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The political economy of rural property rights and the persistence of the dual economy

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ABSTRACT

Rural areas often have more than one regime of property rights and production. Large, private-property farms owned by powerful landowners coexist with subsistence peasants who farm small plots with limited property rights. At the same time, there is broad consensus that individual, well-specified and secure property rights over land improve economic outcomes. If property rights in land are so beneficial, why are they not adopted more widely? I put forward a theory according to which politically powerful landowners choose weak property rights to impoverish peasants and force them to work for low wages. Moreover, because weak property rights force peasants to stay in the rural sector protecting their property, the incentives to establish poor property rights are especially salient when peasants can migrate to an alternative sector, such as when urban wages increase with industrialization.

The fact that the wage level in the capitalist sector depends upon earnings in the subsistence sector is sometimes of immense political importance, since its effect is that capitalists have a direct interest in holding down the productivity of the subsistence workers (…) In actual fact the record of every imperial power in Africa in modern times is one of impoverishing the subsistence economy, either by taking away the people's land, or by demanding forced labour in the capitalist sector, or by imposing taxes to drive people to work for capitalist employers.

Sir W. Arthur Lewis, 1954

1. Introduction

In many less-developed countries, property rights over land are poorly specified and weakly enforced. More specifically, rural areas in developing countries throughout history, and even today, often have more than one regime of property rights and production. A more "modern" group of "capitalist" landowners, with large, private-property farms, coexists with a more "traditional" or "subsistence" group of peasants, who farm small plots with limited property rights.

At the same time, there is broad consensus that individual, well-specified and secure property rights over productive assets, and land in particular, improve economic outcomes. Thus the "dual" structure of the agricultural sector may reduce productivity, and raises some key questions: Why aren't strong, private property rights adopted more widely? Why did this structure emerge and persist?

In this paper, I examine these questions and put forward a theory of endogenous rural property rights. The main message is that politically powerful landowners may choose weak property rights to impoverish peasants and force them to work for low wages. Moreover, I show that the incentives to do this are especially salient when peasants can migrate to an alternative sector, such as when urban wages increase with industrialization.

In the model economy, the elite owns land and holds political power and uses this power to tax peasants and establish property rights institutions governing peasant farms. Peasants, on the other hand, are the only source of labor. They can work on their own farms, for the rural elite, or migrate to an alternative sector. While

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this sector may be any other that competes with landowners for labor and requires peasants' outmigration, it is natural to think of it as the "urban sector" and to associate an increase in the urban wage with "modernization".

When choosing property rights, the elite faces the following trade off. On the one hand, weak property rights on peasant plots may increase landowner profits either by forcing peasants to remain in the agricultural sector to protect their property – "tying" peasants to the land – or by reducing productivity in peasant plots, thus reducing peasant income. These two effects increase peasants' willingness to work for the elite, reducing wages and increasing elite profits. On the other hand, since weak property rights reduce agricultural productivity, they also reduce the elite's tax revenues. Maximizing tax revenues thus compels the elite to establish strong property rights, but maximizing farm profits creates incentives to establish weak property rights.

The model's key predictions concern the conditions under which the elite establishes weak property rights. The key parameters influencing this decision are urban wages, peasant plot size, and the elite's fiscal capacity (ability to raise taxes).

The model predicts that when urban wages are low, strong property rights prevail as long as landowners can effectively tax peasants. Intuitively, setting weak property rights destroys economic surplus. It is preferable not to create this inefficiency, and instead promote efficient production and tax the returns. Moreover, when the elite taxes peasants, this not only creates direct benefits from tax revenues, it also reduces the income peasants receive from working their own plot. Peasants become more willing to work the landowner's plot for lower wages thus increasing landowner profits.

The implications of high urban wages are markedly different. High wages provide peasants with an alternative option in the urban sector. With the effective threat of migration, imposing taxes on peasant's income no longer induces them to work for landowners at low wages. Instead, it reduces the attractiveness of rural areas and the ensuing migration decreases labor input for landowners. Thus, when hoping to avoid labor force migration, the elite chooses minimal taxation and tax revenues account for a lesser portion of total landowner income, muting incentives to adopt strong property rights. To avoid migration and extract more labor from peasants, the elite selects weak property rights institutions. This logic prevails when peasants own little land. If peasants own sufficient land, however, taxable income from peasant farms is high enough that the elite assigns greater importance to resources from taxation. Thus, to increase tax revenues, the elite promotes strong property rights for peasants.

This logic also implies a non-monotonic, U-shaped relationship between the quality of rural property rights and peasant land. Recall that if peasants own little land, the elite selects poor property rights and no taxation to stop peasant migration to the cities. Notice also that if peasants' landholdings increase, they work more on their own plots and less for landowners. This initially strengthens the rural elite's incentives to weaken property rights in order to extract labor. However, if peasant landholdings continue to increase, at some point peasant income is large enough that the elite prefers to tax part of it, even if this creates some migration. At this point, the elite is better off promoting strong property rights institutions to increase tax revenues.

This paper is related to several strands of literature. By proposing a specific mechanism for the endogenous persistence of "bad" rural institutions as development unfolds, it contrasts with other theories of the dual economy in which the disappearance of the peasant subsistence sector is a natural consequence of capital accumulation. In this sense, my paper relates to underdevelopment theories of the "dependency" tradition, most notably applied to Africa[1]. As Clarke (1975) puts it, in these theories: "the 'traditional' social forms are not simply relics of the past but have been necessary and integral to the development, maintenance and reproduction of peripheral capitalism (…). The state, continues to support such 'traditional' structures [which] have been made thoroughly modern, poor, and dependent" (p. 75). I argue that weak property rights are a particularly relevant way of impoverishing the 'traditional' peasant economy. The underlying reason why weak property rights may be preferred by the elite is the fact that they 'tie' peasants to the land. The importance of deterring rural–urban migration in order to lower rural wages is explicitly illustrated by the direct restrictions on peasant migration (vagrancy laws, labor passes, etc.) used by elites in China, Latin America and many parts of Africa. Yet the role of weak property rights has received comparatively little attention[2].

The idea that weak, informal property rights may tie households to their property and affect labor market decisions is studied in a different context by Field (2007). More generally, De Soto (1989, 2000) famously emphasized barriers to legal property ownership of assets in developing countries as a major obstacle to prosperity. However, these papers are vaguer about the causes of such extralegality. This paper, while emphasizing the factor market consequences of imperfect property rights, focuses on their political economy determinants and argues that property rights are intentionally precarious.

A few papers have provided formal models in which poor property rights may be intentionally encouraged by elites. However, the arguments I put forward are distinct. Besley and Ghatak (2010a), for example, explore the consequences of creating and improving property rights so that fixed assets can be used as collateral. Imperfect property rights may in effect protect borrowers from lenders who force them to put up more of their wealth as collateral. Hence, borrowers may oppose improving property rights. Diaz (2000) argues that rural elites grant land with poorly defined rights and low productivity in order to "destroy" this land. This strategy profits landowners under sufficiently strong complementarity of land and labor and sufficient land abundance. However, many other distortions imposed on granted land have similar consequences. In contrast, the attractiveness of poor property rights in the theory I propose depends on a characteristic that distinguishes this distortion from others: it simultaneously affects the productivity of the sector *and* the cost of migration to other sectors. Sonin (2003) offers a theory more focused on property rights, though his emphasis is not on the rural sector or land. He uses the Russian case to argue that the rich have a comparative advantage in the private provision of property rights. Hence, poor definition of property rights for a wide cross section of the population allows them to use this comparative advantage to predate from the poor.

On a more general level, the paper is related to the literature on endogenous institutions and institutional persistence. It concurs with the political economy or "social conflict" view which contends that inefficient institutions arise and persist because powerful political groups support them (Acemoglu et al., 2005). The paper is closely related, both in following this approach and in the formal analysis, to Acemoglu (2006).

The paper proceeds as follows. In Section 2, I lay out the basic setup of the model. Section 3 describes the economic equilibrium for a given set of institutions. Next, Section 4 characterizes the equilibrium institutions by finding the political equilibrium and describes the main results. Section 5 discusses a simple but important extension to the baseline model. Section 6 offers an historical discussion on the relevance of some of the model's assumptions and predictions, using the case of Rhodesia. Section 7 concludes with some final thoughts.

[1] See Phimister (1979) for a historiographical essay.

[2] For instance, it is not part of the list suggested by Binswanger et al. (1995) (or Binswanger and Deininger (1993) for the specific case of South Africa). But the mechanism has not been completely neglected, and Binswanger and Deininger (1993) recognize its relevance when they note: "A further distortion against black African farming was the excessively restrictive 'traditional' communal tenure system imposed by successive land laws [in South Africa], the first and most important of which was the Glen Grey Act of 1894" (p. 1461).