

Role of property rights/Limitations on property rights/Ideology & property rights

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1. The owner of a certain property rights will receive a stream of benefits from those rights. Thus, property rights affect both the distribution of wealth and the distribution of income.

2. Property rights include both ownership rights and control rights. In general, ownership and control can be two different matters. It is possible to own but not be able to control, and to be able to control but not own. The right of control has a market value, e.g., the control premium. However, in market economies, ownership generally implies control, at least de jure control.

3. The establishment of property rights is important not only because it affects the distributions of wealth and income, and control, but also because it affects economic behavior. Often it makes a difference whether there is an owner. New hotels in China, regardless of whether they are government-owned or privately owned, are all beautiful when they open. However, five years later, the government-owned ones typically look more than ten years old. And the privately owned ones often still look new. Why? For the government-owned hotels, no one cares. But for the privately owned hotels, the owner cares. So he or she takes pains to maintain the hotel, and to continue investing in improvements. A sense of ownership is important. Owners as opposed to non-owner managers, tend to focus more on long-term values rather than short-term gains. In general, long-term contracts, even implicit, encourage investment. In the old days, agricultural tenants on fixed rent with indefinite tenure often made investments on their rented parcels. Thus, formalizing property rights can lead to significant changes in economic behavior.

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4. Property rights can also be used as collateral in the broad sense, not just for loans. As long as there is nothing to lose, people tend to become reckless and irresponsible. If there is actually something valuable to lose, individuals and firms tend to become more careful and responsible. In particular, individuals and firms with deep pockets tend to be more careful and responsible because they are cognizant of potential liabilities and what they stand to lose. Thus, formalization of property rights can help reduce moral hazard. Give a manager stock options, he tends to take more risks because he has no downside. Give a manager shares (or better still, make him buy some shares with his own money), he will begin to worry more about the downside and act more deliberately and sensibly.

5. Property rights can also come with obligations, both explicit and implicit. For example, a privately owned public utility has to meet certain standards of service. Under the responsibility system of the early agricultural reform in China, the lessee of the land has to fulfill both delivery and tax obligations. The owner of a piece of land has the obligation of paying the property taxes. The eldest son of the eldest son used to receive a share of his grandfather's estate equal to that of his father and uncles, but he also had the obligation of continuing the worship of his ancestors.

6. People who own property tend to be supportive of property rights. This is especially true of small property owners. They almost never become revolutionaries. (Occasionally large property owners may entertain revolutionary thoughts.) Giving everyone some property is thus expected to enhance social stability and harmony.

7. Property rights include intangible and intellectual property rights. Without rewards such as patents and copyrights, the creation of new intellectual property may be slowed. However, the tradition of intellectual property in China is perhaps a little different. For example, there is a

time-honored tradition in painting and calligraphy to copy, literally copy, from past masters (however, always with acknowledgement). And these works are highly valued in themselves. Imitation is indeed the best form of flattery. As China changes from being only a user to also a creator of intellectual property, we can expect the protection of intellectual property rights to improve (as actually happened in Hong Kong, South Korea and Taiwan). Other possible solutions may include site licenses and limited Chinese editions of publications and software.

8. There was also a tendency in China for credit to go to a group collectively rather than to a small number of individuals. The most famous example is the synthesis of insulin by an institute of the Chinese Academy of Sciences in Shanghai. There is a traditional disdain on the part of Chinese intellectuals for manual labor (including operating one's own computer) and for money. While it is true that intellectuals are often not motivated by money. (It is most certainly true that neither Isaac Newton nor Albert Einstein were motivated by monetary gain.) This does suggest a possible disconnect between theory and practice and provide an explanation for the relative difficulty of commercialization of intellectual property in China.

9. There is no absolute property right anywhere in the world. For example, in the industrialized economies, the use of land is governed by zoning regulations and the permit process. There is the possibility of homesteading on the one hand and eminent domain on the other. The property rights of land ownership can be unbundled into different use rights. Mineral rights can be separate. Property rights are frequently circumscribed or modified especially when externalities are involved or when there are over-riding social objectives.

10. A well-established principle for Chinese economic reform is that it must be Pareto-improving, i.e., no one should be made worse off. (This is possible because of the existence of inefficiencies.) In general, potential losers are compensated either directly or indirectly. For

example, we have all heard of the rise in public demonstrations in China in recent years. Most of these demonstrations were against unfair taking of land by local authorities. But in Shenzhen, there has not been any problem despite the conversion of large tracts of land from agricultural to various urban uses. What Shenzhen has done is to provide adequate compensation to those whose land is to be taken. Each household is given two units from the redeveloped project, one to live in, and one to provide rental income to replace the lost agricultural income. Thus, no losers are created and hence no demonstrations.

11. China has gone a long way towards allowing non-state ownership of the means of production. Ideologically, this can be justified on the grounds that China is only now going through the primary stage of socialism. I once joked with Malcolm Forbes that in China it should call its magazine “Socialist Tool, Primary Stage” rather than “Capitalist Tool”.

12. Is state ownership absolutely necessary? State ownership is not necessary from the point of view of revenue, as long as the state has the ability to impose taxation and enforce it. I have often argued that in the United States, the Government owns close to nothing, but is effectively an implicit partner to everyone, both enterprises and individuals, with a share up to 50 percent (federal, state and local combined). Moreover, it is only a “partner” for the profits/income, but has no responsibility for the losses. Contrast this situation with China, in which the state in principle owns either outright or at least a majority of the shares of the state-owned enterprises; however, it seldom benefits directly from the profits but is more often than not stuck with the large losses. The U.S. clearly comes out ahead—it is better to tax than to own from a purely revenue point of view.

13. State ownership is also not necessary from the point of view of control. The state can impose regulations (and incentives and disincentives) to steer an enterprise to behave the way it

wants the enterprise to behave, shareholding or no shareholding. (Even in the U.S., the Ford Family is able to control Ford Motor Company with only a 10 percent shareholding.)

14. However, state ownership is probably necessary if the state wishes to appoint, directly or indirectly, the senior management of the enterprises, including the CEOs and Deputy CEOs. The Government may be able to get away with being able to appoint the CEOs of a few of the most important enterprises, e.g., the largest commercial bank, even if it only has minority stakes. But it probably cannot do it across the board for all large enterprises, unless it is itself a substantial and preferably a majority shareholder in each of the enterprises. So maintenance of state ownership is not so much motivated by ideological considerations but is intimately connected with the desire of the state/party to maintain control over the selection and promotion of senior personnel.

15. The ability to tax is actually a property right. The right to tax, and the right to regulate, are both worth money. Government bonds are valuable on the market only because the issuers have the right to tax, and hence the ability to service the debts. In the old days, and in fact it is still true in some countries, there is the practice of tax farming, or in modern parlance, the outsourcing of tax collection. Very often the tax collector commits to the delivery of a fixed amount of revenue and whatever excess amount that he or she manages to raise he or she will be able to keep. I am not advocating a return to tax farming, but simply to note that the ability to tax is a valuable property right.