

# **‘The Economics of Property Rights’ is about neither Property nor Rights**

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## **ABSTRACT**

Legal theorists and other commentators have long established a distinction between property and possession. According to this usage adopted here, possession refers to control of a resource, but property involves legally sanctioned rights. Strikingly, much of the ‘the economics of property rights’ literature concentrates on possession, ignoring or downplaying the issue of legitimate legal rights. Some authors in this genre make a distinction between ‘economic rights’ and ‘legal rights’ where the former are more to do with possession or the capacity to control, rather than any right. They argue that ‘economic rights’ are primary and more relevant for understanding behaviour. But it is argued here that legal factors – involving recognition of authority and perceived justice or morality – have also to be brought into the picture to understand human motivation, even in the economic sphere. As other authors including Hernando De Soto (2000) have pointed out, the neglect of the legal infrastructure that buttresses property has major deleterious implications, including a failure to understand the role of property in supporting collateralized loans for innovation and economic development.

## **‘The Economics of Property Rights’ is about neither Property nor Rights**

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And when we understand the meaning of the word Property, we shall find that it will throw a flood of light over the whole of Economic Science ... Most persons in modern times, when they speak or hear of Property, think of some material things, such as money, houses, lands, corn, timber, cattle, etc. But that is not the true meaning of the word Property. Property in its true and original sense is not a material thing, but the Right to something.

Henry Dunning MacLeod (1878)

But not all economic interests are ‘property rights’; only those economic advantages are ‘rights’ which have the law back of them, and only when they are so recognized may courts compel others to forbear from interfering with them or to compensate for their invasion. ... We cannot start the process of decision by calling such a claim as we have here a ‘property right’; whether it is a property right is really the question to be answered. Such economic uses are rights only when they are legally protected interests.

Justice Jackson, *US v. Willow River Power Co.*, 324 US 499 (1945)

A people to whom ownership was unknown, or who accorded it a minor place in their arrangements, who meant by *meum* and *tuum* no more than ‘what I (or you) presently hold’ would live in a world that is not our world.

Antony M. Honoré (1961)

Property is a crucial economic institution.<sup>1</sup> Institutionalist writers on economic development stress the importance of secure property rights (North 1981, 1990, Torstensson 1994, Barro 1997, Acemoglu and Johnson 2005).<sup>2</sup> But it is argued here that the concept of property is often inadequately defined in economics. In particular, property is often conflated with possession, meaning control of a resource.

There is abundant evidence that infants have notions of possession.<sup>3</sup> As Deirdre McCloskey (2010, p. 332) put it: ‘Feelings of private property are hardwired into humans, or so anyone who has raised a two-year-old will attest.’ Property, it is alleged, is part of our natural condition. Without doubt, feelings of possession are deep-rooted (and I have helped raise two-year-olds). But McCloskey conflated property with possession. The failure to distinguish between them is widespread, and this mistake is committed by both Marxists (who wish to abolish private property) and free-market libertarians (who wish to secure it).

Herbert Gintis (2007) outlined a mechanism to explain the evolution of ‘property’, citing evidence such as the recognition of territorial incumbency. Theory and evidence point to the likely evolution under some conditions of possessive instincts. But the claim that possession has an instinctive and evolutionary basis (Stake 2004) should not lead us to the false conclusion that property and possession are the same. The term ‘property’ should be reserved for cases of institutionalized possession with legal mechanisms of adjudication and enforcement. Property involves acknowledged rights granted by legitimate legal authority.<sup>4</sup>

Other writers have pointed to the significance of the distinction between property and possession for the functioning of an economy based on private ownership (Pipes 1999, De Soto 2000, Heinsohn and Steiger 2000, 2013, Cole and Grossman 2002, Steiger 2008, Hoffman 2013). In addition, the present article points to the significance of legal institutions for understanding human motivation and the development of respect for private property in a modern economy. This undermines claims that the distinction between property and possession is unnecessary for economic analysis because *de facto* possession is sufficient to predict behaviour.

This argument depends on a particular definition of law and legal institutions, with a distinction between law and custom. While law often develops out of custom and depends on customary supports, in its fullest sense it more than custom. But influential authors – including Friedrich Hayek (1973, pp. 72-5) – have argued that law and custom are essentially the same. In part this is a matter of definition. But there are good reasons for regarding law as a characteristic of systems with a fully institutionalized judiciary and legislature (Commons

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<sup>1</sup> This paper expands on some material from Hodgson (2015), mostly in sections 1 and 2 below. The author is very grateful to Douglas Allen, Yoram Barzel, Daniel Cole, Frank Decker, David Gindis, Randy Holcombe and Katharina Pistor for very helpful comments on previous drafts.

<sup>2</sup> But Heller (2008) among others has pointed to problems with overly-extended or overly-compartmentalized property rights.

<sup>3</sup> See, for example, Hook (1993), O. Friedman (2008), Blake and Harris (2009), Kanngiesser et al. (2010).

<sup>4</sup> There are interesting laboratory experiments in the emergence of ‘property rights’ (Crockett et al. 2009, Kimbrough et al. 2010, Wilson et al. 2012, Jaworski and Wilson 2013). These experiments rely on reputation effects and engendered trust in relatively small groups. But Sened (1997) showed that such mechanisms are much less effective in large-scale and more complex communities. See Hodgson and Knudsen (2008) for a historically-grounded model of the emergence of property rights that does not depend on reputation effects.

1924, Hasnas 2005, Hodgson 2009, 2015). First, law emerged historically when customs were breached or in conflict, requiring judicial resolution by a powerful authority (Seagle 1941, Redfield 1950, Farnsworth 1969). Second, the enforcement of customary rules relies upon shared understandings and habits in smaller communities that cannot be sufficient when applied to extensive systems of codified law in large-scale, complex societies (Sened 1997). Third, given the complexity and proliferation of legal rules, dispositions to recognize legitimate and moral authority become more important than mere habit or custom in obtaining legal compliance (Hodgson 2009). We return to this crucial question of motivation later. At this point it is established that there are good reasons to confine the definition of law to circumstances where there is a state with an institutionalized judiciary and legislature. This does not mean that custom is unimportant, but that law is more than custom alone.

One possible response to part of the argument in this essay is that essentially it is about chosen definitions and uses of words. In particular, property rights economists might simply say that what I call ‘possession’ they call ‘economic property rights’ and what I call ‘property rights’ they call ‘legal property rights’. Consequently, we can go through and edit the economics of property rights literature, making the appropriate terminological substitutions, and everything else would remain valid. I disagree. While the economics of property rights brings some important and valid insights, it would still be impaired after these terminological substitutions. First, using the word ‘right’ to describe something that is not a right but a matter of *de facto* control is misleading: it obscures the nature and role of real rights in legal and economic systems (Cole and Grossman 2002). Second, in particular, attention is diverted from the roles of moral sentiments and dispositions to obey authority: they are important parts of human motivation, alongside greed and self-interest. Third, even with the terminological substitutions, the existing property rights literature would have an inadequate conception of (legal) property rights that largely ignored the use of property as collateral and the role of strong legal institutions in making that possible (De Soto 2000, Heinsohn and Steiger 2000, 2013, Steiger 2008, Arruñada 2012, Hoffman 2013).

This essay has six sections. The first discusses the distinction between possession and property and its implications. The second section demonstrates that typically ‘the economics of property rights’ is about possession, rather than property or rights. The third section considers views of individual motivation in ‘the economics of property rights’ and shows that they are dominated by both instrumental and pecuniary considerations. The fourth section uses evidence and arguments from psychology and elsewhere to show that obedience to the law can flow from notions of morality or the perceived legitimacy of authority, rather than instrumental calculations of cost and benefit alone. The fifth section considers some of the implications of the foregoing arguments for the economics of developing countries. The sixth section draws the threads together.

## **1. The distinction between possession and property**

In this essay, and in accord with major authors, the term *possession* is used to refer to use or control of an asset or resource, irrespective of any assumed or decreed right to do so. It is important to make this clear, because legal language is not uniform, and sometimes lawyers use the term possession to refer to particular (typically *usus* or *usus fructus*) rights. Also, in some legal systems, longstanding use can be grounds for establishing some kind of right. But by *possession* here we refer simply to use or control, without reference to, and imputation of, any kind of legal or moral right.

Possession is principally a relation between a person and a thing. It does not amount to legal ownership. As the historian Richard Pipes (1999, p. xv) put it: ‘Possession refers to the

physical control of assets, material or incorporeal, without formal title to them.’ Property often implies but does not necessitate possession, and some laws recognize possession as separate right *in rem* (regarding things). But the two are not the same: ‘*Property* refers to the right of the owner or owners, formally acknowledged by public authority, both to exploit assets to the exclusion of everyone else and to dispose of them by sale or otherwise’ (ibid.). The crucial difference concerns the granting of formal rights by public authority. Hence property in its truest sense has another prerequisite – the political authority of the state. ‘Before the state there is only possession’ (Pipes 1999, p. 117).<sup>5</sup>

Property is more than possession and not simply a relationship between owner and object. It is a relationship between people involving rights with regard to tangible or intangible assets. The exchange of property involves a minimum of not two parties but three, where the third is the state or a ‘superior authority’ (Commons 1924, p. 87). These social relations involve rights, benefits and duties (Hallowell 1943, Cole and Grossman 2002). The basis of a right of ownership of a resource is an acknowledgement of that right by others, through mechanisms of institutional accreditation and legitimation. Property is ‘a creature of ... the legal system’ (Penner 1997, p. 3).

Property involves legitimate and enforceable rights. As Antony M. Honoré (1961, p. 115) wrote: ‘To have worked out the notion of ‘having a right to’ as distinct from merely ‘having’ ... was a major intellectual achievement. Without it society would have been impossible.’ As Honoré (1961, p. 134) argued: ‘It is not enough for a legal system to recognize the possibility of people owning things. There must be rules laying down how ownership is acquired and lost and how claims to a thing are to rank *inter se*.’ A legal title to an object of property entails conditions that must be fulfilled for a person to have a claim to an asset.

The term *property* signifies multiple different types of possible right.<sup>6</sup> Owing their codified origin in Roman law, different types of property right include the right to use a tangible or intangible asset (*usus*), the right to appropriate the returns from the asset (*usus fructus*), the right to change a good in substance or location (*abusus*), the right to the capital derived from the use of the good as collateral, the right to sell a good (*alienation*), and several other rights or limitations (Hohfeld 1919, Honoré 1961, Pejovich 1990). The distinction between different types of property right is crucial for any modern economic system. For example, hiring or leasing something may confer a restricted right of use, but not necessarily other rights, such as the right to sell it to others.

Crucially for the functioning of capitalism, durable and alienable property can be used by its owner as collateral and can involve legal encumbrances (Heinsohn and Steiger 2000, 2013, Stadermann 2002, Arner et al. 2007, Steiger 2008). Consequently, as noted below, the registration of much property – particularly land and buildings – with recorded means to identify both property and owners, are crucial institutional mechanisms for economic development: they enable the use of such property as collateral for loans. But this is not straightforward, precisely because property requires an effective legal system and state administration.

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<sup>5</sup> Hegel ([1821] 1942), Proudhon ([1840] 1890), MacLeod (1878), and Commons (1924, 1934) all insisted on the distinction between possession and property. Heinsohn and Steiger (2000, 2013) and Steiger (2008) provide incisive discussions.

<sup>6</sup> Honoré (1961) used the term *ownership* alone to refer to these multiple possible rights. Here *property* and *ownership* are treated as synonyms.

The distinction between property and possession is not one between *de jure* and *de facto* property. According to widespread usage, when something is in effect in reality without a law mandating it, then it is *de facto* rather than *de jure*. But legal rights cannot exist without law, so any notion of *de facto* property is problematic. Purely '*de facto* property' is no longer property: any property by definition entails legal rights. Key distinguishing attributes of property, including legal rights, potential legal enforceability, and collateralizability, cannot exist without legal mandation.

Many social scientists treat property principally as a relation between an individual and a good, thus downplaying the institution of property, social relations between individuals, and between individuals and the state. The institutions that sustain and legitimate property are given inadequate attention. This is true even among most ardent defenders of the institution of private property.

Consider the Austrian school economist Ludwig von Mises. He argued that legal concepts could be largely relegated from economics and sociology. Hence when von Mises (1981, p. 27) discussed the nature of ownership, he considered the legal aspect as merely a normative ('ought to have') justification of *de facto* 'having' something:

From the sociological and economic point of view, ownership is the *having* of the goods ... This *having* may be called the natural or original ownership, as it is purely a physical relationship of man to the goods, independent of social relations between men or of a legal order. ... Economically ... the natural *having* alone is relevant, and the economic significance of the legal *should have* lies only in the support it lends to the acquisition, the maintenance, and the regaining of the natural *having*.

Hence, for von Mises, ownership was natural and historical rather than legal or institutional. A physical rather than a social relationship, it was deemed independent of law or any other social institution. He downgraded the institutions required for the protection and enforcement of the capacity to have, and neglected the social aspects of ownership and consumption, which may signal identity, power or status. Contrary to von Mises, the law does not simply add a normative justification for having something: it also reinforces the *de facto* ability to use and hold onto the asset.

The resemblance to Marx's relegation of law is uncanny: both Marx and von Mises concentrated on raw physical power over objects, rather than legal rights. Marx's numerous discussions of 'property' had little to say about legal rights, and he too conflated property with possession. Hence Marx (1975, p. 351) in 1844 addressed 'private property' and argued that 'an object is only *ours* when we have it – ... when we directly possess, eat, drink, wear, inhabit it, etc., – in short, when we *use* it.' With both Marx and von Mises, effective power over something, is conflated with a *de facto* right. Legal and moral aspects of property are overshadowed.

The distinction between property and possession was central to Pierre Joseph Proudhon's 1840 book *What is Property?* Proudhon quoted the prominent French lawyers Charles Toullier and Alexandre Duranton. They both had insisted that property is a right and a legal power, whereas possession is a matter of fact, not of right. Marx stridently criticized Proudhon's work. But he paid little heed to its central distinction between possession and property. Marx and Engels also claimed that tribal and hunter-gatherer societies owned 'property' in common. This was 'primitive communism.' In response, Thorstein Veblen (1898, p. 358) argued convincingly that ownership and property were later institutional developments: 'no concept of ownership, either communal or individual, applies in the primitive community. The idea of communal ownership is of a relatively later growth.'

While the distinction between possession and property is ignored by Marxists and most modern economists, it is of supreme analytical and practical significance. It is impossible to understand capitalism in terms of mere possession, without an adequate conception of property.

Classic accounts by economists Harold Demsetz (1967) and Richard Posner (1980) discussed the origin of 'laws' of 'property' in primitive societies. These are not so much wrong as mislabelled. Both writers conflated law with custom. Demsetz's discussion of 'property rights' was about customary rather than legal rights. He concentrated not so much on the origin of such rights but how they become valuable. Posner addressed primitive 'laws' concerning property, contract and marriage. His main claim was that various forms of these institutions were 'rational' in the context of prevailing information costs and other factors. But his arguments concerned custom rather than law. And instead of property he described possession.<sup>7</sup>

## 2. The 'economics of property rights'

We now examine prominent definitions of 'property rights' in the 'economics of property rights', alert to any justification for treating mere possession as a property right. The 'economics of property rights' is part of the modern 'law and economics' movement, which was hugely stimulated by the classic work of Ronald Coase (1960) and his guiding editorship of the *Journal of Law and Economics*. Coase defined neither 'property' nor 'property right' in his 1960 article, and I have not come across any clear definition of these terms anywhere else in his writing. But importantly he never suggested that property in a modern market economy could exist without a state legal system. Coase (1988, p. 10) wrote:

When the physical facilities are scattered and owned by a vast number of people with very different interests . . . the establishment and administration of a private legal system would be very difficult. Those operating in these markets have to depend, therefore, on the legal system of the State.

Subsequent writers on 'the economics of property rights' departed from this maxim, enabling them to tackle the definition of 'property right' in a very general way, ignoring its dependence on 'the legal system of the State.'

Hence Armen Alchian (1965) defined private property rights in terms of assignments of the ability to choose the use of goods (without affecting the property of other persons). While he referred to this as 'exclusive authority' and mentioned the possible role of law alongside a greater stress on custom and convention, his definition was largely in terms of *de facto* powers of control rather than legal or moral rights. The *Oxford English Dictionary* defines 'right' (as a noun) as 'that which is morally correct, just, or honourable' or 'a moral or legal entitlement to have or do something'. Thomas Holland (1917, p. 86) wrote in his definitive work on jurisprudence: 'Every right, whether moral or legal, implies the active or passive furtherance by others of the wishes of the party having the right.' Such rights involve appeal to a 'moral duty' or a 'legal duty'. Alchian and subsequent scholars have removed morality from the picture and downgraded the role of law, from being the source of legitimate authority concerning rights, to one means among others for enforcing possession and control.

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<sup>7</sup> To secure possession, Posner assumed elaborate 'insurance' arrangements between parties that Knight (1992, p. 114) persuasively argued are unfeasible.

When we refer to moral or legal rights, we do not simply mean *de facto* ability to control resources.

Later Alchian (1977, p. 238) defined the ‘property rights’ of a person in universal and institution-free terms including ‘the probability that his decision about demarcated uses of the resource will determine the use.’ Alchian’s definitions of property neglect the essential concept of legitimated, rightful ownership. They denote possession rather than property. Similarly, the property-rights economist Yoram Barzel (1994, p. 394) defined property as

an individual’s net valuation, in expected terms, of the ability to directly consume the services of the asset, or to consume it indirectly through exchange. A key word is *ability*: the definition is concerned not with what people are legally entitled to do but with what they believe they can do.

This explicitly removed the question of legal title from the definition of property. The upshot of this is that if a thief manages to keep stolen goods then he acquires a substantial property right in them, even if, on the contrary, legal or moral considerations would suggest that they remain the rightful property of their original owner. Elsewhere Barzel (1997, p. 3) argued:

The term ‘property rights’ carries two distinct meanings in the economic literature. One ... is essentially the ability to enjoy a piece of property. The other, much more prevalent and much older, is essentially what the state assigns to a person. I designate the first ‘economic property rights’ and the second ‘legal (property) rights.’ Economic rights are the end (that is, what people ultimately seek), whereas legal rights are the means to achieve the end. Legal rights play a primarily supporting role ...

Barzel made it clear that his version of ‘the economics of property rights’ is not about legalities. But it is misleading to describe ‘the ability to enjoy’ something as a ‘right.’ Enjoyment can exist without rights, and rights without enjoyment. Rights result from institutionalized rules involving assignments of benefit. They always involve relations between people as well as relations with things. The ‘ability to enjoy’ may not involve more than an individual’s relationship with an object.

Randall Holcombe (2014, p. 471) outlined a ‘positive’ theory of rights in general, where a right is what ‘people actually can exercise’ while making ‘no attempt to determine what rights people should have’. But there is an omitted third possibility here, which is the analysis or description of claimed or decreed legal rights or entitlements. It would be a mistake to assume that any discussion of such entitlements is ‘normative’ and beyond the scope of any ‘positive’ analysis. We should not confuse the description or analysis of a normative claim with the normative claim itself. If a legal system lays out specific rights or entitlements, and we describe or analyse that system, then we are not necessarily being normative: we are not necessarily advocating those laws. Emphatically, a positive analysis of rights must describe normative entitlements; otherwise it is not a theory of rights.<sup>8</sup>

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<sup>8</sup> Similar considerations apply to Holcombe’s response to Hodgson’s (2013b) argument that possessions held by a thief are wrongly deemed ‘property’ or ‘ownership’ by property rights economists. Holcombe (2014, p. 474) wrote: ‘Ownership, as used here, means that an individual is able to make and defend a claim to a right, without any normative judgment as to whether that ownership is rightful.’ This overlooks the possibility (indeed necessity) of defining ownership as involving claimed rights that are endorsed by legal institutions, irrespective of ‘any normative judgment [by the observer] as to whether that ownership is rightful.’ A state that confiscates property acquires enforceable legal claims to rights, irrespective of whether that act is truly just or moral. It is commonplace in ethical theory to distinguish between positive descriptions or analyses of moral claims and the normative advocacy of those claims by the observer.

Douglas Allen (2014, p. 4) put it even more simply: ‘Following others, economic property rights are defined as *the ability to freely exercise a choice.*’ His formulation removed the matter of enjoyment and simply takes the reason for choice as given. This again does not necessarily imply any relation with others, let alone any matter of rights. Allen (1991, 2014) ignored specifically human concerns with rights, duties, or morality. His definition entails no more than possession. It would apply to robots or any living species, including animals that are non-social.<sup>9</sup> It fails to acknowledge specifically human motivations that have evolved over millions of years, and the much more recent human institutions that, in specific ways, exploit and mould our sense of justice and respect for authority. Such definitions of property rights by institutional economists are strangely free of institutions. Property is a historically specific institution. If we make our categories universal, then we fail to capture property.

Ironically, the sub-discipline known as ‘the economics of property rights’ (Furubotn and Pejovich 1972, 1974, Bush and Mayer 1974, Umbeck 1981, Barzel 1997) is about neither property nor rights. To the property rights economists, the ‘structure of property rights’ refers primarily to a set of constraints upon, and incentives and disincentives for, specific individual behaviours. The widespread misconception in economics, that a ‘property right’ is about the probability of control or the ability to enjoy, would be strangely indifferent to whether property were publicly or privately owned, or owned by an individual, a cooperative or a corporation, as long as the denoted probabilities or abilities were unaltered.

As Dean Lueck and Thomas J. Miceli (2007, p. 187) conclude, much of the literature in economics on property rights ‘remains ignorant of property law.’ Benito Arruñada (2012, p. 24) pointed out that much economic analysis treats property as a relatively unproblematic distribution of entitlements and quickly moves analytical attention toward contracting difficulties and transaction costs.<sup>10</sup>

### **3. Law and human motivation: instrumental and other valuations**

Some writers suggest that ‘the economics of property rights’ abstracts from other considerations to focus simply on the ‘economic aspect’ of property. Barzel’s (1997, p. 3) claim that the ‘economic’ is just about the *end* of enjoyment, and not the *means*, is relevant here. But if we uphold economics as solely focusing on the enjoyment of things or experiences, to the neglect of legally instituted rights, then we must consider that economics cannot adequately appreciate the modern world order. To use the words of Antony Honoré (1961, p. 107), such economists seem to ‘live in a world that is not our world.’

By contrast, Adam Smith (1759, 1776) emphasized moral as well as selfish motivations, and the importance of justice in matters of commerce and property. For him, it was about

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<sup>9</sup> This apparent universality is seen by some ‘property rights’ economists as a strength of their approach (Tullock 1994, Landa 1999). On the contrary, I concur with Weber (1949, pp. 72-80) who noted in 1904 that highly general concepts can be less valuable because ‘the more comprehensive their scope’ the more they may ‘lead away’ from the task of explaining the historically specific phenomenon in question (Hodgson 2001). The logician Robinson (1950, p. 181) put it astutely: ‘It cannot, however, be true for all purposes that a concept is improved by being more general; for, if it were so, then, after improving all our concepts as much as possible, we should have no specific concepts left. ... Other things being equal, generality is a loss as well as a gain.’

<sup>10</sup> This section is necessarily brief and I have overlooked the important (Lockean) distinction between absolute and relative rights. Absolute rights are universal in the sense that they apply to all, such as human rights. Relative rights apply to specific people in specific circumstances, and the most important examples of these are contractual rights. Furubotn and Richter (1997) discuss this distinction, and (reasonably) property rights economists mostly address relative rights.

perceptions of justice as well as personal enjoyment. While individuals were largely self-interested, they also exhibited ‘moral sentiments’ that were vital for social cohesion, the protection of private property and the production of wealth. But Smith’s sophisticated vision of human motivation and the scope of economics has got lost (Coase 1976, Heilbroner 1982, Evensky 2005a, 2005b). Bringing it back has fundamental implications for the whole of economics (Hodgson 2013a, Smith 2013), but we confine ourselves here to implications concerning law and property.

Some might attempt to justify the neglect of legally-sanctioned rights in ‘the economics of property rights’ on the grounds that it is simply about the prediction of behaviour, rather than the detailed mechanisms of motivation. Similar arguments are often raised by economists to justify standard assumptions of rationality or utility-maximization. For example, Richard Posner (1980, pp. 5, 53) argued that the ‘rationality of “economic man” is a matter of consequences, not states of mind. ... Rational behavior to an economist is a matter of consequences rather than intentions.’ But better predictions of behavioural consequences would spring from a more in-depth understanding of individual motivations, alongside an understanding of institutional and other influences or constraints. Hence the understanding of human motivation was a major part of Smith’s project to understand individual interactions and the functioning of economic systems.

Coase made concordant observations. Regarding utility analysis as ‘largely sterile’, Coase (1977, p. 488) explained: ‘To say that people maximize utility tells us nothing about the purposes for which they engage in economic activity and leaves us without any insight into why people do what they do.’ Although he did not develop a richer account of human motivation, he certainly saw the need for one.

Many economists may have sidestepped the question of motivations because they have adopted a narrow model of wholly self-interested behaviour. This has led to particular version of utility maximization involving self-regarding satisfaction. Often it is also assumed that individual utility is monotonically related to the monetary value of consumption or wealth.

But this narrow view of self-regarding motivation is now fractured, even within the citadel of economics. Behavioural economists have pointed to evidence of systematic errors or biases that contradict some standard models of rationality (Camerer et al. 2004). While it is still possible that agents are maximising their utility (in fact, utility-maximization is strictly unfalsifiable (Hodgson 2013a, ch. 3)), there is an enormous amount of experimental evidence to undermine the idea that individuals are generally maximizers of monetary payoffs.<sup>11</sup> The notion of other-regarding, ‘social preferences’ has become respectable (Charness and Rabin 2002, Fehr and Fischbacher 2002, Bowles and Gintis 2011). Given this evidence, economists are obliged to probe more deeply into the explanation and motivation of behaviors at variance from payoff-maximization.<sup>12</sup>

Given the strict unfalsifiability of the (broadly-defined) assumption of rationality, and the need to explain motivation rather than merely fitting it into some imagined utility function, the question of rationality becomes secondary. The problem with the assumption of

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<sup>11</sup> See, for example, Henrich *et al.* (2001, 2004), Camerer (2003), Gowdy (2004), Bowles and Gintis (2005, 2011), Gintis *et al.* (2005), Camerer and Fehr (2006).

<sup>12</sup> See the important attempts by Wilson (2010) and Smith (2013) that take the evidence seriously and go beyond the utilitarian calculus and the language of preferences.

'rationality' is not that it is necessarily wrong, but that it is overly-accommodating, unfalsifiable, and 'largely sterile' as Coase (1977, p. 488) rightly put it.

This brings us to the question of the intrinsic role of law in human motivation, apart from the sanctions or rewards of the legal system. In the 'economics of property rights' and 'law and economics' it is generally assumed that law has little or no distinctive impact on utility or motivation, and it impinges on behaviour principally as a cost or constraint. Obeying the law is simply a matter of expected costs and expected benefits, where no benefit is assumed from legal compliance itself. Hence, having made his distinction between two kinds of 'rights', Barzel (2002, pp. 16, 157) claimed that: 'What individuals maximize (subject to their personal safety) is the value of their *economic rights*.' These exclude 'legal rights', which are defined as '*claims over assets delineated by the state*.' In other words, individuals are indifferent to 'legal rights' and act solely to maximize their enjoyment of assets under their control, whether these assets are obtained legally or illegally. This assumes a particular form of maximizing behaviour where law itself has no direct input as an argument in the preference function.

Barzel did not argue that the law does not matter. It may be a major factor in determining outcomes in terms of control and enjoyment of resources. Barzel (1997, p. 3) argued that law matters only insofar as it leads to 'what people ultimately seek', namely the enjoyment of resources. Legal obedience has no intrinsic value, and it is simply treated as an instrumental 'means' to that 'end'.

Accordingly, in a widely-shared view of the scope of 'law and economics', Richard Posner and Francesco Parisi (1997, p. xi) wrote: 'Law and economics relies on the standard economic assumption that individuals are rational maximizers, and studies the role of law as a means of changing the relative prices attached to alternative individual actions.' Implicit here is the view that conformity to law has no part in determining what is being maximized; obeying the law has no intrinsic value for the agent. It is supposed that law itself has no direct effect on human motivation and that legal obedience does not appear as an argument in any presumed preference function. Law is simply instrumental.

Note that Gary Becker's (1968) theory of crime admits the possibility of gaining some utility simply from legal compliance. In that respect his approach is more accommodating than much of 'the economics of property rights', which confines itself 'to comparisons of the value of production, as measured by the market' (Coase 1960, p. 43). While Becker highlighted the maximization of utility, much of 'the economics of property rights' considered the maximization of net market value. Becker's formulation can accommodate the possibility that people gain utility simply from obeying the law, irrespective of other costs or benefits, but the supreme criterion of market value, as adopted by Coase (1960), does not take this into account.<sup>13</sup>

But Becker and Coase both treated law as instrumental, for the maximization of utility and of net market value, respectively. Unlike Coase (1960), Becker's approach can deal with

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<sup>13</sup> Notably, Coase (1960, p. 43) went on immediately to add: 'But it is, of course, desirable that the choice between different social arrangements for the solution of economic problems should be carried out in broader terms than this and that the total effect of these arrangements in all spheres of life should be taken into account. As Frank H. Knight has so often emphasized, problems of welfare economics must ultimately dissolve into a study of aesthetics and morals.' Consequently, matters of morality and justice, which were side-lined in his 1960 article, should eventually come into play. Here 'the economics of property rights' has largely ignored Coase's advice.

gains accruing from obedience to the law alone.<sup>14</sup> But their shared instrumental character overlooks the possibility that law may be sometimes followed for non-instrumental reasons, simply because it is a legitimate, just or moral course of action. The law may be obeyed for reasons other than utility or pleasure. It may be followed – even at personal cost – because it is believed to be the right thing to do.

Claims concerning utility maximization – such as Becker’s – are strictly unfalsifiable, because utility cannot be independently measured or observed. This point has been noted by several authors and it is elaborated elsewhere (Hodgson 2013a, ch. 3). For example, even if our choices appear to be inconsistent, we can make them consistent by adding more (contextual or other) variables. Given non-falsifiability, no amount of evidence can overturn Becker’s formulation, although it may prompt us to search for a better explanation than the ‘catch-all’ device of utility maximization. Because we here focus here on ‘the economics of property rights’, rather than on Becker’s (1968) approach, the reader is left to consult Hodgson (2013a) for the full argument.<sup>15</sup>

Turning to propositions that are falsifiable, there is a great deal of evidence to counter the standard ‘economics of property rights’ views (i) that what overwhelmingly matters is market value, or (ii) that people (within an instrumental interpretation) do not gain ‘enjoyment’ from obeying the law *per se*. Contrary to Barzel and others, the evidence shows decisively that many people do not maximize ‘economic rights’ or the ‘ability to enjoy a piece of property’ alone. Multiple studies suggest that many people are not, other things being equal, indifferent between legal compliance and non-compliance, and they often value obedience to the law *per se*. The following section discusses some of this evidence.

#### **4. Law and human motivation: some evidence and explanations**

The subfield of psychological jurisprudence has gathered considerable survey data to establish that people place some normative value on obeying the law, in addition to any instrumental consideration of expected costs or benefits to themselves. Tom R. Tyler is the leading authority in this area. Tyler (1990, p. 3) contrasted the ‘instrumental perspective’ where ‘people are viewed as shaping their behavior to respond to changes in the tangible, immediate incentives and penalties associated with following the law’ with the ‘normative perspective’ concerned with ‘what people regard as just and moral as opposed to what is in their self-interest.’

Supported by evidence gained from a survey of several hundred citizens in Chicago, Tyler (1990) argued that citizens may be inclined to obey the law for different reasons. The estimated costs (involving estimates of the chances of being caught) and benefits of breaking the law are weighed against the costs and benefits of compliance. But the evidence of Tyler and others suggests that such instrumental calculations have relatively little effect on compliance. More important is internalized obligation, stemming from other considerations.

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<sup>14</sup> Becker demonstrates the flexibility and accommodating nature of utility analysis, but the capacity of a concept or framework to contain (almost) anything does not necessarily bring net benefits, or comprise an adequate explanation of the particular motivational or other causes at work. Note the quotations from Weber (1949, pp. 72-80), Robinson (1950, p. 181) and Coase (1977, p. 488) above.

<sup>15</sup> Other examples of overly-accommodating and unfalsifiable formulations of utility maximization are found in Bowles and Gintis (2011).

First, citizens often comply with the law because they regard the legal authority as having a legitimate right to lay down rules that people must obey. This warrant can have several possible bases, but in modern democracies it mainly derives from the belief that the popular election of a government makes such state authority legitimate. Max Weber (1968, p. 215) saw such legal authority and legitimation as ‘resting on a belief in the legality of enacted rules and the right of those elevated to authority under such rules to issue commands.’

Second, citizens often comply with a particular law because it is believed to be moral. This is particularly the case with laws against murder or rape, but is less effective with other laws, such as those concerning speed limits on roads. Tyler argues that moral beliefs sometimes help to sustain laws, but they can also lead to legal non-compliance when people believe that a particular law is immoral.

Instrumentalists in general, and proponents of utility-maximisation in particular, argue that the issues of legitimacy and morality can be incorporated in the calculations of costs and benefits. Hence advocates of utility-maximisation claim that when someone acts according to their perceptions of legitimacy or morality they gain extra utility from a ‘warm glow’ of self-satisfaction. A problem with this argument is that it undermines the very meaning of legitimacy and morality. The whole point of actions in accord with perceived legitimacy or morality is that they do not necessarily serve self-interest (Mackie 1977, Joyce 2006, Hodgson 2013a, 2014). Acting morally means ‘doing the right thing’, even if it is costly to the actor. People obey legitimate legal authority saying ‘because it’s the law’. These motivations cannot be reduced to convenience, convention, or cost-benefit calculation, in accord with a uni-dimensional calculus of utility.

Both adults and children feel strong obligations to obey the law. Austin Sarat (1975) found that 70 per cent of adults in his US sample agreed that a law ‘must always be obeyed’. In Richard Engstrom’s (1970) sample of US school children only 4 per cent of whites and 8 per cent of blacks said that they might disobey a policeman if he were ‘wrong in what he tells you to do’. A survey of US high school students found that 77 per cent of whites and 72 per cent of blacks agreed that ‘people should always obey the law’ (Rogers and Lewis 1974). Tylor (1990, p. 178) summarized a major implication of his survey of Chicago citizens:

People obey the law because they believe that it is proper to do so, they react to their experiences by evaluating their justice or injustice, and in evaluating the justice of their experiences they consider factors unrelated to outcome, such as whether they have had a chance to state their case and been treated with dignity and respect. ... The image of the person resulting from these findings is one of a person whose attitudes and behavior are influenced to an important degree by social values about what is right and proper. This image differs strikingly from that of the self-interest models which dominate current thinking ...

Our inclinations to respect those in authority were dramatized by the experiments of Stanley Milgram (1974), who invited members of the public to help in a laboratory study ostensibly about learning. A ‘scientist’ asked these recruits to administer electric shocks to a subject, to punish wrong answers to questions. Milgram found that a majority of adults would administer shocks that were apparently painful, dangerous or even fatal, if ordered to do so by the person in authority. In fact, there were no shocks and the subject was an actor, feigning agony or even death. This experiment shows that people can willingly accept the orders of perceived authority figures, even when their own moral feelings are violated.

Milgram (1974, pp. 124-5, 131) argued that our dispositions to respect authority emanate from the evolutionary survival advantages of cohesive social groups. While socialization and

learning are clearly important in developing propensities to obey authority and the law (Engel 2008), Milgram also proposed that the human species has evolved an inherited, instinctive, propensity for obedience that is triggered by specific social circumstances. In accord with the later work of Jonathan Haidt and Craig Joseph (2004, 2008), Milgram suggested that dispositions to respect authority have both genetic and cultural foundations. This is in accord with Charles Darwin (1871), who proposed that human tribes that developed systems of social obedience and cooperation, and a moral code to buttress these attributes, would survive in competition with other human tribes and in dealing with their environment. This evolutionary argument is supported by evidence from primates (De Waal 1996, 2006) and modern evolutionary theory with a careful rehabilitation of the concept of group selection (Sober and Wilson 1998, Henrich 2004, Hodgson and Knudsen 2010, Hodgson 2013a, 2014).

These arguments undermine the ‘economics of property rights’ view that respect for the law – based on its perceived legitimacy or moral concordance – plays little or no part in attitudes towards property.<sup>16</sup> The insistence that property is a legal right does not imply that people never break the law, or that law alone somehow predicts behaviour. But the establishment of legal rights, through perceptions of moral legitimacy and the use of state power, can affect intentions or behaviour. An economy involving mere possession is very different in nature and outcomes from one that has institutionalized rights of property.

The mistaken removal of legal rights from the definition of property cannot be justified on the ground that they are unnecessary to predict behaviour. Any explanation of dispositions, choices or preferences must take such factors into account. If economists are interested in predicting behaviour on the basis of some scientific understanding of what causes it, then they must take matters of motivation, including the instrumental and the normative into account. The focus on *de facto* control is descriptive rather than explanatory. It takes as given what has to be explained. Any predictive power is based on extrapolations of superficial observations, with inadequate explanation of what is observed.

## 5. Property rights and economic development

Arguments emphasising the perceived legitimacy of the legal system have major implications for generally establishing the rule of law, and particularly installing just and secure property rights to help promote economic development.

China is a very important test case for these arguments. China began its market reforms after 1978 and its systems of property, commercial and corporate law are still relatively underdeveloped compared to Europe or North America, for example. This fact, alongside its highly impressive economic growth since 1978 has led some prominent economists to conclude that legally-enforced property rights are of lesser significance (Stiglitz 1994, p. 12).

But on the contrary, there are strong indications that legal systems and legal property rights matter, even when they are imperfectly established (Ho 2005). China’s explosive growth started when land-use (*usus fructus*) rights were widely conceded to the peasants after 1978 (Zhou 1996, Oi 1999, Coase and Wang 2012). Relevant legislation concerning land leasing

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<sup>16</sup> It should be noted that several property rights theorists and many other economists have evoked evolutionary arguments and considered possible hard-wired dispositions. But ‘evolution’ has been used to justify many varied and contradictory claims. Specifically, and in line with Darwin (1871), I stress the theoretical and empirical grounding for (i) evolved propensities to cooperate (Sober and Wilson 1998, Bowles and Gintis 2011), (ii) evolved moral dispositions (De Waal 1996, 2006, Haidt and Joseph 2004, 2008, Joyce 2006), and (iii) evolved respect for authority (Milgram 1974, Haidt and Joseph 2004, 2008).

followed rather than preceded this concession. But this does not mean that legal land-use rights were unimportant. Local power from below tentatively established a *de facto* right, which spread widely and became *de jure* when it was legally ratified by the state. This endorsement, along with the institutional arrangements established from below, was vital to safeguard these rights.<sup>17</sup>

Legalities matter and evidence suggests that they matter still more as capitalism develops. Further economic development in East Asia may depend in part on the installation of superior state legal and political systems governing and protecting property and contracts. Private ordering is important but insufficient. The cross-country evidence of Johan Torstensson (1994), Robert J. Barro (1997) and others suggests that economic growth is correlated with the rule of law, among other factors (Acemoglu and Johnson 2005).

By contrast, the ‘economics of property rights’ would see it as sufficient that Chinese entrepreneurs can control resources sufficiently to enable prosperity and rapid growth. Matters of legal infrastructure and enforcement would be secondary. Instead, the alternative perspective outlined here would point to the priority of developing legal institutions, their separation from political authority, and the related reform of the political system.<sup>18</sup>

More generally, as Hernando De Soto (2000) and others have pointed out, the registration and enforcement of property rights (particularly in land and buildings) is a crucial condition for economic development.<sup>19</sup> The exclusive focus on control in ‘the economics of property rights’ overlooks the use of property as collateral for loans. The possibility of collateralization – which relies on legal and financial institutions – cannot be predicted from possession alone. It involves institutions: relations between individuals as well as relations between individuals and things. While emphasizing the importance of ‘property rights,’ much of this discourse side-lines the vital institutions that are required to sustain them and make them fully operational in a developed economy.

Some authors, such as Alan Gilbert (2002), have pointed out that some experiments with legal registration of property in developing countries have failed. But this does not necessarily mean that De Soto and others are wrong. It is more that political, legal and financial institutions have to be sufficiently well-developed before registration of legal title and individual identity can be effective.

Attempts to make ‘property rights’ analysis universal, so that it applies to societies without effective (state) legal authority draw our attention away from the importance of property rights, properly defined. Of course it is important to understand extra-legal enforcement

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<sup>17</sup> Nee and Opper (2013) showed that for decades from the beginning of reform in China in 1978 there were inadequate legal institutions protecting the property rights and enforcing the contracts of private firms. But we cannot conclude from this that (state enforced) law is unimportant. Nee and Opper pointed out that, with inadequate legal protection, these private firms risked prosecution and arbitrary closure. The private sector lobbied successfully for the 2004 changes to the Chinese constitution to ‘protect the lawful rights and interests of the private sector’ on an equal legal basis to state-owned enterprises. Private sector lobbying also led to a new law on property rights in 2007. As the lobbyists themselves understood, the fact that legislation follows accepted practice does not make legislation unimportant.

<sup>18</sup> It is notable that the main policy recommendation of Coase and Wang (2012) for China was a ‘market for ideas.’ Freedom of expression is very important, but they neglected other needed institutional reforms in land tenure, corporate law, finance, or the polity (Hodgson and Huang 2013).

<sup>19</sup> See Simpson (1976), De Soto (2000), Banerjee and Iyer (2005), Arruñada (2012), Bellemare (2013).

mechanisms, such as with pirates and mafias, but we should not pretend that might and right are the same.

The overall conclusion of this reinstatement of a more genuine concept of ‘property rights’ in development economics would be much greater emphasis on the importance of an effective legal system that enjoys some autonomy from political or sectional power and is seen to be relatively just in its proceedings.<sup>20</sup>

## 6. Concluding remarks

The focus on possession, rather than property and rights, has further deleterious consequences. For example, the notion of contractual exchange becomes mainly a reciprocal transfer of powers over assets, ignoring the transfers of legal property rights. Crusoe-like ‘exchanges’ become possible, between one person and his or her material environment. Hence von Mises (1949, p. 97) saw all action, even by an isolated individual, as ‘exchange’ – as an attempt to swap inferior for superior circumstances. By contrast, Karl H. Rau (1835), Henry Dunning MacLeod (1878), and John R. Commons (1924) all insisted that commodity exchanges are contractual interchanges of *legal rights*, along with any transferred goods or money. Unless a transfer of rights is involved, it is neither exchange nor contract. Such rights are backed by legal sanctions. Exchange, like property, has to be understood in terms of the key social institutions that are required to sustain it.

Contracting rights are different from property rights. As Arruñada (2012) explained, these two types of right can come into conflict when legal ownership is unclear. Consider a person who claims ownership of a house and enters into a contract with a bank for a mortgage. A third party also claims ownership of the building, in conflict with the statement of the mortgagee. A judge might rule in favour of the third party, on the grounds that the mortgagee had no proven legal title to the property. This would be the enforcement of property rights (*in rem*) and it would imply the cancellation of the mortgage. Alternatively, the judge can rule that the contract between the mortgagee and the bank remains intact. This would be the enforcement of contractually agreed rights between persons (*in personam*) and it would mean that the property rights of the third person were disregarded. This further underlines the importance of attention to legal details.

The success of capitalism depends on national systems of law enforcement. But these took a long time to establish. Even today, in much of the world, systems of law enforcement are weak, expensive, corrupt or inaccessible. In their absence, people fall back on other means of establishing obligations and ensuring compliance. Commerce then works through clan or family ties, shared religion or ethnicity, bureaucratic co-option and corruption, or threats of

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<sup>20</sup> There is not the space here to deal with the claims of Ellickson (1991) and others that social order is possible without a state legal system, and custom is often sufficient to establish property and settle disputes. Ellickson’s (1991) main example is the cattle industry in one rural county, where enforcement depends on mechanisms such as custom, gossip and personal reputation. Other cited examples include Grief’s (1993) historical study of medieval Jewish traders. My general response is that instances of social order without (state) law depend largely on (a) coordination games (such as language and some traffic rules), (b) mechanisms involving the reputations of groups or individuals, or (c) trust-building through regular face-to-face contact. Coordination games are not representative of all social interactions (Vanberg 1994), and (b) and (c) are viable with smaller or cohesive communities only (Ostrom 1990, Sened 1997, Hodgson 2015). As North (1994, p. 365) put it: ‘Cooperation is difficult to sustain ... when information about the other players is lacking, and when there are large numbers of players.’ But it is beyond the scope of this essay to elaborate this, and the aim of this section is to illustrate the line of advance that is implied by the foregoing argument, not to complete every step. For more discussion see Hodgson (2015).

violence to person or property. Systems of spontaneous enforcement show how commercial agreements can be maintained in the absence of adequate state systems of law (Greif 1989, 1993, 2006, Landa 1994, Clay 1997, Leeson 2009). Such systems existed in history and persist today in some contexts, but this should not mislead us into believing that fully-developed modern capitalist systems can rest on purely spontaneous or customary foundations.

The failure of most economics to embrace an adequate concept of property is rooted in a crude social ontology of agent-object relations. Often neglected are agent-to-agent interactions that engender and sustain shared interpretations, meanings, understandings, rules, and institutional facts (Searle 1995, Hodgson 2015). Agent-object ontologies in economics have taken a number of different forms, but concerning property and possession there is a commonplace conflation. Property relations, which involve agent-to-agent relations and shared understandings concerning rules and rights, are mistakenly transformed into relations of possession between agents, on the one hand, and physical objects or processes, on the other. A mapping (in the mathematical sense) is created between the set of physical entities (and forces) and their possessors. Rather than from agent-to-agent interactions, economic value is seen as deriving from some measurable physical activity, substance or sensation, such as embodied labour time or utility (Orléan 2011). Various agent-object ontologies pervade both mainstream economics, where the focus is on the individual making choices over the allocation of objects or activities, and Marxism, where agents coagulate as social classes, with differential control over physical objects and forces.

Generally, an agent-object ontology cannot accommodate a concept of property that is anything more than possession; it lacks the key element of institutionally legitimated legal rights. Of course, agent-to-agent interactions are played out on the registers of material objects, and property may connote things as well as rights (Smith 2012), but we cannot understand property simple in terms of an agent-object relationship.

A crucial argument here is that legal institutions have to be taken into account in 'economic' analysis. Law is much more than a constraint: it matters too for an adequate understanding of human motivation and the financial dynamics of capitalism. As odd bedfellows, both Marxists and 'property rights' economists have overlooked these issues. Elsewhere an alternative approach – which takes the impact of legal institutions more seriously – is described as *legal institutionalism* (Deakin et al., unpublished).

Finally, an appreciation of non-instrumental motivations for legal compliance, which are part and parcel of the arguments here concerning the nature of property rights, challenges the use of utility-maximization as sufficient model of human behaviour. If 'economics' is confined to utility-maximizing agents, then 'economics' cannot adequately deal with the reality of property rights. But if 'economics' is rendered closer to Adam Smith, Alfred Marshall and even Ronald Coase, who all had more complex views of human motivation, then any 'economics of property rights' is greatly enhanced.

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