



Threats to property rights: Effects on economic performance of the manufacturing sector in Indian states



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ABSTRACT

We examine the effects of the threats to property rights on the economic performance of the manufacturing sector in Indian states. We constructed indices of the threats using data on crime against property rights. In our analysis, we correct for the problem of underreporting of crimes in official crime data. The results of our instrumental variable estimation show that not only threats to private property but also to contracts adversely affect the performance of the manufacturing sector in India. We also extend our basic model to examine the effects of kidnapping and the scale economies of property rights protection.

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1. Introduction

This study investigates the effects of threats to property rights on the performance of the manufacturing sector in Indian states. We construct indices of the threats from the data available on crime against property rights, and using these indices, we show that threats not only to private property, but also to contracts, adversely affect the performance of the manufacturing sector in India.

Citizens' property rights can be threatened by many actors, including monarchs, aristocrats, dictators, politicians, bureaucrats, enterprises, organized crime cartels, and thieves. [Demsetz \(1967\)](#)² elucidates the role of property rights in his seminal paper:

Property rights are an instrument of society and derive their significance from the fact that they help a man form those expectations which he can reasonably hold in his dealings with others. These expectations find expression in the laws, customs, and mores of a society. . . . An owner expects the community to prevent others from interfering with his actions, provided that these actions are not prohibited in the specification of his rights (p. 347).

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From the quotation above, we can infer that to protect property rights, both the enactment of property right laws and the enforcement of such laws must be ensured. Since institutions that protect property rights are a kind of public good and property rights protection has scale economies, governments are generally expected to play a critical role in establishing institutions such as the police and the judiciary to guarantee the protection of property rights. In a society where private property and contracts are protected, entrepreneurs, in all likelihood, are able to acquire the expected profits from their business activities and use them for their own benefit. In such a society, entrepreneurship and business activity can be expected to thrive. Conversely, in a society without protection for private property or contracts, vibrant business activities cannot be expected.

By now, there seems an almost complete consensus among academics that property rights protection is one of the key determinants of economic development. However, to measure the extent of property right protection, many studies have used indices based on experts' assessments or survey responses from business people. These indices may have several deficiencies, such as subjectivity in the data or selection bias (e.g., toward large firms and urban areas). To alleviate these problems, in this study we use more objective data related to property rights protection, namely, data available on crime against property rights. Furthermore, we focus our comparison to the differences between the Indian states, that is, different regions within the same country, so as to obtain a sample drawn within a relatively consistent national legal and social framework.³ This method is advantageous compared with cross-country studies, which take data from countries with diverse legal and social conditions without adequate controls. In this sense, the present study is complementary to the previous literature using experts' assessments or survey responses.

However, the use of crime data has several deficiencies. Underreporting of crime is a particularly serious issue, because victims may not report certain incidents to the police (or other relevant authority) for several reasons. The International Crime Victimization Surveys (ICVS), the most comprehensive international crime victim survey to date, has shown that the average reporting rates of burglary and robbery are only 74% and 46%, respectively, among the 30 countries and 33 capital/main cities surveyed in 2004–2005. Further, the reporting rates tend to be lower in developing countries. An innovative paper by Soares (2004) shows us how to use official crime data more effectively. Using the ICVS dataset, Soares regressed the crime reporting rate on various relevant variables, and then applied the estimation results to official crime data to obtain a predicted true crime rate. We use an approach similar to that of Soares to obtain the predicted true crime incidence in each Indian state.

In a broad sense, property rights include all rights that have a property value. In terms of its effects on economic performance, two types of property rights are important to consider. The first type involves property rights in a narrow sense, that is, the right to utilize and dispose of one's private property. The second type involves so-called "claims," that is, the right to make a claim on a certain act of another person as specified in a contract. Acemoglu and Johnson (2005) refer to the institutions that protect property rights with respect to private property as "property rights institutions," and those that protect property rights with respect to contracts as "contracting institutions."

In this study, we extend Acemoglu and Johnson's (2005) study, in which they examined the effects of property rights institutions and contracting institutions on economic performance. They concluded that property rights institutions, but not contracting institutions, have a significant impact on economic performance. However, their study also faces the data problems mentioned above from relying on expert opinions and survey data. Since our data on crime are classified into various types, we can separate the respective effects of property rights institutions and contracting institutions more precisely in our examination.

We estimate the effects on the economic performance of the state manufacturing sector for the period 1980–2000 using two different indices related to property right threats. We further conducted instrumental variable estimation to correct for the problem of endogeneity between economic performance and crime rates, and show that threats to contracts, as well as to private property, adversely affect the manufacturing sector in India. Therefore, our results confirm Acemoglu and Johnson's (2005) findings on property rights institutions, but in contrast, we also show that threats to contracts have negative effects on economic performance.

The rest of the paper is organized as follows. We briefly review the relevant literature in Section 2. We then explain our empirical formulation in Section 3. Section 4 provides information about our data sources and method for constructing variables. Our main estimation results are presented in Section 5. We extend our basic analysis in two ways in Section 6, and our conclusions are given in Section 7.

2. Previous studies

Following detailed studies by economic historians on the effect of property rights protection on economic development (particularly North & Thomas, 1973), a new line of empirical research has, since the 1990s, examined the effect of property rights protection on economic performance, mostly using cross-country data. The present study belongs to this line of research. Among similar studies, Knack and Keefer (1995) use country risk indices provided by the International Country Risk Guide and Business Environmental Risk Intelligence to show that the average value of various indices—including the index related to the level of property rights protection (i.e., expropriation risk and rule of law)—has a statistically significant influence on investments and growth rates. Hall and Jones (1999) show that the level of the so-called "social infrastructure"

³ India has a federal system, under which state governments have exclusive jurisdiction or joint control over certain issues as set forth in the Constitution of India. Hence, there remains some diversity among Indian states.

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