

Speaking Points

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I. General Perspective

A) The starting point of our investigation is Dan Usher (1981), who lays down the "Economic Prerequisites of Democracy"

- A sketch of the argument:
 - Democracy (the majority rule) is incompatible with the political assignment of income.
 - The *system of equity* is defined as "a means society employs to assign incomes to people, outside of and prior to the political process" (Usher, 1981, p. 17)
 - The system of equity has to be *feasible*, i.e., in real life, it must guarantee that a large enough fraction of income and property are assigned outside the political process
 - The system of equity must also be *acceptable*, in the sense that the losers must find the cost of disrupting the system higher than the benefits (coming from expropriation).
 - With these premises socialism is obviously incompatible with democracy, whereas the pure textbook general equilibrium capitalist system may be compatible "a competitive economy can apportion the national income among citizens, freeing the legislature of the need to do so, and creating the conditions for the existence of democratic government."

- A tradeoff appears between feasibility and acceptability.
 - The efficiency of the perfect competition allocation may be compatible with an extremely skewed distribution of resources, and hence with unbearable social costs.
 - Natural monopolies may require regulation and the need for the legislature to specify the content of property rights.
 - In general, market imperfections may require collective action to correct distortions

- All the elements that have been introduced to increase the acceptability of the capitalist system of equity have expanded the degree of political determination of income, and hence reduced its feasibility
- *The whole problem is then to find the optimal balance, i.e. to subtract enough power to the market so that the assignment becomes acceptable to the losers of the system, without nevertheless hampering the feasibility.*
- The justification of property has not to be found in a natural right, which among other things is hard to justify: "All ownership derives from appropriation and violence. When we consider the natural components of goods [...] and when we follow the legal title back, we must necessarily arrive at a point where this title originated in the appropriation of goods available to all. Before that, we may encounter a forcible expropriation from a predecessor whose ownership we can, in turn, trace to an earlier appropriation or robbery. That all rights derive from violence, all ownership from appropriation or robbery, we may freely admit..." (L. von Mises, quoted by Usher).
- Looking in particular at property rights, Usher's framework yields a "secular" approach. Property is justified only by its role in sustaining democracy.
- While with no property rights capitalism does not exist, with too strong property rights democracy may not survive. "Democracy is strengthened if certain types of economic freedom are curtailed" (Usher, 1981, p. 90).
- Efficiency must be seen in a broader sense than usual, as the capacity of the system to increase the democratic cohesion. A measure that increases economic efficiency, while at the same time reducing the adherence to democratic principles, is not efficient in this broader sense.
- Too strong inequality in the distribution of property rights may undermine the acceptability of the

B) Why is this framework interesting? After all China is not yet a democracy, but it is well advanced in the construction of a capitalistic society.

- a. The first reason has directly to do with Usher's topic.
 - In fact, sooner or later the problem of a transition towards a more democratic system will emerge as important. Democratization will be pursued by the elites only if it will not disrupt the existing social order.
 - The war between developers and tenants in Beijing's hutongs, and the forced evictions of the latter, had wide media coverage in western countries (e.g., HRW, 2004). Even more serious is the problem in the countryside, where peasants are evicted with negligible compensations. These are just the most known instances of insufficient application of the rule of law. As long as property rights will not be protected for the vast majority of China's citizens,

the system of equity will be unfit to serve as a basis for Chinese democratization.

- A first set of questions, related to this topic, is the following:

Q1) Is the Chinese legal system coherent with the protection of property rights?

Q2) if it is so, as the current literature seems to suggest, why is implementation so poor?

Q3) what are the concrete measures to improve both the legal framework and the implementation?

- b. A second reason of interest comes from an analogy between Usher and the Schumpeter of *Capitalism, Socialism and Democracy* (1942)

- In Schumpeter extreme market forms do not seem to be compatible with innovation and structural change, and the optimum lies in the middle (contestable monopoly).
- Similarly, in Usher, excessive protection of property rights makes the system of equity too unequal, but insufficient protection makes it unfeasible.
- Thus, we have the general question:

Q4) Can we borrow tools and concepts from the literature on innovation to study the property rights regime that is more fit to a fast changing economy?

- C) The last general question directly addresses the relevancy of the issue. Two facts make this question pertinent:

- a. China experienced a steady process of constitutional and legislative adaptation to the needs of a capitalistic economy (an answer to question Q1 above). The constitutional amendment of 2004, and the civil code approved in October 2005, would assure a sufficiently robust legal framework for the protection of property rights. The problems seem to lie in the implementation and in the efficiency of the judiciary.
- b. A very interesting paper by Li (1996) uses the Grossman and Hart (1986) model to show that *ex ante* ambiguity of property rights may prove to be efficient, when facing a gray market. Associating government agencies to the benefits of investment may serve as an “insurance”, and help maximize expected profits when high transaction costs prevent contingent contracts. According to the author this model explains the increasing success of the Chinese system. Che and Qian (1998) show that local government ownership may be efficiency enhancing. Feenstra and Hanson (2005) apply a similar reasoning to FDI.

We can then ask the following questions

- Q5) Can we still classify the issue of property rights as crucial for China, as is for example the problem of finance? (Johnson, McMillan and Woodruff, 2002; Cull and Xu, 2005)**
- Q6) If the answer to Q5 is no, how sustainable will the current situation be in the long run? Up to what stage of development the interaction of gray market, local government officials and private entrepreneurs will prove to be virtuous?**
- Q7) When the system will attain its limits, how to organize the transition to a "standard" system of property rights?**

D) The general approach we must follow in investigating these topics, especially in light of the amazing performance of the Chinese economy, is the refusal of one-size-fits-all recipes. Usher's secular approach becomes crucial in this respect.

II. Specific Questions

A) The relation with developed countries

- Property rights protection may be different between FDI and domestic investment (Branstetter and Lardy, 2006)

Q8) Can we imagine sustainable growth based only on FDI?

- Intellectual property rights. They pose problems for developed countries (Güvenli and Sanyal, 2003), problems that are likely to become less stringent as China develops. But

Q9) Would a better protection of intellectual property rights make a difference for China, in terms of increased trade and/or domestic development?

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