Property Rights, Development, and Democratic Transitions: The Path Ahead

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Article at a glance

• When property rights are not properly documented and property market institutions remain weak – as is the case in many countries – the informal sector dominates the economy and inhibits inclusive growth.

• This pervasive economic exclusion has a direct impact on the quality of democratic governance since widespread informality leads to weak rule of law and corruption.

• The need to broaden property rights, especially for small entrepreneurs, and to strengthen institutions that make property titles meaningful is key to the success of both democratic and market-oriented reforms in transition countries.

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Democracy and development

2011 brought renewed attention to the importance of democracy to development. The Arab Spring in particular opened the door to potential democratic progress, albeit with many challenges ahead.

The world stood before a similar challenge 20 years ago when the communism crumbled in Eastern Europe. However, as the director of the Democracy and Rule of Law Program at the Carnegie Endowment for International Peace Thomas Carothers notes, we should focus on “translating experiences rather than importing lessons,” mindful of profound differences between Eastern Europe and the Middle East. Nonetheless, several key commonalities are clear: 1) democracy is a universal human value; 2) democratic and economic development must go hand in hand; and 3) building institutions that underpin both democracies and market economies is crucial to a transition’s success.

Among those fundamental institutions are property rights. Their importance to the functioning of a market economy is widely recognized. Yet, their importance to democratic development, although no less significant, often remains underappreciated.

Why property rights matter to democracy

Peruvian economist Hernando de Soto, in his book *The Mystery of Capital*, illustrated the importance of property rights to economic development by showing the consequences that ill-defined property rights have. De Soto argues that the problem of many developing countries is not that they have insufficient capital to invest. In fact, the poor in those countries hold immense amounts of capital in the form of land, dwellings, and other possessions. But as long as their property rights are not properly documented and institutions that make them meaningful remain weak, this informally held property remains “dead capital” that cannot be used to propel inclusive growth.

This pervasive economic exclusion has a direct impact on the quality of democratic governance. When ordinary citizens have no easy access to secure property rights, they are forced to live and work in the informal sector where they cannot fully realize their potential. Widespread informality, in turn, leads to weak rule of law and corruption; in the absence of the legal protection that comes with property rights the livelihood of informal entrepreneurs depends on the whim of local officials. When legal protection is out of reach for the majority of the population and when rules are enforced arbitrarily, abuse thrives and democracy cannot flourish.

Given that they do not have a legal right to own and operate a business, extralegal entrepreneurs are routinely harassed. They constantly face the threat of eviction from the streets or market stalls where they conduct business. In a matter of minutes they can lose the investment of their lifetimes in the form of equipment and inventory if they refuse to go along with extortion or cross the authorities.

That was precisely the story of Mohamed Bouazizi, the young Tunisian street vendor whose self-immolation after a frustrating confrontation with the authorities who took away his fruit vending business became the spark of the region’s anti-authoritarian conflagration. In other parts of the world a similar story plays out – without economic opportunities citizens become dependent on the corrupt state and lack the foundation upon which to build a prosperous future and demand better governance.

Property rights can help strengthen democracy and even make it possible by empowering individuals and reducing arbitrary dominance of the state, thereby ensuring healthy democratic competition and debate. While private ownership in and of itself does not guarantee freedom and democracy, it certainly makes them possible if appropriate rules governing responsible and ethical behavior are put in place.

Property markets and the state of democratic development

When property rights are effectively denied to large segments of the society, democracy likewise remains limited in scope because its cornerstone – the middle class – cannot grow. The need to broaden property rights, especially for small entrepreneurs
who build the middle class, is thus paramount. Yet, extending property rights is often narrowly understood as issuing property titles. Clearly, though, a title remains just a piece of paper if the institutions that make it meaningful are absent or weak.

Property market institutions comprise property rights laws and enforcement, access to credit by small businesses, democratic governance, rational dispute resolution, financial transparency, and appropriate regulations. Because of the strong linkages between those institutions, when some of them remain deficient the whole system underpinning a country’s democratic development prospects is underperforming and ordinary citizens suffer the consequences.

If a citizen does not have a legal title to his or her assets, these assets cannot be used as collateral for lending. If the justice system is inefficient or inaccessible, contracts remain unenforceable. If business regulations are too complex and costly to comply with, entrepreneurs are forced into the informal sector. Finally, if democratic governance is weak, businesses have no means of transparently raising their needs and concerns with the decision-makers and have no say in how the rules that affect their livelihood are made.

Property markets are multi-dimensional frameworks that touch upon issues key to the shared foundations of democratic governance and market economy. Therefore, their functioning is a microcosm that reflects the state of a country’s broader institutions. In transition democracies, the issue of strengthening property rights and creating property markets is frequently equated with the need for speedy privatization. However, dismal experiences in many post-communist countries with deeply flawed, corrupt privatizations demonstrated that private property cannot exist in a vacuum.

To be a vehicle for broad-based prosperity rather than enrichment of the few, property rights need to be accessible to all parts of the society in the context of institutions that guarantee transparency, accountability, fairness, and responsibility. They require the mechanisms of democratic representation, impartial judiciary, and financial oversight. In other words, they must be an integral part of a democratic rule of law system. The challenge for new democracies is to avoid the extreme pitfalls common when it comes to establishing an equitable property market regime as a part of larger governance and economic reforms: state capture by the elites on the one hand and destructive populism on the other.

The Path Ahead

Larry Diamond, Senior Fellow at the Hoover Institution and co-editor of the Journal of Democracy, has consistently argued that property rights are among the fundamental aspects of a rule of law society and that “strong guarantees of property rights, including the ability of small holders and informal sector workers to get title to their land and business property, set a broader institutional landscape that limits government corruption.” New and fragile democracies are in the greatest danger of failure if those institutions are not established.

It is no coincidence that emergence of authoritarian or semi-authoritarian regimes – or, alternatively, decline in the quality of democracy – is often associated with expropriation of property. Depriving citizens of their property is either about controlling the means of production or reducing the economic foundation that the political opposition may have.

Elections, even free and fair, are not enough. What comes after the votes are counted is as important: the day-to-day task of governance that not only guarantees democratic freedoms but also creates opportunities for inclusive economic growth. Strengthening property rights and building market institutions that support them is a key element of that process and, consequently, one of the fundamentally important democratic reforms.

How can that be done in practice? The Center for International Private Enterprise’s more than 25-years experience with strengthening democracy around the world through private enterprise and market-oriented reforms has uncovered actionable answers. A key one is to make the broad-based private sector,
including small and informal entrepreneurs, a partner in reform. Through business associations, chambers of commerce, economic think tanks, and other organizations the private sector can become an important voice in every country’s development path.

By exercising freedom of association and collectively making their voices heard in a policy debate, entrepreneurs can help design policies crucial to the middle class and to the economic prospects of their countries. In that context, property rights and the institutions that uphold them are not just a means of building individual wealth; rather, they benefit society as a whole by spreading wealth and power, providing opportunities for growth, building a tax base, and encouraging participation in economic and political processes.7

Understanding the link between democratic reforms and reforms that strengthen the institutions of property rights and markets is of key importance for all countries, but especially ones in transition. Property rights are human rights, as emphasized by Article 17 of the United Nations’ Universal Declaration of Human Rights, and as such are essential to the functioning of a democratic state.

Yet, even though property rights are constitutionally protected in most countries, access to and protection of property rights, and institutions that facilitate property markets, often leave a lot to be desired. This economically disenfranchises their populations and undermines democratic development. If properly institutionalized, however, property rights can become the engine of growth and give ordinary citizens the power to become full stakeholders in their countries’ future.

Notes


4 For a more detailed discussion of those institutions, as illustrated by the International Property Markets Scorecard, see “Building Institutions that Make Property Markets Work” http://www.cipe.org/publications/fs/pdf/113011.pdf. The Scorecard is a tool jointly developed by the Center for International Private Enterprise and the International Real Property Foundation to map the institutional components of property markets and evaluate their effectiveness.


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