

IDE Research Bulletin

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Economic Development and Property Rights in Developing Countries

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Economic Development and Property Rights in Developing Countries

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[The Aim of the Project]

What influence does the legal system that stipulates property rights have over the state of economic activities of people? This study investigates this question from both theoretical and practical aspects.

For our theoretical study, we investigated the manner in which social sciences, including economics, have dealt with the function, role, and basis of property rights from the viewpoints of social justice, economic development, and appropriate resource allocation, examining the respective scope of the analysis and its suitability.

Simultaneously, we focused on the way the laws concerning property rights reflect economic and transactional customs that are formed within the historical and cultural path dependency. As a case study, we will explore real rights in the Iranian Civil Code, which is deeply affected by traditional Islamic law, and will argue that their inherent regional nature is driven from path dependency.

Background of the Research

Recent arguments by economists over property rights have solely focused on the manner in which property rights should be instituted for improving economic efficiency and growth. New perspectives presented by Course, Demzets, and North induced many empirical studies that deal with the relationship between the institutions of property rights and performance of economic growth since the 1990s [Sato 2007]. The implications of these theoretical and empirical studies were that the fully protected

institutions of property rights and the stability of the legal system would stimulate investment activities, and therefore contribute to economic growth. Such an idea significantly influences our society [Matsuo 2009]. Many of the legal adjustment programs in developing countries that were offered by international organizations and governments of advanced countries after the 1990s, for example, focused on property rights and were based on the above-mentioned idea [World Bank 2002]. Nevertheless, these arguments have attracted criticism. Some indicated that the institutions of property rights that the economists thought desirable did not necessarily contribute to economic growth. Considering the historical circumstances of each country, many exceptions were found in which, for example, the development of a dictatorship led to reasonably good economic performance in spite of the government's arbitrary alteration and disposal of property rights.

Therefore, it was necessary to inquire into the best approach and methodology for dealing with the question concerning the relationship between the institutions of property rights and economic development, thus reorganizing the preceding arguments.

In the process of such an inquiry, a case study would significantly contribute toward the examination of the argument's given condition, regardless of the theoretical methodology. The subject of Iran in relation to the institution of property rights was considered for the discussion in our study. Iran was deemed a suitable topic of investigation, for the above-mentioned purpose, as it meets our study's criteria.

In Iran, where Islamic law has been traditionally dominant, modern Western legal system was introduced during the era of modernization (that is, the end of the 19th century until the first quarter of the 20th century). The new legal standard, along with the new social-economic institutions, appeared after long periods of adjustment. These resulted from a blending of and a compromise between modern Western and traditional laws. As a result, property rights in contemporary Iran are based on the concept and wording of the modern Western legal system.

Clearly, in Iran's traditional legal system there always existed property rights that gave ruling power over various objects, even before modernization. However, these property rights might differ from those introduced today. Therefore, the drafting committee of the present Civil Code of Iran (enacted in the modernization period) mainly comprised Islamic jurists so that the provisions contrary to the Islamic law were excluded. In other words, the traditional norms based on the Islamic law were not completely eliminated but, rather, were embedded in the provisions of the modern civil code [Iwasaki 2007].

In view of the historical circumstances, when we focus on the structure of property rights in Iran, which still preserve historical and cultural characteristics, various usufructuary rights provided in the Iranian Civil Code, their legal contents, and their ways of application are worth referring to. It is known that in the Islamic law, unlike in the modern Western law, a substance itself and its utility value, respectively, become the independent objects of property rights [Iwasaki 2007]. It is plausible that the above-mentioned provisions related to usufructuary rights (particularly for real estate) in the Iranian Civil Code are based on such traditional concepts of property rights.

On the process of codification during/after the enactment of the civil code, the interactions caused by blending this code with modern Western property rights significantly influenced various economic customs and practices in the Iranian society. Therefore, the analysis on the real rights (jus in rem) in the Iranian Civil Code presents profoundly interesting examples for investigating the relationship between the property rights system and economic performance.

Iwasaki, Y. (2007) "Law and Custom on Sar-qofli: the Emergence of Haqq-e Kasb o Pische o Tejarat and the Transformation of Shop-lease Contract in Iran," *Ajia Keizai* (Asian Economy) Vol.48, No.6. 50-71 (in Japanese).

Matsuo, H. (2009) *Good Governance and the Rule of Law: A Challenge of Law and Development* (Yoi Touchi to Ho no Shihai: Kaihatsu Hogaku no Chosen), Tokyo; Nihon Hyoron Sha (in Japanese).

Sato, H. (2007) "Law and Economic Development: Reexamination the Theories on Property Rights and Economic Growth" (Ho to Keizai Hatten nit suite: Shoyu-ken to Kieizai Seicho ni kansuru Sho-gakusetsu no Sai Kento), *Forum of International Development Studies* (Kokusai Kaihatsu Kenkyu Foramu) No.34, 19-33(in Japanese).

World Bank (2002) *Legal and Judicial Reform: Strategic Direction*, Washington DC: World Bank (Legal Vice Presidency, Law and Justice Group).

[Outline of Research Products]

The Emergence of "Modern" Ownership Rights

SATO, in his paper *The Emergence of "Modern" Ownership Rights Rather Than of Property Rights*, suggests the necessity of re-thinking private ownership rights as an institutional device in the modern era from an historical and theoretical perspective.

Private ownership rights are one of the most important institutions in the world today. Importantly, the right to private ownership is considered to cause two critical changes in the society. First, by destroying communal ownership-based pre-modern status-based society, the installation of property rights established the modern civil society that comprises people who are legally equal and who enjoy personal liberty. Second, the prevalence of private ownership rights and their assured enforcement promoted economic growth by giving people incentives to invest in various activities and by restraining the problem of negative externalities that might be involved in communal ownership rights. Thus, legal aids introduced by advanced countries and international organizations, which aimed to establish a private ownership rights regime in the name of the rule of law, have been widely deployed in the developing countries, especially since the 1990s. It has, however, been reported that many cases exist in which the transformation of the traditional commons to private property has actually resulted in severe conflicts rather than better resource allocation. In order to understand these issues, first it is important to comprehend the way the theories understand the role and function of private and other ownership rights. From this viewpoint, it seems that there are some definitional and analytical conundrums in the neo-classical theory of the emergence of private ownership rights, which are closely associated with the study of Demsetz. Reconsidering the logic within the theory, this study proposes three arguments: First, the emergence of “modern” private ownership rights should be the subject of analysis rather than private ownership rights per se. Second, modern private ownership tended to emerge as the result of the transformation of taxing powers rather than as a response to the changes in resource prices. Third, accordingly, modern private ownership rights can, in fact, be understood as comprising latent multi-layered rights, and thus should be understood as the relation between various actors in addition to the relation between a person and a thing.

The “Rahn” Contract and its Socio-economic Function

In her paper *An Inquiry into the Socio-economic Function of “Rahn” in the Iranian Real Estate Market*, Iwasaki investigates the relationship between the property rights system and economic performance by focusing on “collateral” provisions in the law and its practical application in the society.

The “rahn” stipulated in the current Iranian Civil Code corresponds to the “arranged collateral” that includes the right of pledge (shichi-ken) and the mortgage (teito) in the Japanese Civil Code. The “rahn” is known in the real estate market of contemporary

Iran as a type of “lease contract” that deviates from its original meaning of the term.

In the “rahn” contract, the tenant can dwell in a house (or an apartment) free of rent, or with reduced rent, in return for extending a loan to the landlord at no interest. The lending amount often approaches 25 per cent of the house price. The exact amount the tenant lent is returned to him when the term of the contract expires.

This is not a contract that is peculiar only to Iran. We can find some other contract forms that are based on similar rights, such as the “jon-se,” in Korea, or the “hudosan-shichi (pledge of real property),” provided in the Japanese Civil Code.

In the conventional argument concerning the “jon-se” or the “hudosan-shichi,” the perspective given is that the sound development of a financial system that satisfies real estate owners with sufficient funding leads to the decline of such contractual institutions.

They discussed the issue from the assumption that both of them are literally “collateral.”

If we attach more importance to the aspect, however, that the “rahn” contract of contemporary Iran is rather a type of lease contract based on the real estate owners’ demand for renting, sound development of a financial system does not necessarily impede the growth of these institutions. Rather than impeding growth, it seems that the development of a financial system has helped the “rahn” contract to become widespread as a way of asset management, not only for some wealthy landlords but also for the ordinary people utilizing the real estate they possess.