The Political Economy of Property Rights Discrimination
Dissertation Summary and Chapter Outline
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Abstract

Economists have long advanced the simple proposition that the protection of private property rights underpins economic performance. They have tested the macroeconomic implications of this argument utilizing sophisticated statistical methods, finding that a country's long-term economic growth increases in its government's propensity to protect property rights. However, economists' focus on these *macroeconomic* effects obscures the *microeconomic* nature of the theoretical claim and reveals an implicit assumption of the public good nature of protecting private property. New data from the World Bank belies the latter assumption; firm-level surveys demonstrate that firm managers' confidence in their property rights varies within countries and that the shape of this *within-country* variation itself varies *across* countries. Extant approaches can explain neither the origins nor the consequences of this pattern.

In response, I merge a more subtle formulation of the microeconomic logic regarding property rights with a micro-political theory of institutions to investigate both the origins and consequences of what I term "property rights discrimination." I contend that, although an economic actor benefits indirectly from the protection of others' rights, his economic choices respond more strongly to the protection of his own rights. Under certain circumstances, he profits when another actor's rights are neglected, particularly when this neglect allows him to violate those rights for his own gain. Assuming that political authorities are chiefly responsible for enforcing private property and that they can differentiate the level of that enforcement across citizens, then economic actors will pressure political leaders for *property rights discrimination* that will keep them in an "in" group of protected property rights, while relegating other actors to an "out" group of unprotected rights. Thus, the security of private property rights will vary within and across countries. Property rights discrimination has two important economic effects. First, it depresses economic activity within the "out" group. Second, it dampens aggregate economic activity. In turn, the shape of property rights discrimination depends on political institutions — namely, the size of the coalition necessary to maintain political leaders in power and the size of the larger group legally empowered to choose leaders. By characterizing regimes by the relative size of the winning coalition and selectorate, I derive specific predictions regarding the *distribution* of property rights protection within and across countries. My framework predicts not only the general level of property rights discrimination, but whose rights will be violated.

I define three empirically testable implications of this theoretical framework. First, I estimate models of two political economic implications of property rights discrimination — variation in firm managers' confidence in property rights enforcement and judicial independence. Second, I estimate a multi-level model of firm mangers' confidence in their property rights, modeling how firm-level and national-level political characteristics interact to shape the probability that a government will choose to protect a particular firm's property rights. Finally, I use firm-level surveys conducted by the World Bank to estimate the economic consequences of property rights discrimination; I estimate the negative effect of property rights discrimination on firm-level investment within "out" groups and on the level of national investment. In addition to this statistical analysis, I document a particular instance of property rights discrimination based on field research conducted in Bogotá, Colombia.

Chapter Outline

Chapter 1. Introduction

Beginning with Adam Smith and continuing through the New Institutional Economics of Douglass North and others, economists have advanced the simple proposition that the protection of private property rights underpins investment and economic growth. Growth economists have increasingly turned to this logic as an explanation of cross-national differences in long-term economic performance. Using sophisticated statistical methods, they have found that a country's long-term economic growth increases in its government's propensity to protect property rights. However, economists' focus on these *macroeconomic* effects obscures the *microeconomic* logic of the theory — i.e., that an economic actor is more likely to invest when he is certain that his private property rights will be protected. Furthermore, these tests reveal a hidden assumption regarding private property rights; although rights are *private*, their protection is a *public* good. Essentially, extant empirical tests engage in a kind of ecological inference, assuming microeconomic behavior on the basis of macroeconomic data.

In contrast, firm-level surveys conducted by the World Bank clearly show that firm managers' confidence in their property rights varies within countries and that the shape of this *within-country* variation itself varies *across* countries. In certain countries, the distribution of firm managers' confidence clusters tightly around the mean level of confidence, whereas in others, there is far greater dispersion in their responses. Examining this pattern carefully forces us to consider the protection of private property rights as spatially distributed. To paraphrase Samuel Huntington, I claim that the most important political distinction among countries concerns neither their *form* nor their *degree* of government, but their *distribution* of it. If, in reality, governments can and do differentiate the protection of private property rights across citizens, what are the microeconomic and macroeconomic consequences of doing so? Why do political actors distribute the protection of private property so differently? Extant approaches simply cannot answer these questions.

In response, I merge a more subtle understanding of the microeconomic logic regarding property rights with a micro-political theory of institutions to understand both the origins and consequences of what I term "property rights discrimination." Answering this question contributes to the study of comparative political economy in at least three ways. First, this research deepens our understanding of *how* and *why* the security of private property rights varies across countries. Second, it strongly suggests that the origins of political institutions that protect private property (e.g., independent judiciaries) lie in their distributional effects. Finally, the theoretical framework developed here suggests avenues for future research in the political economy of development.

Chapter 2. The Political Economy of Property Rights Discrimination

In this chapter, I build a theoretical framework that explains why economic actors desire and how political leaders provide property rights discrimination. First, I review the microeconomic consensus surrounding private property rights. In contrast to open or communal access to scarce resources, private property clearly matches the structure of rights to private actors' incentives to maximize their streams of income. Furthermore, the well-known Coase Theorem states that when transaction costs are negligible, the existence of clear and enforced private property rights is sufficient for economic efficiency. Put differently, the creation of private property rights — and their clarification in any disputes over rights — ensures economic efficiency, no matter *who* is allocated those rights initially.

In contrast, I make three related claims. First, regardless of the level of transaction costs, the creation and clarification of private property rights affects the distribution of economic gains. Simply put, an actor benefits economically when she is allocated private property rights. Second, in the far more

defensible case of non-negligible transaction costs, these distributional effects are intensified. Third, the presence of transaction costs also affects economic efficiency. When less efficient economic actors' claims are favored in the creation and clarification of private property rights, the likely result is aggregate economic inefficiency.

Because an economic actor benefits greatly when he wins access to private property rights, he possesses a strong incentive to modify the process of creating and clarifying private property rights so that his claims are systematically favored. Assuming that the State plays an important role in this process, economic actors will essentially "push" conflict into the political realm, pressuring political leaders for property rights discrimination. Self-interested political leaders thus face the temptation to secure political support by creating an "in" group of citizens who enjoy secure private property rights while relegating other citizens to an "out" group of unprotected rights. Doing so has strong implications for long-term economic growth and inequality. Therefore, private property rights vary across countries not only in the security of the "in" group's rights, but also in the size of the "out" group).

Why do some political leaders engage in more property rights discrimination than others? The selectorate theory proposes a clear answer. The theory states that political leaders remain in power by retaining the support of a winning coalition of citizens, who are in turn drawn from a larger *selectorate* (i.e., the group of citizens who are legally empowered to choose the political leader). Leaders of political systems with a large selectorate and a large winning coalition (i.e., democracies) will avoid property rights discrimination because they most reliably and cheaply retain political power through the provision of public goods. All else equal, the distribution of property rights protection in such regimes should be tightly clustered around a relatively high mean. In contrast, leaders of non-democracies (i.e, those countries with a small winning coalition) that also have a a large selectorate (e.g., one-party fixed democracies) will best retain political office by protecting the property rights of the small winning coalition while discriminating against the remainder of the population. In such regimes, we should observe a lower mean with higher dispersion around that mean, since members of the winning coalition will profess confidence in their property rights. Finally, small selectorate non-democracies (e.g., monarchies, military juntas) will face competing pressures, weighing the political benefits of discriminating in favor of their small winning coalitions against the pressure to support long-term economic growth through providing public goods. Thus, the extent of property rights discrimination in these regimes will likely fall in between the other two ideal types.

Chapter 3. National-Level Models of Property Rights Discrimination

In Chapters 3, 4, and 5, I carefully define and implement an empirical strategy to evaluate the predictions of the selectorate theory regarding property rights discrimination. The first task in building this empirical strategy is carefully defining empirical manifestations of property rights discrimination. Here, I concentrate on two such implications. First, I leverage the World Bank Enterprise Surveys to build measures of national-level variation in firm-level confidence in property rights. Second, my theoretical framework implies that judicial and bureaucratic institutions — which likely play an important role in defining private property rights and resolving disputes over them — will strongly reflect the extent of property rights discrimination. If a leader wishes to credibly commit to avoiding property rights discrimination, she can place these institutions outside of her control. By doing so, she lowers the level of political interference in the protection of property rights and credibly assures a greater number of citizens — not merely political supporters — that that their rights are secure. I show how these two measures are closely related.

I then test statistically whether each of these manifestations of property rights discrimination responds to measures of the size of the selectorate and winning coalition. The results described therein suggest that judicial independence and variance in firm confidence in property rights both respond to the

size of the selectorate and winning coalition as predicted by Bueno de Mesquita and his co-authors. Furthermore, Eastern European and Latin American countries, all else equal, tend to suffer from more severe property rights discrimination in comparison to other regions.

Chapter 4. A Multi-Level Statistical Analysis of Property Rights Discrimination

The theoretical framework I develop in Chapter 2 makes specific predictions regarding not only the general level of property rights discrimination (i.e., the underlying distribution of the security of citizens' property rights), but also *which* citizens' property rights will be protected by political authorities. In short, a citizens' confidence in his property rights depends on the interaction of the political grouping he inhabits and the set of national political institutions that govern. The citizen may be disenfranchised (i.e., in neither the selectorate nor the winning coalition), a selector (i.e., in the selectorate, but not in the winning coalition), or in the selectorate *and* the winning coalition. Meanwhile, these various groupings may be large or small. In this chapter, I estimate a multi-level model of firm managers' confidence in the legal protection of their property rights. In essence I test whether a firm's confidence in its property rights depends on the interaction of firm-level political characteristics (i.e., proxies for the political grouping the firm inhabits) and national-level political institutions (i.e., the size of the selectorate and the winning coalition).

Chapter 5. The Economic Effects of Property Rights Discrimination: An Analysis

Chapter 2 clearly implies that property rights discrimination will depress economic activity within the "out" group while also dampening aggregate economic activity. I test these hypotheses using the World Bank Enterprise Surveys. I estimate two models using these data. First, I estimate a model of firm-level investment, testing whether firm managers with lower confidence in the protection of their property rights systematically re-invest a lower percentage of their profits in their businesses. Second, I estimate a model of national investment (using data from the Penn World Tables and the World Bank's *World Development Indicators*), testing whether high variance in firm managers' confidence in their property rights depresses national-level investment.

Chapter 6. Analytical Case: The 1936 Colombian Land Reform

In the second component of my research strategy, I illustrate the logic of property rights discrimination with field research on land reform conducted in Bogotá, Colombia. A coffee boom in the late 19th and early 20th centuries shifted the relative value of land in coffee-producing areas of Colombia and initiated a rapid colonization of previously uninhabited portions of the country. This colonization gave rise to sometimes violent disputes between owners of large haciendas and small farmers over the rights to rich coffee-producing tracts of land. Given the rising tide of violent conflict over property, Colombian President Alfonso López Pumarejo sought to resolve these conflicts through a comprehensive land reform that would democratize access to newly colonized areas. That reform, however, called into question the legitimacy of many rich landowners' property claims. Rich landowners responded first by using their influence over the upper house of Colombia's legislature to dilute any attempts to award disputed property rights to small farmers. They then blocked the law's implementation by weakening and eventually eliminating a new body of judges that would adjudicate land disputes, leaving these responsibilities to local judges who were politically loyal to their interests. This evidence strongly suggests the presence of property rights discrimination, aided by political institutions. Furthermore, the land reform's economic effects — a concentration in land ownership and declining agrarian productivity — reflect my emphasis on the economic consequences of private property rights.

Chapter 7. Conclusions

My dissertation builds a theory of property rights discrimination based on the distributional consequences of private property and rigorous analysis of political institutions. In doing so, I leave specific implications for future economic performance and political development somewhat unexplored. These open questions will help form the basis of future research into property rights, political development, and economic performance.

In particular, I consider four areas where this research might be expanded. First, higher property rights discrimination should raise income inequality and slow economic growth. More specifically, it implies that the "in" group's income will, over time, show a very different path from the "out" group's. Rather than think of these differences in a static framework, future research, potentially using simulations, should consider long-term patterns as a repercussion of discrimination. Second, this research leaves important spatial dynamics untouched. Though the selectorate theory, as employed here, predicts which political groupings will suffer property rights discrimination, it remains unclear exactly *who* inhabits those groupings. The winning coalition may be defined by race, gender, location (e.g., rural versus urban), religion, membership in the military, etc. Future research must identify these political groupings and analyze the extent to which they suffer property rights discrimination and its consequences. Finally, each of these previous points implies endogeneity in the creation of economic and political institutions. Continued property rights discrimination that creates specific patterns of economic inequality may affect the creation and consolidation of democratic political institutions. We do well to think carefully about this potential path dependence and explore it empirically.