

**Ownership, Property Rights, and Economic Performance:
Theory and Practice in the USA and other Countries**

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1. Introduction

Ownership and *property* have practically the same meaning in English: the right to possess something, to control it, to determine its use, to receive the benefits from its use, and to dispose of it. The related concept of *property rights* (which could be called "ownership rights") refers to the specific content and extent of the rights possessed by property owners, particularly the limitations that may exist on the exercise of those rights and the nature of enforcement of those rights. Property rights are never absolute, since the exercise of control over property may harm individual or social interests and so property rights typically have certain limits.

Ownership and property rights are topics of hot debates around the world today. Many economists -- in the USA, in Europe, and even in China -- assert that only private ownership of enterprises can result in an efficient, and more generally an effective, economy. This viewpoint has been very influential in the world since around 1980. It has provided the intellectual justification for the privatization of many formerly public enterprises, in the West, in the formerly socialist countries in Eastern and Central Europe, and in the developing countries of Asia, Africa, and Latin America, including in China. In some cases international institutions such as the International Monetary Fund or the World Bank have imposed privatization on countries that were dependent on those institutions. In other cases privatization has been undertaken voluntarily by governments influenced by the economists' arguments for the superiority of private ownership.

However, a number of countries that undertook major privatization programs did not gain the benefits that had been promised. In particular, in Russia and in Latin America serious economic and social problems have followed programs of mass privatization. Among these problems have been corruption, increased criminal activity, theft of assets from formerly public enterprises, mass layoffs of workers, growing inequality, and disappointing performance by privatized enterprises.

This has led to two opposing conclusions. Some have questioned whether the basic argument for the inevitable superiority of private ownership is correct. Those who raised such

questions have suggested that the claims for the superiority of private ownership have been based on a theory that is too simple, that makes unrealistic assumptions, and that ignores many specific historical and institutional characteristics of each country that are relevant to this question.

However, the most influential advocates of private ownership did not rethink their initial view in light of new evidence. Instead, they came up with an additional argument to support their original claim. They argued that, if privatization does not produce good results, it is because property rights are not clearly defined and effectively and impartially enforced.

In my brief comments today, I will draw on the experience of the USA and also other countries to present a case that the critics of privatization are correct and that the claim for the necessary superiority of private ownership is false.

2. Public Ownership in the USA

The issue of the ownership form of enterprises is relevant both for a capitalist economy and for a socialist economy that has a large market sector. In the case of the US, we are of course dealing with the context of a capitalist economy. The majority of enterprises in the US have some form of private ownership: individual, partnership, or most importantly the corporate form of private ownership for larger enterprises. However, from the beginning of US capitalism in the early nineteenth century, various forms of public ownership have existed, in a minority position, alongside privately owned enterprises.

There have been, and still are today, various types of public ownership of enterprises in the US economy. Some are owned by the federal (national) government. Some are owned by state and local governments. Some take the form of collective ownership, of which the two main types are worker owned enterprises and enterprises owned by those who buy or use their products. I will give several examples.

Today enterprises owned by the national government are rare in the USA (apart from the manufacturing of US currency!), as a result of the neoliberal wave of privatizations. However, in the past there were some important US government owned manufacturing enterprises. The most interesting were the US army arsenals, which for more than a century produced weapons for the

army. In the mid nineteenth century one of these arsenals, in my home state of Massachusetts, was the first company to invent the revolutionary manufacturing method of interchangeable parts (parts that can be used for any of the products). This was first used to make rifles. This technology was later copied by privately owned enterprises and became a key basis of technological advance in US capitalism in that period.

After World War II the army's arsenals were privatized or closed. Why? Not because they were inefficient or ineffective. The reason was that they provided a way for the government to determine whether the prices charged by privately owned weapons manufacturing enterprises were too high. Disliking this check on their pricing power, the private companies carried out a vigorous lobbying campaign in the US Congress to privatize the army's arsenals, and they succeeded. The result has been that today the privately owned arms companies steal from the taxpayers by charging prices far higher than are justified by the costs of production.

A second example is from the electric power industry. In the US today a substantial proportion of electric power is generated by companies owned by a city or county. Studies using sophisticated methodologies have found that the cost of power from the public companies is lower than that sold by privately owned power companies.

Until a few decades ago, even the privately owned power companies were strictly regulated by government agencies. There were many problems with this system of regulation, including that the private companies had significant influence over the regulatory authorities. However, public regulation forced the privately owned companies to behave, in certain respects, like public enterprises. Their prices were determined by the state, their rate of profit was controlled by the state, and they were required to invest in additional power generation capacity sufficiently so that excess generating capacity would be maintained to avoid power shortages.

Then around 1980 there began a wave of deregulation of the power industry, under the influence of neoliberal ideology. The private power companies were deregulated in much, although not all, of the USA. Deregulation meant that the private power companies were now free to behave as privately owned companies are supposed to behave -- to make decisions based

only on the aim of maximizing profits for the owners.

In California, which deregulated its electric power sector in 1996, only five years later a disaster resulted. At the beginning of 2001 California had a severe power shortage, which caused the price of electricity to suddenly rise more than ten-fold. Selective blackouts had to be imposed. This shortage cost the citizens, businesses, and governments of California billions of dollars, while the profits of the electricity supplying companies rose by more than 500%.

Why did this happen? Deregulation was supposed to make the power sector more efficient and effective. It turned out that the privately owned companies, freed from regulation, had stopped investing enough in new generating capacity. They did this to maximize their profits. Maintaining excess capacity lowers their profit rate, and if it turned out they had not invested enough in capacity and a shortage developed, they knew that prices would jump up and they would make even higher profits. So they had no incentive to maintain the excess capacity that society needs. It also was discovered in an investigation that some private power companies intentionally shut down some of their generating plants to worsen the shortage and raise prices further. People could not fail to notice that, in the city of Los Angeles in California, which owns the electric power company in that city, there was no shortage, no blackouts, and no big rise in prices during the power crisis in the rest of California.

Another type of public enterprise is found in the financial sector of the US economy. Insurance companies in the US developed originally as enterprises owned by those who held the insurance policies, and some still have that ownership form today. But more important is a type of bank, the savings bank (or savings and loan association), which is owned by those who open accounts in the bank -- that is, the bank's customers. After World War II the savings banks played the major role in financing the huge wave of building of new homes in the suburbs of America's major cities. This homebuilding wave greatly improved the housing conditions for millions of Americans, including many working class families. Also, it was a major driving force propelling the rapid growth of the US economy in the postwar decades. At that time most of the privately owned commercial banks were not interested in making small home-buying loans to

families.

Another example is from America's neighbor to the north. Canada has a capitalist economy, but its national passenger railroad system is owned by the state. Canada's national rail system is widely admired for its efficiency and good service. Many Americans like to travel to Canada to ride across that beautiful country on its government owned railroad.

So reality seems to conflict with the simple theory that only privately owned enterprises can be efficient and effective.

3. Property Rights and the Robber Baron Era in the USA

As I mentioned earlier, the advocates of privatization have recently insisted that any problems with privatization are not a result of any flaw in their theory of the superiority of private ownership, but rather are a consequence of absence of effective property rights in certain countries. Russia is the prime example they give, where privatization failed, they claim, because property rights were not effectively enforced, allowing some individuals to steal from the enterprises (and hence from the other shareholders) instead of operating them effectively.

The Robber Baron Era in the late nineteenth century USA provides evidence that the security of property rights is, in practice, not an essential determinant of the economic performance of enterprises, compared with other factors. The US legal system in the late nineteenth century in some ways resembled that of Russia today. The new wealthy capitalists who emerged in the USA in the 1860s and 1870s, such as Cornelius Vanderbilt in railroads, John D. Rockefeller in oil, and Andrew Carnegie in steel, were ruthless in their pursuit of wealth. They each had corrupt judges on their payroll, some of them maintained private armies, and they broke contracts whenever it was to their advantage to do so. One independent oil refinery owner who refused to sell his refinery to Rockefeller had his refinery blown up with dynamite, an act for which a Rockefeller employee was convicted. This was not a situation of secure property rights. Only after 1900 was the behavior of the Robber Barons brought under control due to a militant popular movement demanding social reform.

Yet despite the absence of secure property rights, the above mentioned Robber Barons

built railroads all across the US, erected modern oil refineries, and constructed efficient steel plants. They did so because they could make enormous profits by making such productive investments. This was so because the US government acted as a developmental state, financing the building of railroads by the Robber Barons and providing protective tariffs against superior European imports. This created a large and protected market which made productive investments highly profitable. By contrast, Russia's neoliberal state does nothing to foster productive investment, which is the real reason why the owners of newly privatized enterprises there mainly steal resources rather than investing in new capital goods.

China also provides a lesson about property rights. Western economists often complain about a lack of clear property rights in China. Yet this has not stopped massive Western investment in China along with rapid domestic development. Again, the reason is that the Chinese state has actively provided an economic environment in which productive investments are profitable and are encouraged.

The lesson is that, while secure property rights may be desirable, they are not a major factor in determining economic performance. Privatization has often failed, not because of the absence of secure property rights for the new owners, but because the theory underlying privatization has been seriously flawed from the start.

4. The Potential Advantages of Public Ownership

I could go through the specific flaws in the neoliberal theory of the inevitable superiority of private ownership but I do not have time to do so. Instead, I will finish by discussing some advantages of public ownership, in either a capitalist economy or a socialist economy with a large market sector.

First, a publicly owned enterprise can follow aims other than just profit maximization. It can pursue various public aims that have been decided on by the authorities to whom it is responsible. For example, public enterprises may continue to make investments when the economy is entering an economic recession, while private enterprises are rapidly cutting their production and investment. Not being responsible to profit-hungry shareholders, public

enterprises can take a long view, realizing that a recession will eventually end, and that investing during a recession is a good policy since financing is cheap and there is ample excess productive capacity in the economy. A few years ago a dissertation by a student of mine from China did a study that found that China's state owned enterprises have tended to invest "counter-cyclically." That is, when economic growth has tended to slow down, they have increased their investment. This has helped to stabilize the Chinese economy, maintain economic growth, and avoid recessions.

Public enterprises can plan investments with an aim to increase development in less developed regions of a country. This may not be the most profitable investment in the short run, but it reduces regional inequality, contributes to overall economic development, and helps to maintain the unity of a nation.

Publicly owned banks can be directed to make loans only for productive investments rather than speculative purposes. They can be required to make loans to new industries that are not yet very developed but which have a long run potential to become successful. Privately owned banks will tend to make loans to whatever borrower promises the highest profit to the bank's owners, of course with due regard for risk. This can lead to lending for speculative investment and also loans that favor industries that are already well developed rather than those that have a future long-run positive potential. Private owners tend to be impatient.

Another student of mine, also from China (and now on the faculty of Tsinghua University), did a study of a large sample of countries and found that a higher share of state owned enterprises in the economy was associated with a higher long-run rate of economic growth. He used sophisticated statistical techniques in this study, and its results were persuasive in providing evidence that publicly owned enterprises can contribute positively to long-run economic development. His study also found that income inequality is lower in countries with a large share of publicly owned enterprises. The latter result was not surprising, since public enterprises tend to pay relatively high wages and have a relatively narrow range between their highest and lowest pay rates compared to privately owned enterprises.

Public enterprises tend to offer secure jobs that last a long time. They are often criticized for this. However, people need stability in their lives. The current neoliberal form of capitalism has practically abolished job security in my home country throughout the private sector, and this has had a very harmful effect on the well-being of working people.

Finally, in a country such as China, which is striving to maintain a socialist system with a large market sector, there is another major advantage to public enterprises, whether they are owned by the central or local government or take the form of a collective. That advantage is that public enterprises do not exploit their workers. By contrast, the owners of private enterprises exploit their workers, gaining profits from the labor of their workers just by owning the enterprise. Exploitation of labor creates a very wealthy class that has an interest in abolishing the socialist features of China's system. This wealthy class tends to become powerful over time. The existence of a large sector of domestically owned private enterprises poses a challenge to the survival of socialism in China.

5. Concluding Comments

Economic theories can be very useful for guiding economic policy and institutional change. However, for a theory to be useful, its assumptions must accord with the reality of the economic system that actually exists and must take account of the history and institutions of each country. Furthermore, careful attention must be paid to the actual consequences of the initial applications of a theory and appropriate conclusions must be drawn from such experiments. All of those requirements were violated when a simple and unrealistic neoliberal theory of ownership and property rights was used to justify privatization everywhere and under all conditions, regardless of the outcomes. The result has been serious economic and social problems in many countries throughout the world.