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Working Paper No. 2010/109

Property Rights and Elites

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Abstract

An elite derives its status from its relationship to property, whether physical or human capital. While stable property rights are necessary for everyday business, unstable property rights that result in major institutional changes (such as land reform) may have a positive impact on economic development. When are the ‘wrong’ property rights right? Institutional changes have a positive impact on economic development when a country’s elite can manage them. To support this generalization we examine the managerial capacity associated with elite status, highlighting which capabilities enable them to control changes in property rights regimes to their individual and national advantage. We compare how nationalization of foreign firms, a radical change in property rights, was managed in Argentina, China, Korea and Taiwan after the Second World War.

Keywords: Elites, property rights, indigensim, capabilities, role models

JEL classification: A1, FO, JO, LO

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1 Introduction

Elites can be defined in terms of their relationship to property, and property rights provide the foundation for the institutions through which elites operate. Compared to non-elites, elites hold a controlling interest in property, and exert power over its regulation and use.

The established wisdom of market theory is that ideal property rights are stable. Stability enables elites to exercise the power bestowed by their property holdings. But in practice, property rights are not always stable, and changes in property rights, even if convulsive, are not always negative for either the economy or for the performance of elites themselves. A discontinuity in property rights may arise internally, such as a change in the relationship between landlord and peasant that leads to a land reform – a redistribution of property from owner to tiller – which is considered highly favourable for sustained economic growth. Or a discontinuity may arise from ‘indigensim’, meaning the transfer of control over foreign-owned assets, the most extreme form being expropriation, such as the 1960s nationalizations of foreign oil concessions in the Middle East, or the appropriation of Japanese properties in neighbouring countries after Japan’s defeat in 1945.¹ While stable property rights are the mainstay of a laissez-faire economy, economic development at historical turning points may thrive from ‘getting the property rights “wrong”’ through instability.

When do ‘wrong’ property rights positively impact development? Under what conditions is a generation of elites an effective agent of discontinuity, capable of navigating a change in property rights to its own advantage *and* that of its country?

A discontinuity in property rights, one that may be intrinsically beneficial for development in theory, is ‘right’ or ‘wrong’ in practice depending on the skills and experience (knowledge) that an elite embodies, where knowledge connotes uncoded and undocumented understanding of complex social and economic processes.² Being tacit, an elite’s knowledge transcends what is typically associated with a mere technocrat. The greater the elite’s capabilities to organize, engineer, administer and manage the complex projects that a change in property rights entails, then the more positive is the impact of a property rights change on a country’s economic development. Beyond formal schooling, the determinants of the postwar de-colonized elite’s skill set depended on a nation’s acquisition of capabilities, not least of all by learning from each other, initially on a regional basis that give rise to ‘role models’ (Amsden 2009).

¹ We use the terms nationalization (with or without compensation), expropriation and seizure interchangeably.

² For the argument that in a developing country the subsidiaries of FOEs (foreign-owned enterprises) tend to be bureaucratic whereas POEs (private-owned national enterprises) tend to be entrepreneurial and, therefore, better for economic development, see (Amsden 2009).

2 Capabilities of a de-colonized elite

To be able to manage the ‘wrong’ property rights requires a scaling up in skills and competence. A greater degree of change in foreign property rights is associated with greater opportunities for new approaches to economic development.³ With more capabilities to capitalize on opportunities, the national elite becomes stronger, however embedded it may be in a new international economic order. The relationship between property rights changes and national competence is illustrated briefly below with a comparison of postwar property rights changes and elite capabilities in Argentina, Chile, Korea and Taiwan. The nationalizations of multinational companies in the oil belt of the Middle East and Mexico, the formation of national oil companies in South America and West Africa, and the appropriations of Japanese properties after the Second World War, involve large swaths of the developing world that have spawned some of the best-performing economies of the de-colonized generation following radical property rights change. The manufacturing corridor of the Far East, starting with Japan, and the oil belt of the Middle East, starting with Iran, evolved into regional ‘role models.’ Countries and their elites in these role model families learned from each other, inductively, and their skill sets expanded to deal with the property rights changes that each role model tamed.

De-colonization created a new political economy devoted to studying the multiple channels through which resources were being redistributed to independent countries, or ‘indigenism’. A spectrum of channels specific to Indonesia was provided in a Cornell Ph.D. thesis by John Sutter (1959). His systematic classification is helpful in organizing an answer to the question of what the conditions are under which the ‘wrong’ property rights are right. Out of Sutter’s nine categories of *Indonesianisasi*,⁴ five are relevant for the discussion below, with adaptation and reorganization

Modes of indigenism are as follows:

- (1) Change in government control over foreign-owned business.
- (2) Change in participation by indigenist people (nationals) in the management of foreign-owned companies – called ‘localization’.
- (3) Establishment of new enterprises in sectors previously closed to nationals (under colonialism).
- (4) Establishment of state-owned enterprises.
- (5) Transfer of formerly foreign state-owned enterprises or private-owned enterprises.
 - (i) To nationals (public or private).

³ See the discussion in Amsden (in process).

⁴ Sutter’s nine categories were: formation of new enterprises in sectors previously closed to Indonesians; transfer of formerly colonial publicly owned enterprises to the Indonesian government; formation of publicly owned enterprises; greater state control over foreign-owned businesses; greater participation by Indonesians in the management of foreign-owned companies; transfer of private foreign-owned enterprises to the Indonesian government; transfer of private foreign owned enterprise to Indonesians ; greater Indonesian equity ownership in corporations established by non-Indonesians; return of landholdings to Indonesian communities by foreign-owned enterprises.

- (ii) By means of market forces ('takeover') or state coercion ('nationalization').⁵

Inappropriate skills, stable property rights and stagnation: Argentina

Argentina under Juan Peron (1946-55) was the lightning rod in Washington for everything wrong with statist elitism: it was populist, corrupt, and inefficient. But like the rest of Latin America, Argentina, in fact, nationalized very few foreign firms, those in question being mostly utilities such as railroads and electric power. But then, Argentina inherited around 35 choice properties from former German owners. At a moment in history, when Argentina's elite yearned to enter higher-tech industries for both jobs and prestige, into its lap fell subsidiaries of some of Germany's greatest global companies, such as Mannesmann, Beyer and Bosch. What to do with these jewels?

According to a new generation of historians, less hostile to the Peronist age, the United States wanted Argentina to sell its German properties and use the proceeds to pay victims of Axis aggression as Juan Peron had maintained cordial relations with the Axis Powers. At minimum, it wanted Argentina to gut the enterprises, removing all German assets such as managers and engineers, and severing all German ties to banks and suppliers, thereby effectively cutting these gems off at the knees. By contrast, the Argentine government envisioned the emergence of new growth poles, and 'the evidence suggests that there was no thought of converting nationalized properties into state-owned enterprises' (Belini 2001). However, a century of émigré exchanges had left Argentina's private sector with a large number of small, relatively inefficient firms. Due to their lack of human and physical capital, Argentina's large scale private entrepreneurs were not able to acquire the German companies and the state was forced to take over the properties. Although confiscated properties were operated profitably by the Argentine government for a short time, its plans fizzled in the long run. Underneath the graft, what was the problem?

Despite Argentina's wealth and tutelage by émigrés (or because of its tutelage by émigrés who espoused free markets), the various elites responsible for its postwar planning did not know exactly what to do. Although in the figure of Raul Prebisch, Argentina could boast one of the leading theorists on import substitution industrialization, an indicator of its high education level and intellectual capital, his writings did not provide a roadmap for making new manufacturing properties work. Prebisch was 'demonized' in Washington for defending tariff protection, but he was no inward-looking statist (Kapur et al. 1997). He saw Argentina's future as lying in exporting manufactures, not primary products. In a report on the Argentine economy undertaken for the United Nations, he warned Argentina as early as 1968 that it had to start exporting more (Mallon and Sourrouille 1975). But while he elaborated on the trade policies necessary to shift Argentina from selling at home to selling abroad, he wrote little about the industrial policies that were needed to create export-generating industries in the first place. Like orthodox economists, his field of expertise was exchange, not production.

⁵ For a fuller discussion of indigenism, see Amsden (in process).

The German firms that the Argentine government inherited represented a wide array of industries (metallurgy, electronics, construction equipment, pharmaceuticals and industrial chemicals), so none could be 'targeted', and little industry-specific expertise was accumulated on the government's part. A diverse portfolio also got the government in trouble with the private sector, which objected to new competition from state-owned enterprises; that these operated across industries attracted political opposition from a strong industry-wide business association. Enterprise management was assigned to a new government bureaucracy, *Dirección Nacional de Industrias de Estado* (Di.N.I.E), with raw energy but little experience in running companies, or in receiving financial support compared with Argentina's military-industrial complex. Di.N.I.E displayed only rudimentary understanding of what policies to use to make an industry prosper and grow. Instead, inappropriate policies were overused. 'Policy implementation was difficult because there were no clear indications of the methods to use to reach the goals articulated in the first Five Year Plan. Thus, for example, although the production of cotton yarn was among the industries to receive government attention (a sensible choice), the bureaucracy failed to design a sectoral policy. Instead, it concentrated its attention on price controls, and the economy stagnated' (Belini 2009).

The same ignorance of industrial policy was evident in Chile, Argentina's rival for Latin America's richest country at the time. Chile's tiny automobile industry was excoriated by American critics for comprising a large number of inefficient foreign assemblers all surviving behind high tariff walls. But it turns out the reason for this did not lie with perverse interventionism. 'The government considered restricting entry to only a few firms, so that each could operate at higher, more economic levels of output. But the government was not able to formulate acceptable criteria by which companies could initially be selected' (Johnson 1967). It relied instead on the market to stimulate competition and self-select a few winners, but the whole industry collapsed. Thus, ignorance about how to target firms to build a new industry ended badly, just as they had done in Argentina.

Indigenism and national skill formation: Korea

When Japan's properties fell into Korean hands, Korea appeared poised to squander them much as Argentina had done with its German windfall. The sale of Japanese properties, like the disbursement of American foreign aid, had been corrupt. But both Korea and Taiwan were in an advantageous position. They 'were knowledgeable about the ways in which the Japanese bureaucracy established production targets, financial and labour inputs, price-control machinery, and rules to enforce law and contracts', which helped them manage their new acquisitions (Kobayashi 1996). Workers in Korea and Taiwan had received 'intensive training due to the wartime demand for educated and trained workers'. The upper layers 'rapidly improved their skills and sometimes advanced to higher-level jobs due to openings caused by industrial expansion and positions left vacant by drafted Japanese workers' (Park 1999). Although Japan spent very little on health in its colonies, it created a healthier environment:

It relied heavily on administrative measures and direct control. It controlled infectious diseases and improved sanitary conditions by enforcing quarantine regulations, compulsory testing for and treatment of malaria, vaccination campaigns, supervised collection of human waste, and regular public health inspections. Significantly, the police carried out these assignments (Ho 1984).

After Japan surrendered in August 1945, Korean engineers and workers immediately took over the Onoda Cement Company, emblematic of Japan's colonial expansionism, by forming 'self-governing councils' in what became North Korea (the Sunghori plant) and South Korea (the Samch'ok plant). A Japanese manager who returned to Sunghori before learning about Japan's surrender was told, 'Everything in the plant will be done by Koreans from now on'. The Japanese remaining at the plant, who were to be repatriated after three years, were instructed to teach Koreans industrial planning and to start a one-year technical school, in which they taught cement, firebricks, ceramics and glass manufacturing. The Samch'ok plant was sent seven new engineers in 1942, one of whom was a 22-year old Korean (Oh Pyong-Ho), the eldest son of a landlord, fresh out of engineering college in Japan. Due to a large number of unfilled vacancies, Ho worked long hours, rotated jobs, and 'was able to learn all the production processes in the factory'. In 1945 he was the only living Korean with a full practical knowledge of cement-making, and provided detailed technical assistance when the Samch'ok plant was reconstructed in 1957. Two other workers became presidents of small cement-related plants, still operating in the 1980s (Park 1999).

It was the Soviets who had detained the Japanese managers for technology transfer purposes and the Soviet Occupation Army took control of the Sunghori factory on 29 August 1945. Mr Ho went to Seoul in September, as representative of the self-governing council of Sanch'ok, 'to ask the U.S. Military Government for financial support to keep the factory going' (Park 1999). The request was granted, but, Onodo, and soon all of Korea were engulfed in political factionalism and civil war.

After the civil war, instability of property rights was 'right' for South Korea and 'wrong' for North Korea, whose socialist experiment failed. But the new capitalist order in the South was sustainable due to a national elite's knowledge of Korean society and its large-scale modern business enterprise. Without Japanese FDI, Korean companies learned to stand on their own feet, having dragged them for years behind those of their Japanese partners. Five years after the Korean War ended in 1953, both heavy and light industry are estimated to have grown faster in South Korea than in any other developing country for which data are available, including Argentina and Chile (Amsden 1989).

Generally, then, countries in Japan's 'Greater East Asia Co-Prosperity Sphere' experienced the colonial world's most extensive 'localization', especially in the 1930s, when their economic development accelerated because Japan invested in their industry and infrastructure to mobilize for war. The human costs of war in East Asia were exceptionally high, but the benefits were also extraordinary. Following military surrender, Japan's productive enterprises – its overseas factories and farms – fell into national hands. Incipient national elites in Korea, Taiwan and Manchuria thus acquired modern business organizations overnight (Indonesia went to war over Dutch properties that Japan had seized in 1942, while India acquired British firms through market forces – British owners fled amidst political uncertainty, and Indians bought them out). National business elites in these countries no longer had to compete in their own backyards against foreign-owned companies, although they continued to benefit from the skills that foreigners had imparted to them. Japan, after all, had left a detailed roadmap of its forced industrialization of Manchuria.

Asia experienced further direct military intervention during the Cold War, designed by the US to overthrow communist property rights. The unintended but highly beneficial consequence was more homogeneous nation states and national elites. Cohesion of the nation-state in Asia was strengthened by the defeat of a communist insurgency (as in Indonesia and Malaysia), or the victory of an insurgency over a divisive capitalist force (as in Vietnam), or the establishment of separate capitalist and communist countries (as in the Koreas and China/Taiwan). Military operations in Asia strengthened national unification, which facilitated capitalist land reforms as bulwarks against subversive forces – nationalism in this case went hand-in-hand with egalitarianism.

With national unity, national skills, and nationally owned firms, all closely integrated into three of the world's leading spheres of economic influence, that of Japan, the US, and now China, why has East Asia's elite has performed so well?

3 Conclusion

These examples suggest that the performance of the de-colonized world's elites needs more analysis in terms of the fundamentals that underlie politics, economics and institutions: namely, property rights and the broad set of project execution skills that successful elites must embody to harness the developmental forces inherent in changes in property rights regimes. But if the 'property rights – capabilities' approach holds explanatory power beyond the Third World's oil fields and manufacturing belts, then it should have something to say about elitism in today's poorest countries.

At the industry level, indigenism is beginning to repeat itself, whether in Latin America (under the influence of Venezuela), West Africa or Asia. Mongolia's gold and copper mines, for example, are facing some of the same supply-side problems that the Middle East's oil industry faced in the 1950s, resulting in sub-par tax revenues and foreign reserves. The Mongolian governments initial response has been to cease issuing any new mining licenses, placing more burden on local elites to manage the mineral sector, because existing foreign concessionaires are using their property as 'money-making tools and not investing in any active exploration' (Rocha 2010). Mongolia has been criticized by the US State Department for 'creeping expropriation' (US Department of State and Service 2005/7).

In sub-Saharan Africa's peasant-export economies, characterized by small agricultural holdings and fragmented markets, changes in domestic property rights are on the agenda in order to increase farm size. Ghana's farmers, for example, have managed to grow a delicious tomato, but with land consolidation under chieftain control, they have not produced in sufficient quantities to justify investments in processing and overseas distribution. If local land laws and customs are to change, and local chiefs and communities are to buy into new money-making ventures, then modern elites must have the capabilities to operationalize such ventures, insuring that they work, just as manufacturers in Ricardian England had to demonstrate their value-creation skills to win the support of the landed aristocracy.

Beyond formal schooling (at home or abroad) the postwar de-colonized elite's tacit knowledge and skill set, especially in the Far East and Middle East, benefited from learning in the context of a regional role model. Membership in a regional coalition of countries, at roughly the same stage of development and experiencing the same types of

industry-level problems is helpful for experimentation with new policies and institutions. Integration into a global elite is no substitute. Without a role model among countries with a common de-colonized past, a change in property rights is less likely to reach its potential (as shown in the case of postwar Argentina).

A role model for Africa's peasant export economy could help elites design more favourable property rights regimes, but to date no convincing role model seems to have surfaced.⁶ Will Africa's elites manage to create one, as they tend to the specific problems of their own countries?

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⁶ For the logical internal inconsistency of the grass roots anti-poverty role model, see Amsden (2010).

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