

## CHAPTER II: PROPERTY RIGHTS AND ECONOMIC DEVELOPMENT

A well-functioning property rights regime allows for economic assets to be productive by reducing transaction costs and encouraging the creation of surplus value that can be reinvested without fear of expropriation. The link between secure property rights and economic development lies in the ability of the property rights system to infuse what Hernando de Soto called “dead capital” into the formal economy. Many developing countries’ experiences, however, illustrate the difficulty in creating and maintaining a property rights system that works for all citizens. It is, therefore, even more important to continue to highlight the benefits of property rights regimes that facilitate economic growth and development.

### Private Property Rights

Economists have identified at least four ways that insecure property rights negatively affect economic activity. Professors of Economics and Political Science at the London School of Economics Tim Besley and Maitreesh Ghatak have recently summarized these four aspects. First, insecure or weakly enforced property rights increase the risk of expropriation, which diminishes incentives to invest and to produce. Second, insecure property rights decrease productivity by necessitating the need to defend property. Third, insecure property rights fail to facilitate gains from trade (i.e., if property rights are not full or entirely secure, assets sometimes cannot be transferred to those who can use them most productively). Finally, property serves as an important tool in supporting other transactions such as obtaining financing via its role as collateral (Besley & Ghatak, 2009).

Hernando de Soto’s pioneering work documenting the amount of “dead capital” – assets that cannot be represented in the formal economy or used for collateral – in the developing world spurred an increasing interest in property rights. Governments around the developing world are presented with a puzzle on how to convert dead capital into viable economic assets that can put their countries on a path toward prosperity. One of the answers lies in ensuring that the poor can register their assets within a formal property rights system with minimal transaction costs. As de Soto discovered, there is still ample work that needs to be done in eliminating these hurdles.

Finally, no property rights system can operate in a vacuum without full support of the legal and judicial system aimed at enforcing property transactions. An institution with a strong rule of law and independent judiciary void of corruption and political instability provide the environment for a formal property rights system to flourish.

While property rights hold the key to economic prosperity and growth, it is important to keep in mind that many other social institutions play a significant role. In particular, a well developed banking system to provide the capital necessary to infuse the economy is largely complementary in the development process. Recent microfinance efforts have been successful in bringing loans to the poorest in developing countries. But a sophisticated financial system is needed to bring these economies into the integrated world market.

### Intellectual Property Rights

The modern economy relies not only on physical property rights but also intellectual property rights (IPRs). Intellectual property rights are exclusive rights over creations of the mind. These include inventions, literary and artistic works, and symbols, names, images, and designs used in commerce.<sup>6</sup> The world economy has come to depend on IP goods – from airplanes to business software, and from pharmaceuticals to cell phones.

In many ways, intellectual property rights play a similar role to physical property rights. Secure intellectual property rights create incentives for innovation just as secure property rights create incentives for production. Similarly to physical property rights, IPRs reduce transaction costs. For example, trademarks signal information about the quality of products, which reduce consumer search costs (Baroncelli, Krivosos, & Olarreaga, 2004).

The challenge of protecting intellectual property rights, however, is even more daunting compared to physical property rights because theft of IPRs is facilitated by their own intrinsic qualities. Therefore, countries with weak IPRs require substantial resources to build an effective enforcement system of IPRs. While some countries may feel this investment is beyond their means, they need to realize that an effective IPR system is an important ingredient for long-term economic success. In addition to spurring domestic innovation, strong intellectual property rights increase incentives for foreign direct investment (Branstetter & Saggi, 2009), which in turn also leads to economic growth (Saggi, 2002).