

Institutions and private property

The 1993 Award of the Nobel Peace Prize to FW de Klerk and Nelson Mandela overshadowed the achievement of Douglass North, joint winner of the 1993 Economics award. It's a pity; both local leaders can learn plenty from North's work. North, from Washington University in St Louis, Missouri, has spent his working life emphasising the role of institutions: "Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the directions of economic change towards growth, stagnation or decline." Effective institutions "create an economic environment that induces increasing productivity".

Private property rights enrich us all

North's message is both simple and profound. If individuals have proper incentives they will behave in ways which enrich both themselves and the rest of society. But it is not as straightforward as it sounds, for North is quick to emphasise that "economic history is overwhelmingly a story of economies that failed to produce a set of economic rules of the game (with enforcement) that induce sustained economic growth". The crux of the matter is the right to own and exchange property. It insulates property owners from the power of the state to grant privileges to special interest groups. Yet historically there has been no easy road to security of property rights. For North, the state is both essential and a potential villain. It must protect and enforce property rights, yet its arbitrary interference with economic activity must be shackled. The right balance is crucial.

Governments matter – they guard property

North has covered huge amounts of historical ground in his search for the determinants of growth. With his colleague, Robert Thomas, he has explained the demise of the stagnant feudal system in Europe by the transition from common property in land to private ownership. As markets evolved and population increased, old land was enclosed and new land brought into cultivation. Exchange became more common, and serfs had the incentive to bid for private plots, using for payment the surplus sold after they had met their subsistence needs. When one farmer adopted new techniques he could gain from his own innovation. Others could see and imitate. Individual owners did not have to conform to the pace of the ox determined by common ownership.

North further emphasises that the traditional historian's focus on the industrial revolution and technology as "the key to Utopia" is deficient. Much of the world has failed to realise the benefits of more advanced technology. Marxist explanations are also deficient for they involve assumptions about an unnatural (and unforthcoming) behavioural change by individuals.

Wealth depends on property – not technology

There is a better story, says North. Technology certainly places an upper boundary on growth. Marxist economics has proved to be an empty box, while conventional neoclassical economics, although helpfully emphasising problems of resource constraints and choice, leaves the issue of growth largely unexplained. Why, in short, should we invest in new technologies? Where are the incentives to do so? What institutions encourage the development of these incentives? Why have poor countries not adopted such incentive structures? Can the institutional structures which make the incentives possible be imposed from without or must they evolve from within? North has not yet answered all these questions. But his most recent book concludes with an interesting research agenda. Where do "effective traditions of hard work, honesty and integrity come from"? Such traditions lower the cost of transacting and make possible more complex economies. Would England have become the world's first industrial success story had the rent-seeking Stuart monarchy not been removed? The Glorious Revolution of 1688 removed the crown's arbitrary and confiscatory powers. "A major consequence was an increased security of property rights."

North suggests that had this not occurred England might have followed Spain in developing a large centralised bureaucracy devoted to furthering the interests of the state. In Spain the special interest groups of the priesthood and the military prospered, but Moors and Jews were expelled (or worse) and rent ceilings on land, price controls on wheat, and confiscation of merchants' silver holdings all resulted in disincentives to productive activity. We need to know more, North admits. But he points out that the divergent paths followed by England and Spain in North and South America have still not converged – despite common ideological influences. If economic well-being is as “path-determined” as North suggests, then decisions being taken now on SA's future institutions will affect us for a long time to come. How you start is important in determining how you proceed and where you end. Conversely, that part of our institutional system which fits positively within North's analysis, the private property-based, profit-and incentive-oriented sector with its co-ordinated and implicit work ethic, is a thing to be cherished and encouraged.

Africa – misled by European socialists

Certain Western countries first discovered the capitalist secret, yet it is a universal one. Ghanaian economist George Ayitteh has applied these lessons in his book *Africa Betrayed*. Ayitteh argues that “independent Africa” reacted to the end of colonial rule by rejecting the pluralistic democracy and relatively market-oriented economic structures of the former colonial powers. Instead they embraced the one-party, socialistic structures of the Eastern bloc. In doing so, Africa ignored its own consensual political roots based on councils of elders and chiefs with limited powers. Africa departed from the private property, market-based “indigenous” system which was in place “long before the first European set foot on the continent”. Instead of private markets we had the establishment of control boards to fix agricultural prices below prices attainable on world markets. The results were as tragic as they were predictable. Agricultural production slumped, famines became endemic and smuggling became a way of life for many. Ayitteh pleads for a politico-economic system based on mutually beneficial voluntary exchanges between freely contracting individuals. As he neatly put it: “African chiefs never fixed prices.” Ayitteh argues that Africa, including SA, should ditch command socialism (not the voluntary communalistic welfare support systems of extended families which also have a long history on the continent) and return to voluntary market trading.

Returning to Africa's market-oriented roots

Douglass North would agree. However, he goes beyond agriculture. Capitalism registered impressive technological change in the 18th and 19th centuries, but its continued progress was retarded until appropriate laws and institutions evolved, such as the joint stock company and limited liability which facilitated voluntary borrowing and lending on a large scale. Again, appropriate property rights were crucial. Hiccups occurred, such as nationalisation and state control of health and education. But the trend is clear. We can apply North's analysis to the worldwide privatisation exercises of the 1980s. They are simply extensions of the earlier enclosure movements of the common lands. Real ownership is replacing nominal ownership. Economic efficiency and individual wealth are both increasing. Inequalities are declining.

Many SA economists and lawyers probably only found out about Douglass North when he won the Nobel Prize. His ideas, however, are part of a global revolution in thought and practice. Our indigenous (peace) laureates should have along talk with such economics colleagues.

This Briefing Paper was written by Henry Kenney and Duncan Reekie and first appeared in Business Day in November 1993.