Political Economy of Property Rights: Sample Country Cases

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Abstract

Property rights are the main components of liberal economic system. Therefore, free market economies support institutional mechanism and political economic performance of the countries. More specifically, property rights protection and income inequality are the key legal and economic factors for economic growth. However, literature is lack in order to explain the relationship between property rights protection and income inequality in a theoretical and statistical way. This paper aims to fill these gaps with political economic perspective and through simple country analysis. It is important to show this relationship in order to show up the substitutability of legal protection of property rights with the political economic perspective in the event of income inequality. Especially developing countries are under the impact of efficient or inefficient institutions and political economic problems. In order to verify our hypothesis, this study try to reveal whether or not property rights protection and income inequality have a negative relationship simply. It is chosen Russia and Turkey as sample states and simple ordinary correlation analysis has done. The empirical results show the negative correlation between income inequality and legal protection of property rights under relevant conditions. Empirical results are consistent with the theoretical background and literature review part of this study.

Keywords: Political Economy, Property Rights, Income Inequality, Russia, Turkey.

INTRODUCTION

Property rights are the key market supporting institutions. They help to market mechanism through implementations and their efficient results. Therefore, property rights are assumed to be well defined and perfectly protected because of zero transaction costs in the world of neoclassical economy (North, 2002; Leblang, 1996; O'Driscoll and

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Hoskins, 2003). Protection of property rights has crucial role on economic growth through influencing individuals' expected opportunity sets, resource allocation (Foss, 2010: 93; Hoskins and Eiras, 2002: 40) and reducing transaction costs (Mahoney, 2004). In addition to property rights protection, income inequality is also key factor for economic performance or welfare issues in the economies. Especially in developing countries lack of efficient institutions and political instabilities affect the market mechanism in a negative way. However, more specifically the literature is lack in order to explain the relationship between property rights protection and income inequality as an individual economic indicator. This paper aims to show this relationship in order to show up the substitutability of legal protection of property rights with the political economic perspective in the event of income inequality. Legal protection becomes substitutable for rich agents with political protection under the conditions of high-level income inequality and undemocratic type of regime. In order to support the hypothesis, to reveal whether or not property rights protection and income inequality have a negative relationship is vital. Therefore, it is chosen Russia and Turkey as sample states and we make simple ordinary correlation analysis. The results show the negative correlation between income inequality and legal protection of property rights under relevant conditions. They are consistent with the expectations.

The remaining part of the paper is organized as follows. Part one covers political economic background of property rights. Part two explains the literature review, in part three ordinary correlation analysis with a special focus on Turkey and Russia and then the empirical results are presented. In the last part of this study general conclusion and policy recommendations are presented.

POLITICAL ECONOMIC UNDERSTANDING OF PROPERTY RIGHTS

Property Rights as an Institution

The basic institutions in free market economy are property rights and also freedom of contracts with an efficient governmental control. Pejovich (1990) analyze the property rights economics through institutional economics perspective clearly. According to his approach, those institutions help to "generate incentives that have specific and predictable effects on the behavior of decision makers, the allocation of resources and the flow of

innovation". More specifically scarce goods and transaction costs in the market economies caused the construction of property rights in the system. "Property rights" in other words "right of ownership" increase incentives for the owner to seek and reach the highest-valued use for possible resources. From the ownership concept; the right of ownership consists of some basic functions. These are; usus means the right to use an asset, fructus means the right to capture benefits from that asset, abusus means the right to change its form or substance and the right to dispose that gives the individuals or owners to sale. In addition, the right of ownership affects economic behavior in several ways such as; Exclusivity of ownership that provides incentives for those who own assets to put them into the highest-valued uses, transferability of ownership that provides incentives for resources to move from less-productive to more-productive owners and constitutional guarantee of ownership that separates the accumulation of economic wealth from the accumulation of political power" (Pejovich, 1990: 28-29).

Thanks to "exclusivity of ownership" individuals who own the asset have right to owner has the right to access, dispose and use. The owner is responsible for the cost and benefit of his/her rational choices. In addition, with the right of transferability of ownership owners can transfer the assets freely to the chosen parties. This property right help to efficient allocation of resources in the markets. Because owners have right to transfer their assets to most productive players in the markets. The property right that gives constitutional guarantee to the owners help to diminish the possible negative impacts of political power. Economic well-being of the politicians generally increases when they move up the power. Absence or weak constitutional guarantee of property rights in the political market has decisive influence on one's economic wealth.

Freedom of contracts is a legal right that provide free economic behavior to the players in the free market mechanism. Contracts or the law of contracts are the tools in order to link the property rights and economy. Therefore, directly or indirectly property rights and freedom of contracts help to create economic output in the markets. More specifically contractual agreements (Pejovich, 1990:31);

- Encourage the exchange process simultaneously

- Encourage the optimal level of economic activities

- Reduce transaction costs

- Affect trade activities

- Reduce risks in the market

Free contracts or law of contracts are the rights that are given to the individuals by the liberal system or, with an institutional perspective, are the rights that are given by the efficient judicial system. In this type of economic systems, roles of governmental organizations are focusing on the efficiency and managing the system depending upon the rules of the game. Property rights and contractual agreements output depends upon the states' behavior. Market mechanism is efficient if rules are benefit for the individuals. Otherwise, rules can cause costs because of the individuals' behavior for this time. In other words, efficient rules reduce the institutional and individual risks therefore limiting the governmental control (constitutional government) such as the director of the game in order to enforce the rules including itself most beneficial for economy.

Property Rights and Market Mechanism

Property rights can be defined through liberal market mechanism. The basic term of this economic system is scarcity. Because of the scarce goods individuals have to make choices. Our choices and also scarcity of goods in the nature create competition in the market. Production, consumption and allocation of scarce goods can be efficient through property rights protection. So, scarcity can get out of being a central problem thanks to property rights only. Property rights are the only practical way that can solve this problem. Efficient income distribution is possible through protection of property rights. As there are property rights, individuals decide in a rational way. This is because "property rights" is an economic concept. Property rights present framework to the individuals in order to able to use and know their rights on the goods. This is an economic right because people know how to control the process freely. Property right can be defined

as an economic right because they are about current and future time properties. In addition, they resulted with economic output in the market mechanism.

Scarce inputs used in production process in order to have output. So, property rights support production function such as land, labor, human and physical capital, technology and entrepreneurship in the market economy. In developing countries, political economic institutions include in the judicial system impacts the developments in the economies. For instance; when the legal protections increase in these types of countries the number of the investments also increase (Dao, 2021:329). It means that firms or individuals begin to trust the countries legal protection process. In addition, contractual process has a relationship with the protection of property rights directly. It helps to reduce the risks for investors and also for entrepreneurs. Political economic problems such as abusing the political power and corruption are the results of weak protection of property rights (Dao, 2021:330). So, it means that, depending upon these dimensions, corruption leads to income inequality but mainly income inequalities arise from weak protection of property rights.

Productivity of the economies depends upon the role of profit and price issues. The efficient usage of the resources and transfer of these type of goods will help to prevent the high costs and risks during the production process. In addition, as it is defined above, the right of ownership through property rights creates incentives for producers in the market. The economic rights such as to own, to transfer and to use of resources help to gain profit because individuals and organizations choices or preferences are the results of their interests. They can be able to gain profit with transferring the low-valued goods to high-valued ones. In addition, thanks to freedom of contracts individuals have rights to free seeking, negotiating, exchanging simultaneously. Property rights help to minimize the "cost of exchange" through the high satisfaction of the individuals thanks to their own rational and free decisions. This is an institutional environment that is embedded in the economy. Individuals are self-interested and their choices also determine the prices in the markets. In other words, price and quantity of the scarce goods in the market depends upon the rational choices.

SELECTED LITERATURE REVIEW

As Cooter and Schäfer (2012: 407) asserted that "…the richest people are so rich that they can transform their wealth into political power and monopoly positions and need no constitutional safeguards to protect it." In the oligarchic countries, rule of law is meaningless for the richest families because concentration of political power, which weakens rule of law, increases in the extreme inequality (Cooter and Schäfer, 2012: 409). Alesina and Rodrik (1994), Persson and Tabellini (1994) and Benabou (1996) showed that inequality is harmful for growth. Scholars also identified the effect of property rights protection on economic growth (Everest-Phillips, 2008; Besley and Ghatak, 2009; Hall and Jones 1999; Knack and Keefer 1995; Acemoglu et al. 2004; O'Driscoll and Hoskins 2003; Hoskins and Eiras, 2002; Haydaroğlu, 2016).

Clearly defined, protected and enforced property rights reduces uncertainty and promotes investments (Ball and Kesan, 2010; Johnson et al., 2002; Kerekes and Williamson, 2008; Torstensson, 1994). Apart from the well-defined substantive rules, court performance also plays key role for property rights protection (Ball and Kesan 2010). Court performance has more apparent impact on economic growth than substantive law. Since most of the people in the society adapt their opportunity sets and expectations according to the institutional operations of judiciary rather than the efficiency of legal rules. It is easier to observe the efficient performance of judiciary than the efficacy of substantive rules which require expert knowledge. For instance, in Turkey, there is a positive relationship between institutional performance of judiciary and economic growth for the time period of 1980-2010 (Emin Benli, 2017).

Insufficient protection of property rights causes inefficient allocation of scarce resources (Furubotn and Pejovich, 1972). According to Torstensson (1994), economic growth will be positively affected by well-defined and protected property rights through the channels of human capital and technology. Otherwise, productive activities of human capital turn into rent-seeking and redistributive activities. Dinçer (2007) found that if the well protected property rights exist in a country, the positive effect between property rights and economic performance increases. According to Clague et al. (1999), economic growth increases when the property rights on financial assets are protected. In addition,

higher degree of social polarization reduces the secure of property rights that negatively influence economic growth (Keefer and Knack 2002). Glaeser et al. (2003) and Sonin (2003) asserted that good institutions are mostly based on equal income distribution. In addition, Gradstein (2007) considered the protection of property rights as a political outcome. The author states that the more protection of property rights leads increases the level of equal income distribution and reduces political bias. If these conditions exist, "the politically influential rich elite may prefer to relinquish its power through democratization in order to commit future policy makers to the enforcement of property rights, thus ensuring larger investment and faster growth along the transition path." (Gradstein, 2007: 252). Thus, democratization, as a commitment to protect property rights, only emerges in equal economy (Gradstein, 2007). Sonin (2003) also have important contribution to the literature. The author asserted that "Rich agents use their wealth and accumulated political power to shape economic institutions in their favor." (Sonin, 2003:716). Sonin (2003) also displayed that if the rich people have enough political power to determine the level of public protection of property rights, public protection weakens in the long-run period. The author gives an example from Russia that Russian state failed to provide well defines property rights because of oligarchs' political power. On the contrary, Persson and Tabellini (1994) differs from Sonin (2003) in terms beneficiaries of redistribution. Persson and Tabellini (1994) alleged that incomplete property rights protection causes a redistribution of wealth from rich to poor agents. In other words, poor agents benefit from redistribution but according to Sonin (2003), rich agents benefit from incomplete property rights protection and or redistribution.

SIMPLE EMPIRICAL ANALYSIS: COUNTRY SAMPLES
Data and Methodology

Data for the income inequality were collected from United Nations University's 'World Income Inequality Database' (WIID). Property rights protection data were provided from 'International Property Rights Index' (IPRI). Sample countries are chosen as Russia and Turkey[2], according to 'The Economist Intelligence Unit's Democracy Index' (EIUDI)

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[2] Turkey and Russia are chosen as sample countries because they are both developing countries. In addition, they have both strategic importance about past/current political economic issues in the World. Turkey has

which categorizes countries into four groups. Russia is also analyzed in addition to Turkey because it is listed in the category of authoritarian regime and it is known as a developing country like Turkey. Simple ordinary correlations were calculated by Eviews with using Principal Components Analysis.

Empirical Results

This paper asserts that legal protection becomes substitutable for rich agents with political protection under the conditions of high-level income inequality and undemocratic type of regime. In order to support our hypothesis, we examine whether or not property rights protection and income inequality have a negative relationship. We choose Russia and Turkey as sample countries and we make simple ordinary correlation analysis.[3]

Analysis covers the time period of 2007-2013 because of the lack of dataset before 2007 in the IPRI and after 2013 in the WIID[4].

Table 1

Ordinary Correlation Results for Turkey, 2007-2013

Ordinary Correlations for Turkey, 2007-2013		
	PRPI_T	INIE_T
PRPI_T	1.000000	
INIE_T	-0.005231	1.000000

Table 1 very clearly shows ordinary correlation results for Turkey for the time period of 2007-2013. According to the empirical results, there is a negative correlation between property rights protection (PRPI) and income inequality (INIE). The value of the negative correlation is nearly -0.005.

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also hybrid competitive authoritarian regime while Russia has post-soviet authoritarian regime. These two countries are chosen in order to reveal the importance property right issue under the indicated common country profiles.

[3] The most general aim of this article is to proof the theoretical argument of the "positive or negative relationship between property rights protection and income inequality" with using simple concrete method. Therefore, simple correlation method is done to prove this political economic argument. For further studies and arguments, time series analysis, cross country analysis will be done.

[4] International Property Rights Index and Income Inequality Database variables for the sample countries are not available for long period of time. These variables will be collected in different type of databases separately.

Table 2

Ordinary Correlation Results for Russia, 2007-2013

Ordinary Correlations for Turkey, 2007-2013		
	PRPI_T	INIE_T
PRPI_T	1.000000	
INIE_T	-0.734421	1.000000

In addition to Turkey, Table 2 shows ordinary correlation results for Russia for the time period of 2007-2013. According to the empirical results, there is also a negative correlation between property rights protection and income inequality. The value of the negative correlation is nearly -0.734.

Tables display that negative correlation in Russia is higher than Turkey. It seems reasonable because Russia is in the category of authoritarian regime while Turkey was ranked in the hybrid regime according to the EIUDI.

CONCLUSION AND RECOMMENDATIONS

Economic performance of the countries and especially sustainable economic growth in the countries are under the impact of efficient or inefficient institutions. Specifically, protection of property rights supports the efficient allocation of resources. Efficiency and protection of property rights depends upon the legal institutions, liberal market mechanism and also political stabilities.

Inequalities are the political economic factors that are under the impact of institutional mechanisms. They create negative incentives and outcomes in the economies individually and socially. The lack of efficient property rights prevents individuals' economic abilities such as exclusivity of ownership, transferability of ownership and constitutional guarantee of ownership. Because of the complexities in legal systems income inequality reveals as an economic problem. From the supply and demand side, thanks to well protected property rights, efficient allocation of resources can be occurred. Illegal process will be under control, firms will rely on the countries legal systems and rules, coordination problem between the players in the market will decrease.

This study aims to explain the political economic side of property rights clearly. Property rights are the economic institutions in the market mechanism. Therefore, this study offers the political economic background of the property rights, it presents the relationship between property rights and income inequality through the theoretical background, literature and the sample country case. In line with the theoretical background and literature review, and according to the empirical results of this study there is a correlation and there is a negative relationship between property rights and income inequality for Turkey and Russia.

The lessons learned from the results of this study extreme income inequality must be reduced otherwise political protection of property rights take legal protection's place in favor of rich agents in the society. Moreover, legal protection of property rights must be improved by lowering its transaction costs. It can be started with increasing the performance and efficiency of judicial systems. Last but not least, in Turkey and Russia, growth-oriented legal reforms should be improved by protecting makers of wealth through the rule of law. Economy-oriented rule of law should be established.

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