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PROPERTY RIGHTS SPECIFICATION AND PROTECTION IN TRANSITION ECONOMIES

The article reviews the economic consequences of weak protection and unclear specification of property rights and necessary precondition for improvement of property rights security in transition economies. Rich experience of these countries attests to hardships in building and supporting efficient property rights institutions and this negatively affects social and economic situation. On the other hand, such state of affairs indicates the existence of a considerable economic potential provided property rights protection is enhanced and the rights themselves, clearly specified.

Keywords: transition economy; property rights protection; transaction costs.

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СПЕЦИФІКАЦІЯ ТА ЗАХИСТ ПРАВ ВЛАСНОСТІ В ПЕРЕХІДНИХ ЕКОНОМІКАХ

У статті розглянуто економічні наслідки слабого захисту і нечіткої специфікації прав власності та необхідні умови для вдосконалення відносин прав власності в країнах з перехідною економікою. Багатий досвід цих країн свідчить про наявність труднощів у побудові і підтримці ефективних інститутів прав власності, що негативно позначається на соціально-економічній ситуації. З іншого боку, такий стан справ вказує на наявність значного економічного потенціалу за умови посилення захисту та забезпечення чіткої специфікації прав власності.

Ключові слова: перехідна економіка; захист прав власності; транзакційні витрати.

Форм. 1. Рис. 1. Літ. 30.

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СПЕЦИФИКАЦИЯ И ЗАЩИТА ПРАВ СОБСТВЕННОСТИ В ПЕРЕХОДНЫХ ЭКОНОМИКАХ

В статье рассмотрены экономические последствия слабой защиты и нечеткой спецификации прав собственности и необходимые условия совершенствования отношений прав собственности в странах с переходной экономикой. Богатый опыт этих стран свидетельствует о наличии трудностей в построении и поддержании эффективных институтов прав собственности, что негативно сказывается на социально-экономической ситуации. С другой стороны, такое положение дел указывает на наличие значительного экономического потенциала при условии усиления защиты и обеспечения четкой спецификации прав собственности.

Ключевые слова: переходная экономика; защита прав собственности; транзакционные издержки.

Problem setting. Many years of reforms in transition countries reconfirm the extreme importance and strategic role that the institutional aspect of transformation plays in economic policies implemented by government. Low efficiency of market-driven transformations at the beginning of transformation phase in a number of post-socialist states has been conditioned by an insufficient attention to institutional components of economy growth in these countries.

Transformation practice of post-socialist countries shows that set up and further sustainable development of institutional framework needed by a transition economy

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must be assured not just by the development of legislative framework and establishment of an efficient judiciary system. Interaction between economic policies and processes of new, market-driven institutional framework in transition-type economies reveals numerous serious issues. Transformation experience elicits a tendency to overlook some of the most important aspects of market reforms like the need for setting up fundamental institutional basics of market economy, the most important of them being the provision of efficient protection and specification of property rights.

Despite a substantive body of research on property rights and problems of their enforcement accumulated worldwide to date, the theory of property rights remains not sufficiently developed to be efficiently used in practice, specifically for solving the problems of property relations transformation with the aim of assuring sustainable economic development. Global scientific experience in this area focuses mainly on the assessment of the impact of property rights protection and specification onto economic growth of developed economies which makes it impossible to use this experience in transition economies without proper regard to specifics of their transformation.

Latest research and publications analysis. The theory of property rights, a rather important direction worthy attention was set by institutionalists and conceived by such notable representatives of Western economic thought as A. Alchian and H. Demsetz (1973), R. Coase (1988), H. Demsetz (1967), D. North (1997), S. Pejovich (1981), O. Williamson (1996) and others. The issues of property rights emergence, enforcement and protection have been also investigated by Russian and Ukrainian researchers, among them V. Dementiev (2005), V. Geets et al. (1998), R. Nureyev (2007), A. Shastitko (1999), V. Tambovtsev (2006), A. Tkach (2004) etc.

D. Acemoglu et al. (2001; 2005), J. Aron, (2000), R. Barro (1996), J. Dawson (2003), S. Knack and P. Keefer (1995), L. Tamlina (2005) in their works look directly into the effect of property rights on economic growth. Similar researches on the microlevel were carried out by A. Green and C. Moser (2012), S. Johnson et al. (2002), K. Ojah et al. (2010). At the same time, the impact of property rights protection and specification onto economic processes in transitional economies remains underexplored.

The objective of this research is to provide insights into particularities of the effect of property rights protection and specification onto economic processes in transition-type economies.

Key research findings. A clear specification of property rights provides for realization of interests of economic agents by, first of all, minimizing uncertainty in interactions of the latter, and secondly, optimizing the use of limited market resources. Under loosely defined resource property rights negative external effects emerge inevitably. Given that a considerable uncertainty in operational conditions is rather characteristic for transition-type economy and ties with severe shortage of resources, the issue of efficient legal support and regulation of property relations remains the basic one for all sorts of transformational changes in society.

For a successful production activity to be organised it shall be necessary, first of all, to specify and protect each individual's resource property rights and outcomes owing to which effective stimuli for increasing efficiency of these resources use will be provided (Demsetz, 1967). According to the theory of property rights, contents and

distribution of these rights affect not only the distribution of resources per se but also the procedure and volume of their exchange, levels and distribution of income and pricing processes (Pejovich, 1981). This provision finds its formal corroboration in the R. Coase (1988) theorem: with property rights clearly specified and transaction costs absent, production structure shall not undergo changes regardless of whether any changes in property rights distribution happen, ignoring the income effect.

In the most general sense, the notion "transaction costs" includes resource expenses (financial, temporal, labour etc.) borne in connection with planning, adaptation and monitoring of performance by individuals of their undertakings related to transfer or appropriation of publicly accepted property rights and freedoms (Shastitko, 1999). The range of transaction costs also includes those related to specifying and providing protection of property rights, also maintaining judiciary and arbitration systems, related government structures, resource and temporal expenses on restoration of violated property rights as well as expenses borne due to insufficiently efficient protection.

The Coase theorem has one very important implication: with positive transaction costs, property relations start affecting production (Coase, 1988). This happens in practice because transaction costs do always exist in real life, so there always is a close interconnection between property relations and production. Thus, the Coase theorem is by no means unimportant as it viably serves to substantiate the existence of interconnection between property relations and production performance as well as the structure of the latter and the level of income. With the view of this conformity, one may reach an important conclusion to the effect that property rights, certain conditions fulfilled, represent an economic growth factor.

T. Besley and M. Ghatak (2009) identify 4 main channels through which property rights affect resource distribution and economic activities, namely:

- Protection channel: it is assumed that investments provide inflow of revenues that need to be secured from expropriation with clearly defined and properly protected property rights. The existence of such protection will make an incentive for investments; herewith, the lack of property rights protection presupposes the absence of possibility for businesses and private persons to reap the harvest of their investment efforts.

- Efficiency channel: provides for asset mobility through transactions in which assets are transferred to individuals or businesses able to use these in the most productive way.

- Lower protection costs channel: the security of property rights presupposes releasing private persons of the need for spending resources on protection on their own property owing, so resources spending is reduced and possibilities of their more productive usage emerge.

- Transaction promotion channel: the existence of formally defined property rights gives owners the possibility to use their property as a collateral for transactions aimed at attracting resources from financial markets owing to which productivity can be increased in the ways described by H. de Soto (2000).

The international "Property Rights Index" (IPRI, 2013) is one of the indices, which measure intellectual and physical property rights protection by nations around the world. The values of such indices for transition economies are generally modest

and that the countries find themselves in the end the rating attests to poor efficiency of property right protection in these countries. Property rights in many transition economies both during privatisation of enterprises and following its completion remain attenuated, poorly protected and subject to various restrictions, thus leading to a substantial increase in transaction costs.

The amount of transaction costs in transition economies is rather high also because of such factors as low market transparency and scarcity of data on privatised objects; underdeveloped information market and distortion of pricing signals due to negative impact of structural disparities and high monopolisation rates; incomplete market formation and a great number of its participants; lack of certainty in observance of terms and conditions of negotiated transactions; presence of criminal component in privatisation processes etc.

Noteworthy, in the short-term perspective the attenuation of property rights turns out a certain advantage for national budget as it reduces the expenditure load (North, 1997). Nevertheless, in a longer term such rights attenuation will have a negative effect on investment activities due to uncertainty that increases entrepreneurial risks (Johnson et al., 2002).

Given property rights and their regulating institutions, being the basic market institutions, reduce uncertainty in operations and minimise negative external effects, property denationalisation should have become the first-hand task for Eastern European countries that have launched market reforms. Sadly, the circumstance was never taken into consideration by the majority of post-socialist states that ventured onto the road of market reforms: privatisation in these countries was given a start already after primary specification of property rights when public property actually changed hands in favour of a limited group of persons. It was a situation when everything was mostly decided upon one's personal contacts and dependencies. It can be mentioned that in this case the attenuation of property rights happened when such rights, due to the lack of clear definition, fall under the influence of various types of opportunistic behaviour. The threat of property rights violation remains the most important and topical issue for transition economies to date capable of becoming the reason of disruption of balance throughout the whole socioeconomic system.

Primary negative effects of inefficient property rights institutions that lead to threat of such rights violation are (Figure 1): transaction costs increase; spread of destructive rent-seeking behaviour; shadowisation of national economy; corruption; lowered investment activity; and drain of national capital. The listed consequences themselves become the reason for economic growth slowdown leading to increased poverty and social tensions in the country and from here, to political instability under which property rights continue to be violated and national income to be distributed in favour of a few.

Because of failure of the state to provide for property rights specification and protection in transition economies, the burden lies on economic agents who thus are compelled to make independent efforts to protect their rights of property by incurring costs on setting up their own security services and maintaining friendly relations with government structures: tax offices, police, courts, administrative bodies etc.

The situation gives rise to a range of problems, among which a tendency towards aggressive and forceful conflict resolution (e.g., illegal takeover) as well as the need for

redistribution of a considerable share of resources away from production necessities towards property rights protection and contract enforcement – surely hardly contributing to sustainable economic growth and development.

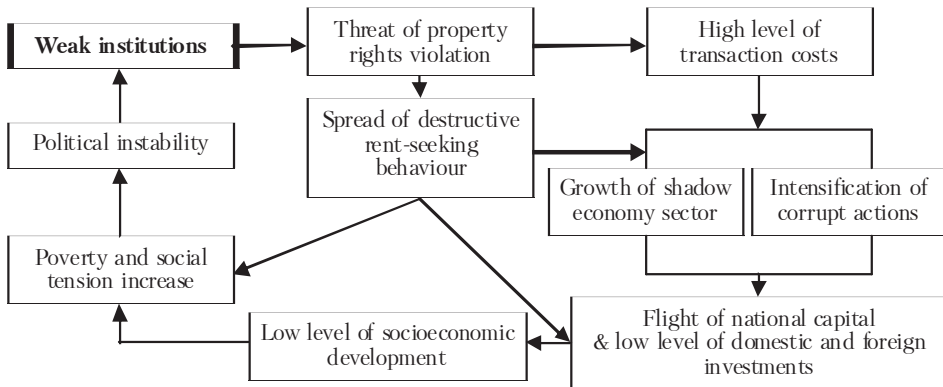


Figure 1. Interconnection between weak institutions and political & economic instabilities, author's

With the view of insufficient property rights protection leading to growth of violence, slowdown of economic growth and reduction of revenues of economic agents, one would expect the state to design and implement a mechanism of property rights protection institutions development; however, one will be at pains to find this logical conclusion implemented in the majority of transition economies which, most probably, can be explained by the failure to account in this statement for expenses necessary for strengthening property rights protection as well as for incomes that economic agents can potentially derive due to property rights attenuation.

Because of imperfection of property rights institutions, economic agents find incentives to provide for private security (Sonin, 2005). Herewith, protection expenses of big enterprises are not that substantial owing to considerable economy of scale; moreover, as such agents retain possibilities of grabbing property of smaller enterprises, this leads to increased capital concentration and greater monopolisation of the economy. This state of affairs offers advantages to bigger enterprises that, for that purpose, will do what they can to counter improvement in property rights protection. This results in the absence of demand for the institutions that ensure sustainable economic growth, and the economy reaches an equilibrium state of the kind characterised by meagre economic growth rates, a considerable gap between the rich and the poor and big business and government employees' rent-seeking activities. A confirmation of that can be found in L. Polishchuk and A. Savvateev (2004), K. Sonin (2003), E. Glaeser, C. Sheinkman and A. Schleifer (2003) as well as in K. Hoff and J. Stiglitz (2004) who mention that, in the conditions of accessible for appropriation resources, the richest economic agents (oligarchs) become less interested in the rule of law seeing it as a limitation to their possibilities. In these circumstances property rights protection for the rest of population becomes weak. Here, when voters opposing rent-seeking find themselves insufficiently represented politically, the power in the state may be seized by oligarch groups not really willing to implement reforms that

potentially threaten them. Moreover, dominating groups opt for the institutions that contribute to rent extraction, except the rule of law and proper protection of property rights of large majority of population. This results in a vicious circle when poor property rights protection contributes to rent-seeking that, in its turn, leads to further weakening of property rights protection. In such situation national economy risks getting stuck in the "institutional trap", a persistent equilibrium state with poor property rights protection, for an undetermined period.

K. Sonin (2005) demonstrates 3 types of negative effects of weak property rights protection by the state. One of these concerns the need for economic agents to divert their resources away from production and subsequently redirect these towards protection of their own property rights. Another yet negative effect is that risks of losing production outputs lead to deformation of economic environment when production growth and capital accumulation become suboptimal. The last effect is in increased fight for property conditioned by high level of income distribution inequality. The author also points out that the lower the level of property rights protection is offered by the state, the harsher budget constraints become.

The state provision of property rights makes a special case of social benefits it provides. The state has a two-alternative choice: either it leaves property rights protection at its current level or incurs extra costs to improve protection. State spending on property rights protection will increase budget revenues; however, the structure of such spending will include not only direct costs of activity arrangement of law enforcement but also income amounts that bureaucrats might receive from business-grabbing activities. Therefore, it will be advantageous for the state to engage in property rights protection only in the case when the rate of budget revenue increase related to such improved protection exceeds the costs of improvements.

Following the above, we may compose an inequality that reflects the necessary conditions for the improvement of property rights protection that, in its turn, is the most important factor contributing to positive economic growth dynamics:

$$Y_p - C_p > Y_a + Y_g - C_1, \quad (1)$$

where Y_p is incomes of national budget and entrepreneurs related to improved property rights protection; C_p is the costs of enhancing the property rights protection; Y_a is the incomes related to attenuation of property rights (rents, bribes received etc.); Y_g is the incomes from business grabbing obtained by bureaucrats and big corporations; C_1 is the costs borne by the ruling elite because of chances of losing power due to victory of their political opponents under the slogans of state's greater involvement in property rights protection.

The fact that this inequality remains inoperative in practical terms in transition economies is related to a considerable impact of the shadow sector where economic relations continue being more reliable and profitable than in the legal one. A wide spread of shadow economic activities can be observed in the countries with inefficient legal regime in which the rate of prosperity of economic agents is tied to the costs these economic agents have to bear under law rather than to their performance. A more skilful manipulation of these costs or connections with bureaucrats assures economic success of entrepreneurs.

Most of transition economies, the post-socialist ones including, sustain tremendous losses because of shadow economic activities, which makes analysts conclude about the downturn of national economy and market reforms collapse. Meanwhile, there also exists a somewhat alternative view of the current situation that states that market transformations in post-socialist countries have led to insufficient development of market relations. In this case, the informal market plays the role of an economy restoration indicator rather than of symptom of disease; subsequently, the problem lies not in the existence of shadow business per se but the need for its formalisation (de Soto, 2000). The concept may be agreeable with certain reservations in consideration of the short duration of the mentioned positive effects.

The important lesson taught recently to the international economic community by the world financial crisis and ensuing economic downturn should be also noted. No economic prosperity will be possible without such important precondition as clearly specified and reliably protected property rights. Observance of this precondition plays a decisive role also when strong economy recovery is necessary. In the situation when fully fledged financial markets operation has not yet been recovered and when national economies are busy reviving themselves, the world economy needs additional inflows in the form of economically viable, not fully legalised and insufficiently protected assets.

Conclusions. Summarising the above, it is worth noting that transition economies during and after the privatisation phase witness the attenuation of property rights when such rights are not clearly defined, subject to various limitations and poorly protected, thus considerably increasing transaction costs and leading to growing levels of shadow economy, activation of corrupt activities, flight of national capital. All this results in the decrease of economic growth and development rates that, in turn, conduces to growing poverty, social tensions and political instability which contribute to further violation of property rights and ongoing national income redistribution among limited groups of people in the country.

Consequently, efficient protection and clear specification of property rights to resources and production outputs is a necessary condition for successful economic development under transition. In today's settings of property relations transformation in transition economies the condition of expediency of property rights protection and specification enhancement looks, as follows: the total of incomes of economic agents reduced by their costs borne in relation to improvements in property rights protection must be in excess of the total of incomes received due to the attenuation of property rights or their weak protection excluding the costs related to the risk of losing power due to opponents' victory in a political campaign organised under the slogan of State's enhanced involvement in the organisation of property rights protection.

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Стаття надійшла до редакції 25.03.2014.