Rationality means that people have well-defined preferences and act systematically to maximize their well-being subject to their wealth and income constraints. Because resources are not limitless, rational maximization requires individuals to weigh the benefits and costs of their choices. As we shall see later, the rationality tenet is particularly important in thinking about how property rights evolve because rational actors will work to define and enforce property rights only if the benefits of doing so exceed the cost.

Rational maximization in the face of resource scarcity leads to the third principle, namely that individuals will compete for control of scarce resources and that the nature of the competition

What Are Property Rights?

11

will depend on the rules of the game. Consider the example of scarce movie theater seats. If the demand for seats exceeds the supply and the price of seats does not rise to reflect this excess demand, people will queue to get the seats. Alternatively, if the seat price rises, those who value the seats more highly will compete by paying more. Similarly, American Indians competed with early European settlers for scarce land. When the two sides agreed on the property rights, they traded with one another, as the famous exchange of trinkets and beads for Manhattan Island illustrates. When the rights to land were less clear, however, as in the case of nomadic Plains tribes, and when the European settlers had a standing army press their interests, competition for land took the form of fighting rather than bargaining. Racing for theater seats or fighting for western lands are costly forms of competition because of the time, effort, and resources expended in the process.

The final tenet is that well-specified and transferable property rights encourage gains from trade. Racing and fighting waste valuable time and money. Therefore, individuals and groups have an incentive to develop property rights and encourage exchange. With property rights well defined and transferable, owners have an incentive to husband the resource because they capture the future value of conservation. If owners do not put a private resource to its highest and best use, others who see the waste can offer to buy it and improve on its use. For these reasons, private ownership replaces the waste of racing and fighting with more efficient long-term use. Instead of people rushing to catch fish and in the process depleting fish populations, owners with fishing rights are more likely to harvest on a sustainable basis (De Alessi 2003). When water can be freely drawn from a stream, there is a race to the pump house. On the other hand, if water rights are well-specified and transferable, owners have an incentive to conserve the precious resource (see Anderson and Snyder 1995).

Conclusion

The four tenets described above guide the analysis of property rights that follows. In chapter 2, we elaborate on how property rights encourage efficient use of scarce resources, offering numerous empirical examples to compare private ownership with alternative institutional arrangements. The examples document the positive impact property rights have on resource stewardship, human cooperation, and wealth.

If private property is generally a superior institution, it is important to understand the rules by which property rights are defined and enforced. In chapter 3, we consider the evolution of property rights by introducing the institutional entrepreneur who recognizes gains from moving resources from open access to private ownership. After realizing the possibility of higher-valued uses for an asset, the entrepreneur must define and enforce property rights to capture the higher values.

Government may be the cheapest way of defining and enforcing property rights, but it is naive to assume that government, with its monopoly on force, is always the optimal solution. In chapter 4, we raise the fundamental question of political economy: When collective coercive power is necessary to enforce property rights and the rule of law, how can it be constrained from taking and redistributing property rights, especially without compensation to the property holder?

The efficacy of property rights and free societies depends on our ability to build and maintain barriers against takings. In chapter 5, we discuss the future of property rights and the new frontiers for the evolution of property rights. Here we hope to stimulate the reader to find new applications of the property rights approach.