# In China, property rights take wrong turn

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China's economy, long an engine of world growth, has been sputtering lately. During the second quarter of 2024, it grew at an annual rate of 4.7%—down from an average 7% a year during the past decade. For the next two years, the International Monetary Fund forecasts more of the same.

Analysts have blamed China's slowdown on short-term factors, such as debt-ridden real estate and a delayed recovery from the COVID-19 pandemic. But new research from Texas McCombs suggests a longer-term problem: an erosion of private property rights.

"Bringing Dead Capital to Life: Property Rights Security in China" is published online in *The Journal of Law and Economics*.

The study by Kishore Gawande, chair of the Department of Business, Government & Society, looks at what happened after China granted nationwide protection to private property rights in 2007. It finds that the law turbocharged China's business climate.

The nation created an average 39,000 more new businesses per year during the five years after the law, compared with the five years before. Within three years, 1.3% of those businesses grew into exporters, boosting the nation's overall output and pushing existing companies to become more efficient.

"The country benefited when these firms survived, and some of them became superstars," Gawande says. "Without the law, they would not have existed."

But today, he warns, property rights in China have started moving in the opposite direction. The result could be lasting damage to the economy.

"Once you reverse this process, all the statistics get flipped around," he says. "This is a macroeconomic shock about to happen."

## Property rights are primary

Rights to private property have always been a fundamental economic principle, Gawande says. Without them, it's hard to do something as basic as getting a loan.

"To get loans, I need to be able to post collateral," he says. "But the bank won't give me loans unless I have property rights over that collateral. We take these rights for granted in the U.S."

In China, however, they had been abolished after the 1949 Communist revolution. Starting in the 1980s, piecemeal economic reforms had created a patchwork of property rights across the country. Some prefectures (the equivalent of metropolitan areas) protected them better than others did.

Gawande saw that patchwork as an opportunity to test the economic impact of property rights on a large scale.

Where property rights protections were weaker, he reasoned, potential investors would be less able to convert assets to money or use them as collateral for loans—making them effectively dead capital. If property rights were key to economic growth, then the 2007 law should bring more of that capital to life. Its biggest impact should be in prefectures where protections had been weakest.

"Now that the constitution protects your property rights over your assets, you can make investments, and extra businesses come into being," he says.

## Boosting business creation

To test his theory, Gawande and Hua Cheng of China's Zhongnan University of Economics and Law analyzed data from 1998 to 2012 on 14,369,183 private companies and 480,526 state-owned ones.

They rated the strength of property rights in each of the 341 prefectures prior to 2007. The smaller the percentage of private companies in a prefecture (which varied from 44% to 97%), the less secure the rights and the lower the rating.

The researchers found that the least secure locales enjoyed the most growth during the five years after 2007. Every 10% drop in a prefecture's pre-law security rating corresponded with:

- A 6% greater number of new private businesses.
- A 5.5% gain in business survivals.
- Increased overall production of 22%.
- Higher total sales of 21%.

Most striking to Gawande was a 59% rise in the value of exports by new businesses. "That means you're taking this global," he says. "You can compete in a very, very competitive arena, which is the world market.

"This is what property rights security brings you. The law caused dead capital to come to life, it caused the birth of firms, and it caused the firms to become exporters."

## Cost of going backward

If a hands-off approach to property rights fueled years of explosive growth, Gawande worries that the country has been reversing course since 2020.

New regulatory restrictions on tech giants erased $1.1 trillion in market capitalization for companies such as e-commerce platform Alibaba Group, video game creator Tencent, and search engine company Baidu. After publicly criticizing regulators, billionaire Jack Ma was pushed out of controlling roles in Alibaba and the financial tech firm Ant Group and saw his fortune cut in half. Other economic purges have targeted developers, health care, and even private tutors.

The retreat from property rights is part of a larger trend of concentrating power, both economic and political, Gawande says. "Decentralization has reversed to recentralization. The central government has grabbed a lot more of the resources, which is not efficient and not economically productive," says the researcher.

He fears that as property rights become less secure, investors will head back to the sidelines. Less capital investment, in turn, will lead to lower economic output and lower tax revenues for local governments.

"When you start messing with private property rights, you are going to see long-term consequences for the whole economy, and no macroeconomic Band-Aid is going to solve it," Gawande says. "It's not just a one-year or two-year thing. They could be laying the stage for 10 years of lower growth."

**More information:** Hua Cheng et al, Bringing Dead Capital to Life: Property Rights Security in China, *The Journal of Law and Economics* (2024). DOI: 10.1086/727444

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