# 3

# Property Rights

## The Key to Economic Growth

*by Lee Hoskins and Ana I. Eiras*[1]

For the past 20 years, there has been a movement toward more open markets and greater economic freedom. The Heritage Foundation/ *Wall Street Journal* annual *Index of Economic Freedom* has chronicled these changes for the past eight years. Greater economic freedom has brought prosperity, advanced innovation, and created wealth as never before. Expansion of trade, capital flows, and economic activity has permitted improvements in health care, longevity, education, and other social indicators.[2] Yet, at the same time, millions of people continue to live in poverty. Even worse, some countries that once were wealthy have stagnated and are even threatened with poverty.

The *Index* evaluates economic freedom in 10 institutional factors, including monetary and fiscal policy, government consumption, trade openness, and regulations. It also evaluates, in the property rights factor, how strongly a country's legal system protects private property and contractual agreements.

The term "property rights," however, has broader implications. In fact, the entire *Index of Economic Freedom* can be viewed as an evaluation of property rights protection, broadly conceived, since public policy can infringe on citizens' property rights through regulations, inflation, and government ownership of scarce resources. Unless otherwise specified, this chapter will treat property rights in its broader sense rather than simply referring to the "property rights" factor in the *Index*.

The more government policy facilitates the use of private property, the more prosperity it helps bring. In contrast, when governments infringe on citizens' property rights by implementing policies that restrict access to markets and interfere with the use of private property, they bring poverty to their countries. Accordingly, the extent to which governments carry out their responsibility to respect and protect property rights does much to determine the extent to which economic growth is possible and individuals can use freely what is theirs and enjoy the things that science, technology, and innovation can deliver to improve their lives.

When property rights are difficult to delimit, protecting them becomes more challenging. In the integrated world we inhabit, it is often difficult to assign rights to environmental resources that are in common use. Protecting intellectual property also poses problems because it is very hard to trace such property's use. In any case, the fact remains that effective protection of property is the only way to ensure that individuals are able to make the most efficient use of what they own, which in turn promotes economic growth and prosperity for all.

### THE IMPORTANCE OF PROPERTY RIGHTS

The ability to accumulate private property, whether in the form of income, investment, or purchases, is the driving force behind a market economy. For individuals to work, save, and invest, and for firms to begin operations or expand existing activities, they need to be secure in the knowledge that they will be the full owners of their property and that nobody will take it from them. The greater the protection of property, the more individuals and firms will embark on all sorts of economic activities, thereby propelling economic growth.

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These elements derive from the human condition, and the government's role is to preserve them. In his *Second Treatise on Civil Government*,[3] John Locke explains this point well:

> To understand political power right, and derive it from its original, we must consider, what state all men are naturally in, and that is a *state of perfect freedom* to order their actions, and dispose of their possessions and persons, as they think fit, within the bounds of the law of nature, without asking leave, or depending upon the will of any other man....

For Locke, humans have an inherent right to act freely, and it is their labor that defines the things they own:

> As much land as a man tills, plants, improves, cultivates, and can use the product of, so much is his *property*. He by his labour does, as it were, inclose it from the common. Nor will it invalidate his right, to say every body else has an equal title to it.

Finally, he explains that political power—the government—has the function of recognizing through legislation and protecting through the judiciary people's property rights:

> Political power, then, I take to be a right of making laws with penalties of death, and consequently all less penalties, for the regulating and preserving of property, and of employing the force of the community, in the execution of such laws, and in the defense of the common-wealth from foreign injury; and all this only for the public good.

Apart from their moral significance, property rights are important because they drive economic growth. Property rights are best protected in free economies. For that reason, the freer the economy, the more likely it is to generate wealth.

Chart 1 shows the relationship between economic freedom as measured against the 10 factors of the *Index of Economic Freedom* and wealth measured in GDP per capita. The strong, positive relationship depicted in the chart indicates that the freer the economy, the wealthier it is. Furthermore, there are no cases in which free economies are poor. In fact, the cluster lying very close to the trend line for unfree economies indicates that the relationship between unfree economies and poverty is very strong.

Unfree economies, in which property rights are weakly protected, lack a tradition or culture of private ownership of resources and the institutional arrangements to secure them. In his book *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*,[4] Hernando De Soto solidly argues this point. He suggests that, in many countries, burdensome regulations to register property leave people—mostly the world's poorest people—with no option but to operate in the black market. In Haiti,

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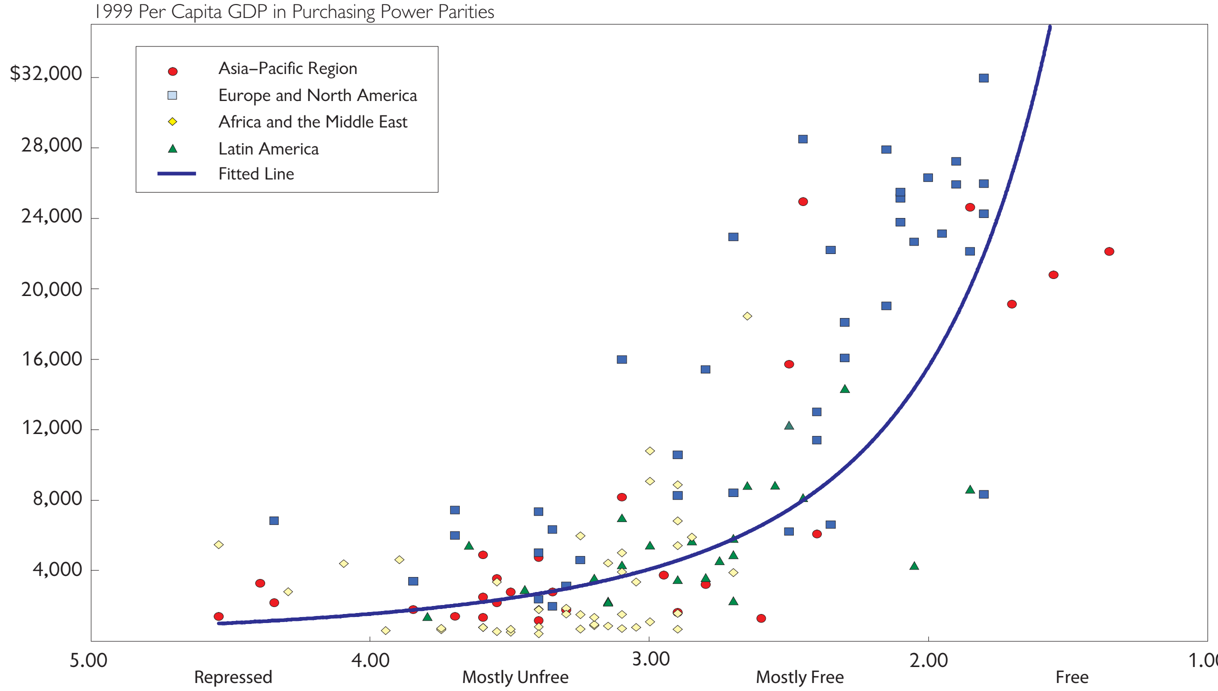
Chart 1

## Economic Freedom and Income




**Note:** Per capita GDP figures were not available for the following countries: Armenia, The Bahamas, Bahrain, Bosnia, Democratic Republic of Congo, Cuba, Djibouti, Iraq, North Korea, Kuwait, Lebanon, Libya, Malta, Oman, Qatar, Suriname, Taiwan, Tajikistan, United Arab Emirates, Yugoslavia. Per capita GDP figures are in current international dollars and are from 1999.
**Source:** The World Bank, *2001 World Development Indicators on CD-ROM.*

for example, it takes 19 years and 176 bureaucratic steps to legalize the purchase of private land. Citizens of Egypt, the Philippines, and Peru suffer a similar bureaucratic burden. In the face of such bureaucracy, affected citizens opt to live outside the law.

De Soto further argues that the poor in Third World countries have a strong sense of property. Since what they own, however, is not recognized legally, they cannot use it as collateral to borrow, invest, or expand their opportunities. As a result, not only do they remain confined in their poverty, but they are unable to appropriate the full economic value of owning what is theirs.[5]

A strong judiciary encourages support for property rights. The independence, transparency, and effectiveness of the judicial system are key determinants of a country's prospects for growth. Simply put, capital accumulates over long periods of time in places where it is afforded effective protection. This aspect of property rights is what is measured most closely in the property rights factor of the *Index of Economic Freedom*.

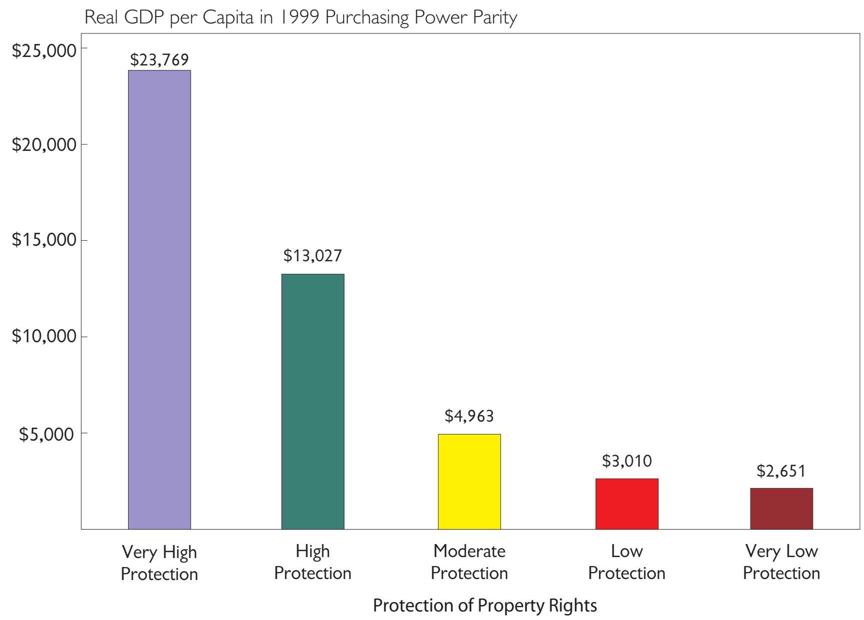
Chart 2 depicts the relationship between protection of property—defined in terms of the transparency, independence, and efficiency of the judicial system—and wealth measured in GDP per capita, for 150 countries around the world. On average, GDP per capita is twice as high in nations with the strongest protection of property than in those providing only fairly good protection. Once the protection of property shows clear signs of deterioration (moderate protection), even without a totally corrupt judicial environment, GDP per capita drops to a fifth of that in countries with the strongest protection. Countries with a very corrupt judicial system are also very poor.

The United States has been particularly fortunate in respecting property rights from the beginning of its existence. The framers of the U.S. Constitution fervently desired voluntary exchange in a setting of private property rights in which they could conduct business, trade, and initiate different economic activities. At the same time, they had a broad concept of property rights. Consider how James Madison, for example, defined private property:

> A man has a property in his opinions and free communications of them. He has a property of peculiar value in his religious opinions and in his profession and practice dictated by them. He has a property very dear to him in the safety and liberty of his person. He has an equal property in the free use of his faculties, and free choice of the objects on which to employ them. In a word, as a man is said to have a right to his property he may be equally said to have a property in his rights.... Government is instituted to protect property of every sort; as well as that which lies in the various rights of individuals as that which the term particularly expresses. This being the end of government, that alone is a just government which impartially secures to every man whatever is his own.[6]

Chart 2

**Protection of Property Rights and Per Capita Income**




Source: The World Bank, *2001 World Development Indicators on CD–ROM*. Property rights score extracted from the *2001 Index of Economic Freedom*, The Heritage Foundation and The Wall Street Journal.

Madison's concept of property recognizes that human rights and property rights are inextricably linked. Madison also emphasized a person's right to his own industry based on the production of knowledge. The Constitution explicitly recognizes the value of intellectual property rights. This recognition is especially relevant today with respect to patents and copyrights, without which there would be less incentive to invent.

The U.S. Constitution has been able to guarantee high economic freedom throughout most of the country's history. The vibrancy and dynamism of the U.S. economy are testimony to these constitutionally protected economic liberties.[7]

Property rights and their rightful enforcement are an essential part of economic growth and prosperity. The presence of property rights shapes a culture that prompts citizens to save, innovate, and invest more than otherwise would be the case, and reinforces an upward economic spiral that permits most people to reap the benefits of economic liberalization.

## THE CONSEQUENCES OF UNDERMINING PROPERTY RIGHTS

When governments make policies that interfere with economic activity, their economies suffer and the living standards of their citizens decrease.[8] For that economic activity to be effective, governments need to define property rights and create a legal framework for their enforcement. Workers, for example, should be able to work 12–14 hours a day seven days a week if they choose to do so. A business should be able to open or shut down without undue interference. When appropriate, individuals and firms should be able to sue and to have their lawsuits adjudicated justly and promptly.

Regulation affects economic activity because it interferes with private property rights. It does so by attempting to modify, supplant, or replace market outcomes with outcomes mandated by government. Deregulation, as a result, responds to the realization that a strengthening of property rights ensures the best use of resources.

Consider regulation in the banking system. According to the *2001 Index*, for example:

- **In Malaysia,** banks may not provide certain financial services.

- **In the United Arab Emirates,** foreign banks may not open more than eight branches and must give the government 20 percent of their bank earnings.
- **In Oman,** the government restricts foreign currency trading and lending for investment in the Muscat Securities Market.

By restricting products, transactions, and expansion, banking regulation in these countries keeps investment and money from flowing to their most valuable use. These regulations not only confiscate shareholders' wealth, but also undermine economic activity.

Government-mandated programs without compensation also represent an erosion of property rights. The U.S. government, for example, traditionally has compensated property owners for the taking of private property.[9] This compensation, however, did not always apply to government actions that appropriated or destroyed part of the value of property. Consider the case of mandated government programs. Through mandated provision of day care, health insurance, life insurance, pensions, environmental and product safety provisions, and the collection of data for use by government agencies, the government imposes a cost, without compensation, on business activity. In this way, it subtly confiscates wealth by taking part of the value of property.

Richard Epstein, Professor of Law at the University of Chicago, makes a solid point on how the U.S. government confiscates the value of property, either entirely or in part, without compensation. In *Takings*, he argues that there are "cases in which the government has destroyed rather than taken private property." At the same time, "the government, like any private party, is under an obligation to compensate if it takes and incorporates the property of another into its own property.[10]" Within this framework, government-mandated programs represent a form of "taking" in the sense that government takes part of the value of the business, making it its own property, through the mandate.

The case of *Palazzolo* v. *Rhode Island* illustrates this point. Anthony Palazzolo, an 80-year-old retired person from Rhode Island, was almost a victim of a government taking. According to *The Wall Street Journal*, Palazzolo sued the state for compensation for the loss of value in his property after the state declared the area of his property "protected wetlands." By declaring Palazzolo's land protected, the government also caused the value of his property to plummet, because no development could take place on it. The state courts denied the compensation, but the U.S. Supreme Court disagreed and ordered the Rhode Island court to revisit the case.[11] Palazzolo was lucky after the Supreme Court ruling. Many other property owners were not.

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Many governments around the world mandate programs without compensation. According to the *2001 Index*, for example:

- **In Sweden,** businesses must provide a five-week vacation to employees.
- **In Switzerland,** businesses must comply with equipment standards and certain codes.
- **In Belgium,** the government also requires generous work benefits.[12]

These burdensome mandates indeed represent a taking by the government and an erosion of private property rights. To the extent that the cost of these takings is significant, the market value of those businesses' stocks will be lower than otherwise would be the case.

Minimum wage laws represent another weakening of private property rights. In *The Wealth of Nations*, first published in 1776, Adam Smith reasserted John Locke's belief that labor was the property of every man: "The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable."[13] Accordingly, minimum wage laws restricting the right of individuals to sell their property (labor services) to employers for a mutually agreed upon price ineluctably weaken the right of workers to sell their own property. The costs of such erosion of property rights are explicit to the individual in the form of lost wages or lost jobs, and to society in the form of lost production. Similarly, efforts by unions in industrialized countries to impose a world labor standard on poor countries, if successful, would restrict the ability of the poor to sell their labor services at the price they agree upon with their employers.

Government ownership and use of scarce resources also infringes on private property rights and undermines economic performance. State-owned enterprises crowd out private investment and influence price determination, thereby thwarting the choices of individuals. Privatization, by contrast, is an implicit recognition that privately owned resources produce more efficient outcomes than state-owned resources. A private business, for example, must respond to a loss in earnings by improving its use of resources. If it does not do so, it will fail and its assets will be sold to someone else who will put those resources to more highly valued uses. This is not the case for state-owned enterprises, which have little incentive to restructure in order to achieve higher profits for their owners. When the government owns businesses that could be run by the private sector, the economy suffers not only a loss of economic freedom, but also distortions and loss of efficiency.

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Even inflation can be evaluated in terms of property rights. As John Maynard Keynes observed, "by a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens."[14] Inflation, in this way, weakens property rights and steers resources toward less efficient uses. Unanticipated inflation represents an involuntary redistribution of wealth. Holders of monetary assets and contracts suffer a loss of purchasing power with no offsetting compensation, and debtors arbitrarily gain rights to

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consume more than they otherwise would because they pay off with a currency that purchases less. Individuals will alter the way they use or hold resources in order to protect themselves against inflation. Furthermore, in countries with high and variable inflation, long-term fixed-rate loans may disappear. The result is a confiscation of wealth and a less than efficient use of resources.[15]

Economists, politicians, and the public at large increasingly recognize that government-managed economies concentrate wealth and power in the hands of a few, waste resources, and fail to raise living standards for the majority. Over the past two decades, more and more countries around the world have attempted to respond to popular dissatisfaction with their economies by gradually opening their markets. This is notably the case in countries like Estonia, Chile, Ireland, and Taiwan. These changes respond, in part, to a growing recognition that open markets and private ownership allow for unhindered economic activity and therefore improve economic performance.

Yet, in many parts of the world, liberalization has come as the result of random patches of incomplete privatization, fiscal tightening, deregulation, and inflation controls, usually in response to some kind of crisis. This is the case, for example, in some of the Eastern European countries that once were part of the Soviet Union, and of Latin American countries like Peru, Argentina, and Brazil. The partial opening of markets has benefited only certain parts of the population, usually the wealthy and the political elite. The poorest in these countries remain poor.

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## A TALE OF TWO COUNTRIES

It is not the amount of physical resources that a country has within its borders that determines the wealth of its people. It is how the resources are employed, and the institutional environment within which they are employed that counts. Russia, for instance, has abundant natural resources and Hong Kong has few; yet Russians are poor and the people of Hong Kong are prosperous. The same is true for the Democratic Republic of Congo (formerly Zaire), which is richly endowed with natural resources while also being home to some of the world's poorest people, and Singapore, which has almost no natural resources but whose citizens are well-off.

But perhaps the most striking comparison can be made between Australia and Argentina. Both countries are in the Southern Hemisphere. Both are endowed with abundant natural resources, are multicultural, and have the same type of climate. And for both countries, agriculture, fuel, and minerals are an important part of their exports. In other words, both countries are very similar in terms of resources; yet Australia's GDP per capita is more than twice as high as Argentina's. (See Chart 3.)

The main difference between these two countries is institutions. Particularly in the past 25 years, Australia has lowered its trade barriers to an average of 3.8 percent,[16] which has helped the Australian economy to be more competitive.[17] In addition, the government has cut expenditures in order to achieve budget surpluses, which have been used in turn to lower the country's debt. Australian authorities have fostered a competitive environment through extensive privatization and deregulation of the economy. Equally important, Australia has fostered, throughout the century, a transparent, independent judiciary that effectively protects property rights, thereby securing investment and private contracts.

Argentina, however, has taken a radically different course. By entering the Common Market of the South (MERCOSUR), the government has raised trade barriers to an average of 13.5 percent. In addition, Argentine authorities increasingly have spent more than they collected through taxes. In the absence of economic growth, the fiscal deficit has increased the need to resort to debt as a way to finance it. Today, as economist Charles Calomiris predicted in March 2001, Argentina "cannot generate enough currency receipts to service its debt."[18]

Argentine authorities cannot generate more growth in the short or medium term, but they could have prepared the ground with policies that attract investment, facilitate economic activity, and sustain economic growth in the long term. Instead, however, they have only partially deregulated the economy while continuing to impose a tax level that is too high relative to Argentina's economic growth prospects. The markets have responded to this burden with lower investment, lower consumption, a higher level of black market activity, and an unemployment rate of 14 percent.[19]

Unlike Australia, Argentina has failed to create a

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competitive environment. Many Argentine utilities are in the hands of a few monopolies, which have improved their services but still charge high prices for their use.[20] In addition, since the 1930s, Argentina's judiciary has failed to protect property rights, thereby undermining long-term investment and imposing greater costs on contractual agreements.

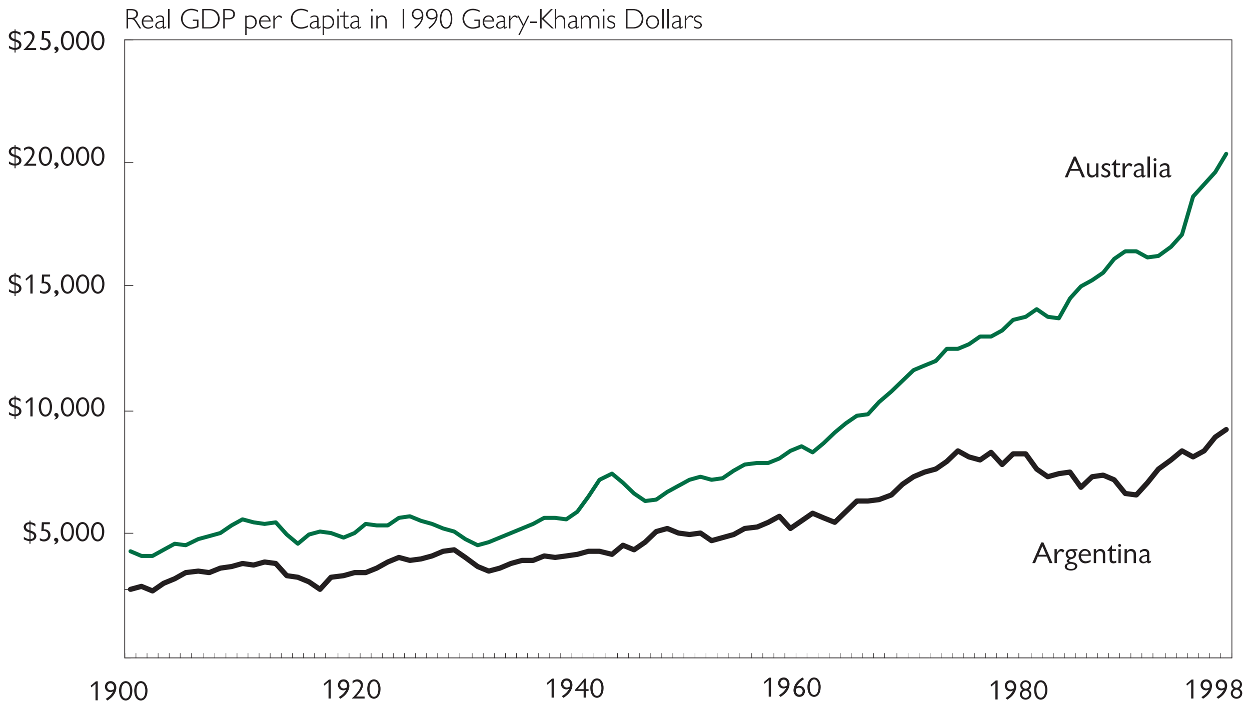
Argentine authorities recently have decided to pass a zero-deficit plan in order to avert a default and reduce Argentina's financial needs to a minimum, and then wait until international financial markets are willing to resume lending and growth occurs.[21] But this is hope, not policy. A better alternative for Argentina would be to implement sound policies, such as additional deregulation, lower taxes, and lower tariffs on trade, to prepare the ground for sustained, long-term economic growth.

By contrast, the combination of sound policy, open markets, and competition has allowed Australia to grow steadily and increase productivity. Multifactor productivity (i.e., productivity of capital as well as labor) has grown more than 2 percent a year, well over twice the OECD average and faster even than in the United States.[22] It is this high level of productivity that has helped Australia to sustain growth for the past 17 years.

Chart 3 compellingly shows how policymaking has affected both Argentina and Australia. The chart depicts real GDP per capita for both Australia and

Chart 3

**Real GDP Per Capita in Argentina and Australia, 1900-1998**




**Source:** Angus Madison. *Monitoring the World Economy.* OECD. August 1995. Data from 1995 to 1998 from Angus Madison. *The World Economy: A Millennium Perspective.* OECD. June 2001.

Argentina since 1900.[23] Although Australia had higher per capita income than Argentina throughout the 20th century, the gap between both countries does not vary much until the late 1930s. After the 1930s, Australia's growth in real GDP per capita becomes increasingly higher, and after the 1970s, the difference between both countries increases at a much faster pace.

The difference in wealth between both countries is due to the different public policies each country has chosen to implement. Technological improvements to facilitate capital movements throughout the world have rewarded sound policy and punished poor ones. Capital undoubtedly has flown—and continues to fly at an increasingly rapid rate—to the safest, most predictable economies. Australia, in this sense, has been rewarded for implementing sound economic policy. Argentina, by contrast, will continue to suffer until it decides to throw open its markets and strengthen the protection of property.

## FUTURE CHALLENGES FOR PROPERTY RIGHTS

Preserving property rights is the only way to promote economic prosperity. Most of the world, however, has little experience with clearly specified private property rights. Without such rights, people cannot buy, sell, borrow, and invest efficiently. There are cases, however, in which defining and enforcing property rights can be particularly challenging. These areas include intellectual property and certain problems involving the environment.

**Intellectual Property Rights.** Knowledge is a very important part of wealth creation, market integration, and the transmission of efficient practices around the world. Ideas, theories, and new discoveries, for example, have played a key role in increasing productivity, thus helping to sustain economic growth. It therefore follows that the assignment and enforcement of knowledge-based property rights—commonly known as intellectual property rights—is crucial to the continued increase in knowledge-based activity. Authors, creators, and inventors will continue to make knowledge-based investments only if they can capture the returns from their investments.

Assigning property rights to knowledge-based goods, however, can be challenging. There are at least three reasons for this.

- **First,** many of these goods are public goods. By definition, as a practical matter, public goods cannot be withheld from one consumer without being withheld from all, and after producing these goods, there is no cost for additional people consuming them.[24] Songs, for example, do not disappear after one listens to them and can be consumed by many people at the same time and many times. It is difficult, though not impossible, to find a way to charge people for every time they consume that good.
- **Second,** some inventions can be very expensive to produce, so poor contries may try to obtain cheaper copies of those inventions. This is the case, for example, with AIDS drugs in African countries. On the one hand, pharmaceutical companies that invested millions of dollars in research for those drugs want to capture the returns from their investment; on the other hand, African countries that cannot afford to purchase the drugs, like South Africa, import unlicensed copies from India. The challenge is to find the right balance between the time pharmaceuticals need to capture the returns of their investment and the time other countries could access unlicensed cheaper copies without affecting the pharmaceutical companies' investments.
- **Third,** there is no general understanding across nations on what intellectual property rights are and how they should be defined. For example, in the United States, it is illegal to reprint books without the author's permission. In Thailand, it is legal to do so. Unless both countries can define property rights similarly, their citizens will not be able to know what is legal and what is not legal in a global marketplace.

Reaching a worldwide consensus to assign intellectual property rights and enforce them is a challenge because it involves certain costs, and it is not clear yet whether all nations are willing to absorb that cost.

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**The Environment.** Property rights play an important role in preserving the environment. Assigning property rights to the use of environmental resources usually encourages both conservation and the efficient use of natural resources. Many times, however, assigning property rights for environmental concerns can be difficult, in particular when it comes to unowned areas. Again, there are at least three reasons for this.

- **First,** it is difficult for nations to agree on how to deal with environmental problems.
- **Second,** there is no international enforcement power to preserve property rights even if they were defined.
- **Third,** international agencies typically respond to political interests and therefore can become bureaucratic organisms that fail to achieve their stated goals.

In unowned areas, nations share natural resources. These unowned areas are typically known as common pools. For example, nations have access to unrestricted fishing in the open ocean, can explore seabeds, and use and pollute the air. Such unrestricted access, however, brings undesirable consequences for the environment such as overfishing, acid rain, and the extinction of species.[25]

Consider the case of lobster fishing on the coast of Maine in the United States. According to a Political Economy Research Center (PERC) report, anybody with little capital can enter the lobster fishing businesses.[26] When the catch is good, hundreds of newcomers are motivated to give it a try. Pretty soon, however, the number of lobsters begins to dwindle. Overfishing leads to gradual depletion of lobsters, affecting the business. In response to this problem, Maine fishermen have taken the initiative to assign rights for fishing. They have divided the state into zones, and the zones into districts. They have crafted rules for fishing that successfully prevent overfishing, preserving the lobster and enabling many to remain in business.[27]

The story of the Maine fishermen exemplifies how countries can solve their own environmental problems. Environmental problems in other common pool areas, however, are challenging. Consider, for example, seabeds exploration. According to the Law of the Sea, "coastal states have sovereign rights in a 200-nautical mile exclusive economic zone with respect to natural resources and certain economic activities."[28] Outside that zone, countries have unrestricted access to ocean exploration, which is likely to increase since improvements in technology have raised the economic value of seabeds exploration.

A system of property rights to seabed exploration would help protect the ocean, just as it protected the lobster in Maine. But the challenge will be to create an international agency to assign and enforce those rights. The reason: Creation of such an agency requires a consensus among sovereign nations on what those rights are and what constitutes adequate enforcement of those rights once they have been defined.

The recent disagreement about the Kyoto Protocol between the United States and other nations illustrates this point well. According to Charli E. Coon, Senior Policy Analyst for Energy and the Environment at The Heritage Foundation, there is "evidence of considerable lack of consensus, both in the United States and abroad, concerning the protocol's underlying principles and its policies…."[29] While the United States rejected the treaty on the grounds of its being flawed, other nations thought it was worth pursuing and recently agreed to bring it into force.[30] As of this writing, however, no country has ratified the agreement, which they must do if it is to become law. Accordingly, international efforts to reduce the global warming effect will likely be futile.

The environment will be at the heart of one of the biggest potential conflicts over property rights. While the cost of assigning and enforcing rights to these natural resources remains high, the benefits of doing so rise daily. As a result, the sooner we move away from holding resources in common pools, the sooner we will make progress on waste, pollution, and reduction of conflict.

## CONCLUSION

The protection of property rights is the driving force behind wealth generation and higher living standards. Property rights not only are inherent in the human condition, but also drive economic growth. Property rights are best preserved in free economies. For that reason, economically free economies are also the wealthiest in the world. Free economies foster people's sense of private ownership and prompt them to value property rights.

When government policy interferes with economic activity, the economy suffers and people's living standards decrease. Governments can infringe on property rights directly by enabling a weak judiciary or indirectly by raising taxes, enacting burdensome regulations, consuming scarce resources, and mandating that business implement social programs. Government infringement of property rights subtly confiscates wealth, decreases the value of economic activity, and prevents resources from flowing to their most valuable use. At the same time, it helps to concentrate wealth in the hands of a few at the expense of the poorest. For many countries, like Argentina, the ability to generate economic growth has been undermined consistently by government policy for the past 70 years.

Even though preserving property rights clearly enhances countries' growth and development perspectives, assigning and enforcing property rights in some areas can be challenging. This is particularly true with respect to knowledge-based goods and the economic use of natural resources. In both cases, it is very difficult to achieve a consensus across nations either on how to define property rights or on what sort of international mechanism should be created to enforce them. In this sense, the environment and knowledge-based products will be at the heart of the biggest potential conflicts on property rights.

Nevertheless, the fact remains that effective protection of property is the only effective means for societies to make use of what they own, in the most efficient way, to promote both economic growth and general prosperity.

## Notes:

1 The authors would like to thank Anthony Kim, a Research Assistant in the Center for International Trade and Economics, for his assistance.

2 See Allan Meltzer, Introduction, *Report of the International Financial Institution Advisory Commission* (Washington, D.C.: U.S. Government Printing Office, March 2000).

3 John Locke, *Second Treatise on Civil Government*, original version available on-line at *http://www.orst.edu/instruct/phl302/texts/locke/locke2/locke2nd-a.html#CHAP.%20V*.

4 Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

5 Elsewhere in this volume, Mary O'Grady argues that "Experts on culture…prop up the theory that the values of Latin Americans—with Roman Catholic and Indian tribal roots—clash with the notion of individual freedom. Latins, we are told, are collectivist and want government to protect them from savage capitalism. Just what kind of a transformation they undergo to arrive in the U.S. as immigrants brimming with entrepreneurial verve, has never been explained." See Mary Anastasia O'Grady, "Too Many Promises: How Latin American Constitutions Weaken the Rule of Law," supra.

6 James A. Dorn and Henry G. Manne, eds., *Economic Liberties and the Judiciary* (Fairfax, Va.: George Mason University Press, 1987), p. 3.

7 Gerald P. O'Driscoll, Jr., Kim R. Holmes, and Melanie Kirkpatrick, eds., *2001 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2001), p. 377.

8 When the use of resources by one individual imposes uncompensated costs on another (often called "market failures" or externalities), there may be a role for government action; but government actions that attempt to correct for market failures can make matters worse. The incentive system in government has little to do with efficient resource use and everything to do with lobbying and bureaucratic decision-making. Thus, the existence of a market failure in itself does not imply a justification for government intervention.

9 The Fifth Amendment to the Constitution of the United States specifically protects citizens against the taking of private property without compensation.

10 Richard Epstein, *Takings: Private Property and the Power of Eminent Domain* (Boston, Mass.: Harvard University Press, 1985), p. 37.

11 "The Earth Rebalanced," *The Wall Street Journal*, July 10, 2001.

12 O'Driscoll, Holmes, and Kirkpatrick, eds., *2001 Index of Economic Freedom*, pp. 94, 348, and 350.

13 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: The Modern Library, 1937), pp. 121–122.

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16 See Chapter 6.

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23 The Geary–Khamis approach is based on twin concepts of purchasing power parity of currencies and international average prices of commodities. The annual GDP per capita levels shown in Chart 2 were derived by merging GDP indices with benchmark values of 1990 GDP levels. In order to compare levels of output or output per capita in different countries, it is necessary to convert them into a common unit.

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25 Acid rain results from the sulfur dioxide emitted by the burning of fossil fuels, such as coal and oil, and can spill over countries other than those where it is generated.

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30 "Breakthrough in Bonn?" *The Economist*, July 24, 2001. On July 23, 2001, 180 countries met in Bonn and struck an agreement that should enable the protocol to come into force. The United States, Canada, and Japan did not agree to abide by the Bonn agreement, and no country has yet ratified the protocol.