Readings
of particular interest

Planning Their Way to Poverty

The Poverty of "Development Economics" by Deepak Lal (London: Institute of Economic Affairs, 1983), 127 pp.

The distinguishing feature of "development economics" has been its claim that the prescriptions of "orthodox" or "neoclassical" economics are of little relevance to the Third World. In this book Deepak Lal, professor in political economy at University College, London, argues that developing countries ignore price theory at their peril and says hard experience is leading many leaders of less developed countries to reevaluate their policies.

In the development theories of the 1950s and 1960s, Lal says,

> the allocation of given resources, a major concern of orthodox economics, was considered of minor importance compared with the problems of increasing material resources. . . . Changes in income were substituted [for changes in relative prices] as the major adjustment mechanism for bringing supply and demand into balance.

The theory attached prime importance to "macro-economic accounting aggregates such as savings, the balance of payments, and the relative balance between broadly defined 'sectors' such as 'industry' and 'agriculture.' "

This theory resulted in a distinctive set of recommendations. Free trade and reliance on the price mechanism might be all very well for advanced industrial countries, but developing countries could not afford them. In particular, development economics embodied a perspective Lal calls "trade pessimism," holding that poor countries were "unequal partners" faced with "inexorably declining terms of trade." For them to prosper by exporting manufactured goods seemed out of the question, since industrial countries were already specialized in doing that. The demand for traditional tropical goods such as tea and rubber was declining, or at least not growing as fast as northern economies were. The demand for raw materials was cyclical, and in any case countries that relied on such exports risked exploitation, if not outright neoimperialism. Since poor countries could not expect exports to lead them out of poverty, they had to aim for self-sufficient growth. Moreover, this internal growth could not very well be left to the usual unplanned capitalist processes; that would, at best, enrich the few while leaving the masses behind. What was needed was a government "strategy" for economic development.

These ideas were soon embraced by national leaders the world over. "The typical development plan," Lal says, "first laid down a desired rate of growth of aggregate consumption." Planners then decided how much of each commodity the plan would require by consulting an "input-output" chart of the national economy. Since the plans specified desired quantities of various goods, their implementation generally entailed direct production controls, "including state provision of some goods considered either too important to be supplied by the private sector or unlikely to be produced by the private sector in the planned amounts."

The exercise neglected the role of prices. Planners doubted that the poor and ill-educated masses would respond rationally to changes in relative prices anyway. In their role as consumers, the poor were presumed to use only "necessities," not "luxuries" whose consumption might be responsive to price. In their role as producers, they were presumed to rely on traditional modes of production that were thought to require fixed input ratios. Indeed, the fatal oversimplification of the input-output chart, the author believes, was its assumption that inputs must be used in fixed proportions to generate outputs regardless of price.

Most plans sought to encourage the development of domestic industries to replace imports wherever feasible, and governments erected high protective barriers, especially quotas, to keep out foreign goods. This policy of "import substitution," with its implicit withdrawal from the arena of international trade, could impose severe isolation. In India, beginning in the late 1950s, "[a]ll requests to import were subjected to administrative scrutiny, and even the most petty imported items required a license. Moreover, import licenses were not available for goods which could be produced within India."

This led to effective tariff rates that were both high and quite variable. One common device was the "cascading" tariff that imposed especially high burdens on more highly processed products. For instance, there might be a high tariff against cotton cloth, but no tariff against raw cotton itself, so that the effective tariff rate against cotton *manufacturing* was even higher than the official rate would suggest.

Foreign exchange controls became a major way of enforcing the plan. By making it illegal to hold foreign exchange without authorization, and then doling out currency reserves at its pleasure, the central government could easily determine which industries and enterprises could import and which could not—a decision that usually determined which would live and which would die. The controls were usually billed as a response to a chronic shortage of foreign exchange, but the shortage soon became a self-fulfilling prophecy, since the import controls were in effect a tax on existing and potential exporters.

It did not take forever for Third World leaders to begin noticing that the system did not work as intended. The policy of import substitution had replaced cheap imports with expensive, inefficient domestic industries. The bias toward manufacturing and the import of capital goods had resulted in the establishment of overly capital-intensive factories that made too little use of the local labor force. Controls on imports and foreign exchange, along with export subsidies, had led to immense corruption and waste.

Meanwhile, the export of manufactured goods to the West was turning out not to be a dead end after all. Aside from fuel, the share of developing-country exports represented by manufactures has increased from 10 percent in 1955 to more than 40 percent in 1978. At the same time a number of countries, notably in East Asia, were beginning to enjoy tremendous success by pursuing "outward-looking" trade policies. South Korea, for instance, is as populous as Egypt and was even poorer in 1950; yet by the late 1970s it had become a major industrial exporter.

Lal concludes that the developing world is learning a crucial lesson from the failures of development economics, but at the same time is becoming vulnerable to a new danger: the prospect that the North may slam its doors against the products of the South. The author says "protectionism poses a more serious threat to Southern prosperity than the mere slowing down of Northern growth."

The Economics of Title: How the Law Decides What's Whose

"Information, Uncertainty, and the Transfer of Property" by Douglas G. Baird and Thomas H. Jackson, in *Journal of Legal Studies*, June 1984, pp. 299-320.

Nearly all theories of private property assume that an owner of property has the right to transfer it to someone else. In fact, this right is the basis of most property rights we enjoy, since few of us have actually turned things we own into private property from a state of nature or ownership in common. An elaborate network of legal rules has developed over the centuries to govern the transfer of property rights—ranging from the symbolic "delivery" of a ship at sea to the creation of a security interest in a partially completed motion picture. In this paper, Douglas Baird and Thomas Jackson, professors of law at the University of Chicago and Stanford University respectively, examine these rules as ways of enabling present and would-be property claimants to reduce the uncertainties that inhere in every assertion of ownership.

They begin with the observation that in a world where information is not perfect, we can fully protect a later owner's interest or an earlier owner's interest, but not both. For example, a rule that prevents an individual from becoming an owner if there is a thief in his chain of title protects present owners fully but slights the interests of would-be owners. The reverse rule, which grants legitimate title to a thing to anyone who buys it from a person in possession, protects buyers fully but owners not at all. Most of us are both owners and buyers, both potential victims of theft and innocent purchasers of dubious goods, and we profit if the law arranges matters so as to minimize the sum of the two dangers—that felons will make off with our property and that a long-lost claimant will show up to take it away. The more effective a set of transfer rules is in increasing acquisitional certainty *and* dispositional certainty, the more valuable it will be to own property in the first place.

The rules of transfer, the authors say, can themselves affect the total amount of risk both parties collectively must bear. For example, a public filing system wherein all owners are required to make a permanent record of their interests lessens the risk of defective title in land without undermining the consensual nature of land transfers. These benefits must of course be balanced against the costs of maintaining a recording system. Property transfer rules should also allocate risks sensibly between present and would-be owners, with the allocation depending, to some extent, on which party can better guard against the risk of defective title.

The paper uses these principles to illuminate the question of why different rules apply to different kinds of property transfers in Anglo-American property law. For example, in olden days an owner of property, whether real or personal, had to take actual physical possession before he could be certain that his claim would remain superior to that of others. Baird and Jackson say such a rule allows the state to keep its enforcement costs extremely low, even though it sacrifices other values.

"Mrs. Wilcox? I think you'll be happy to hear we've recovered your stolen car."

In modern times more differences have emerged between real and personal property in the rules governing transfers. Transfers of real property generally must be recorded, which puts prospective purchasers on notice of claims and greatly reduces uncertainty. But not all types of property are made more useful by compulsory disclosure. The best example of a kind of property that is *not* suited to a filing system is money. It would be possible to identify each bill precisely by serial number in a registry, but the disadvantages of doing so would be enormous. Unlike land, money is transferred frequently, and seldom serves as collateral; when it does, because it is divisible, it hardly ever has to serve as security for several different lenders at the same time. Unlike goods such as ships at sea, possession of which cannot be readily handed over, money can always be passed easily from one person to another. A legal rule that makes possession of money virtually the sole source of relevant information seems to balance the need for information and the concept of consensual transfer.

Between the polar opposites of money and land, other kinds of personal property provide intermediate cases. Recording systems that establish title of personal property are rare, at least for goods whose owners are in possession, since the informational advantages of such systems do not generally seem to outweigh their costs. Personal property is usually less valuable than real property and is likely to be transferred more frequently. Moreover, a title-based recording system is hard to organize for, say, grain, which (unlike land) cannot be identified reliably by mere description. There is no easy way of knowing that the grain in a silo was the grain grown on this parcel rather than that, or the same grain that was there yesterday. Grain is also moved commonly from one jurisdiction to another, which would make it hard for prospective purchasers to know which files to check.

Some items of personal property, however —notably airplanes, cars, and ships—are covered by title recording systems. Although serial numbers and the like can be changed, individual airplanes, cars, and ships, like real property, are relatively easy to identify in a unique way. Anonymous 747s seldom turn up. Like real property, moreover, these sorts of tangible property tend to be valuable enough to justify the costs of a title-recording system. Since they are mobile, however, the title-recording systems differ from those that cover real property, which by definition never moves. It is usually easy to know *which* filing system to consult in the case of real property, but lawmakers must decide where to establish registries for mobile items and how many to maintain. Legal principles can provide guidance on these questions as well.

The main difference among the filing systems in use today concerns whether a subsequent purchaser may take legitimate title if a prior owner has an otherwise legitimate interest in the property but did not file it properly. Baird and Jackson argue that the claims of those not in possession, who have failed to record their interest or who have recorded it improperly, should lose to those of subsequent purchasers, and it is irrelevant that the subsequent purchasers may have had knowledge of the faulty claim. First, any inquiry into states of knowledge is likely to be expensive and time-consuming. Second, it is easier to live in a world in which everyone must comply with a few simple formalities than to live in a world in which the validity of anyone's property rights can be compromised by doubts over whether certain individuals had knowledge at some particular time in the past.

Furthermore, Baird and Jackson offer another argument against punishing purchasers with knowledge. Acting with knowledge, in and of itself, is not the same as acting in bad faith. We deny thieves the right to convey any title at all to third parties because we want to discourage theft. We refuse to recognize the rights of those who lie or are otherwise in bad faith, because we want to discourage fraud. We should not, however, penalize people merely for having knowledge. Other things being equal, while we do not want to encourage people to steal or lie, we do want to encourage them to gather information.

Certain categories of legal rules, such as those banning insider trading, act to prohibit persons with knowledge from taking advantage of their knowledge. Whatever the merits of those rules, however, they do not apply here, the authors argue. A purchaser who discovers that a filing by an earlier claimant is defective enjoys no special advantages in a world that allows him to take good title notwithstanding his knowledge. He competes on the same footing as everyone else, because all bid for the same thing: the right to acquire title free of the interest of the person who had recorded the defective claim.

Litigation without End

"Terminating School Desegregation Lawsuits" by Michael Greve, in *Harvard Journal of Law and Public Policy*, vol. 7, no. 1 (Winter 1984), pp. 303-315.

Charles Dickens's famed case of *Jarndyce* v. *Jarndyce* notwithstanding, most lawsuits get resolved within a finite time period. Civil-rights cases involving the public schools are an exception. "Desegregation lawsuits are not a matter of months or even a few years," writes Michael Greve of the Program on Courts and Public Policy at Cornell. "The fact is that desegregation suits are never terminated. . . . In fact, there has almost never been a desegregation case which has been conclusively settled"—in which the court has pronounced itself satisfied and retired from the scene. A number of cases once thought settled have been reopened; and even Topeka, Kansas, the defendant in the landmark 1954 case of *Brown* v. *Board of Education,* is once again being sued.

In theory, a busing case ends when a school system is found by a court to be "unitary," or fully desegregated. What this means in practice is far from clear. The Supreme Court has upheld very sweeping busing orders, but has declined to hold that the Constitution requires proportional representation by race. Moreover, because families are constantly moving from neighborhood to neighborhood, any balanced assignment plan is balanced for the moment only.

One Court decision, from 1976, has dealt directly with the termination question. In 1970 a judge ordered the school board of Pasadena, California, to comply with a rule of "no majority of a minority" in any school. It did so. Later a few schools slipped out of compliance as families moved. The judge ordered reassignments to restore balance, but the Supreme Court overruled, holding that once a city has qualified in a court's view as a unitary school system, the court may not impose further remedies. Greve says the lower courts have resisted this principle, so that the teaching of *Pasadena* has come to be this: "if a district judge provides school authorities with too clear a standard, e.g., 'no majority of any minority,' he runs the risk that they will meet it."

Part of the problem in such cases is simply the general phenomenon of judicial activism, the author says. But there is more. At their heart, desegregation lawsuits are not controversies about particular individuals' rights. "The subject-matter is inherently a grievance about public policy." Resolving the competing claims of the various parties is thus "an extremely difficult undertaking in social planning." Student reassignment is just one element; others include personnel desegregation, race relations training, reform of discipline codes and student organizations, and on and on. The "implementation of court orders has to be permanently controlled, and this supervisory function drags the courts deeper and deeper into the details of everyday school life." In the Boston busing case, sometimes known as "Garrity's Vietnam," Judge W. Arthur Garrity has distributed basketballs in schools, ordered the locks on schoolhouse doors to be replaced, and examined (and "corrected") the budget of the city of Boston.

It is unlikely, Greve says, that the courts will voluntarily let go of their ongoing supervisory role. He thus proposes a "statute of limitations" that would provide for the termination of a lawsuit after a school district has operated under court order for a given length of time. "Such a statute would operate as a 'sunset' law rather than a bar to initiation of suits." Anyone could still sue to remedy new acts of intentional segregation; but statistical imbalances of students would not constitute *prima facie* evidence of such intent.

A Crude Solution to the Balance-of-Trade Problem?

"The Benefits of Eliminating the Alaskan Crude Oil Export Ban: An Economic Policy Analysis" by Calvin T. Roush, Jr. (Federal Trade Commission Bureau of Economics, August 1984), 45 pp.

When Congress authorized construction of the Trans-Alaska Pipeline in 1973, it added a requirement prohibiting the export of Alaskan North Slope oil. This restriction has been extended and tightened in subsequent amendments to the Export Administration Act. As a result, North Slope crude must be shipped to domestic markets, primarily California and the Gulf Coast region, even though producers would find it more profitable to sell some of it to foreign buyers.

This study from the Bureau of Economics of the Federal Trade Commission analyzes the economic costs and benefits of these restrictions, including the distributional effects on various groups within the United States such as producers of Alaskan oil, taxpayers in various jurisdictions, and West Coast oil consumers. According to the author, the late Calvin T. Roush, Jr., repealing the export ban would increase U.S. net welfare by at least $150 million and perhaps as much as $800 million a year, depending on how competitive the West Coast petroleum market is and whether there is excess capacity among U.S.-flag oil tankers (which under the Jones Act are the only tankers that may legally transport oil from Alaska to other domestic ports).

While the net benefits of repealing the current restriction would be substantial, they would not be evenly distributed across the U.S. population. Some groups, such as producers of Alaskan oil and residents of Alaska, would realize large substantial benefits from repeal, while others, such as consumers who live in the western part of the continental United States, would be made worse off.

Producers of Alaskan oil would clearly benefit if the export ban were repealed. The net price obtainable from selling Alaskan oil to the Japanese—the price of crude oil in Japan minus the cost of shipping the oil there—is higher than the net price that can be earned by shipping oil to the U.S. Gulf Coast, the market in which residual Alaskan oil is now sold. Other beneficiaries of repeal include crude oil producers in California, who now compete with the artificially low-priced Alaskan product.

Only a minority of the increase in oil company revenues that would result from repeal would be translated into higher profits for oil producers. Approximately 60 percent would be captured by the federal government in the form of revenues from the windfall tax, and 30 percent would be captured by the governments of Alaska and California. Roush estimates that the net gains to oil producers would amount to somewhere between $60 million and $225 million a year, after the payment of increased tax revenues amounting to at least $542 million a year and perhaps $2 billion.

The increased tax revenue should either reduce the need for other sources of tax revenue or permit government to provide more services. Since oil consumers are also taxpayers and recipients of government services, they will benefit to some extent, offsetting in whole or part the cost to them of higher oil prices. How big a benefit this will represent depends heavily on which state the consumer resides in. The average family living in Alaska would get tax cuts or service increases amounting to between $700 and $2,750 a year if the ban were removed. California families would get between $12 and $62 a year. Families located in other states would receive average annual benefits in the range of $4 to $17.

On the other side of the ledger. oil consumers on the West Coast would have to pay more for petroleum products, the increase costing the average West Coast family between $35 to $103 per year. Thus, on net, residents of West Coast states would be made somewhat worse off, although a significant share of the cost is offset for California residents by higher state tax revenues.

Permitting Alaskan oil to be sold abroad would also reduce the demand for the services of U.S.-flag tankers currently used to transport Alaskan oil to U.S. ports, lowering revenues for their owners. These losses are estimated to be between $459 million and $891 million, before tax, assuming that the industry is operating at capacity before repeal but not after. Overall, however, the gains of repeal to those who gain are much larger than the losses to those who lose, Roush concludes. As a whole, the U.S. economy would clearly be better off if the ban were removed.

The Carrot and the Stick

"Prices and Sanctions" by Robert Cooter, in *Columbia Law Review*, vol. 84, no. 6 (1984), pp. 1523-1560.

Scholars of jurisprudence traditionally view law as a set of obligations or commands backed by sanctions or threats. In contrast, economists tend to view law as a set of official prices attached to behavior that harms others. Each of these viewpoints partakes of a characteristic blindness, argues Robert Cooter, professor of law at the University of California at Berkeley. The jurisprudential perspective blinds lawyers to the fact that officials cannot regulate an economy efficiently by giving orders. Instead, they must rely on legal instruments similar to prices. Conversely, the economic perspective is blind to the distinctively normative aspect of law, because not all misbehavior ought to be available for purchase by willing buyers. In brief, Cooter argues, the economic analysis of law lacks a clear account of sanctions and the jurisprudential tradition lacks a clear account of prices. His article attempts to bridge the two traditions by developing a theory about the differences between the effect of prices and sanctions on behavior.

A sanction is a penalty imposed for doing what is forbidden, and a price is an amount of money exacted for doing what is permitted. "Officials should create prices to compel decision makers to take into account the external costs of their acts, whereas officials should impose sanctions to deter people from doing what is wrong." The effect of creating an obligation by erecting a sanction is to partition possible acts into permitted and forbidden zones, with the dividing line representing some social judgment about correct behavior. Typically there is a jump or discontinuity in the costs the actor encounters at the point of the partition: transgressing the limit by even a step is punishable by the full force of the law. No such discontinuity applies to a price: to get a bit more of a priced good one need only pay a bit more money.

This discontinuity has profound effects on behavior. Because the typical sanction is more than adequate to deter most actors, few of them are on the margin, the place where people would respond to moderate changes in the magnitude of the sanction or the frequency of its exaction. Actors, however, do respond to changes in the *location* of the partition. In other words, when an obligation is backed by a sanction, more actors' behavior will be responsive to the exact substance of the obligation than to moderate changes in the magnitude of the sanction or the frequency of its application.

By contrast, pricing grants discretion to the individual to decide whether or not to pursue an activity, so long as he pays the price. Since prices do not usually create discontinuities in the costs faced by decision makers, the individual will balance benefits and costs at the margin. In cases where benefits and costs are equipoised, a change in price will tip the balance and cause a change in behavior. Thus, many individuals will respond to changes in the magnitude of a price or the frequency of its exaction. In summary, behavior is more elastic with respect to prices than sanctions.

A prescriptive and a descriptive conclusion can be derived from this theory, the author says. To create incentives for efficient behavior using sanctions, the lawmakers must choose the right place to partition the world, whereas to create efficient official prices for externalities, the lawmakers must correctly measure the external harm that is to be priced. These facts suggest a norm: If officials know the optimal level of behavior in general, but cannot measure how much external harm is done in particular cases, sanctions are the preferred instrument of social control. Conversely, if officials can measure the magnitude of the external harm in particular cases, but do not know what overall level of behavior is optimal in general, prices are the preferred instrument of social control. This norm can be restated in different words: If obtaining accurate information about efficient behavior is cheaper than obtaining accurate information about external costs, impose a sanction; if the converse is true, impose an official price.

The author says various bodies of law can be tested to determine whether or not they conform to this prescription, including fundamental rules in torts, contracts, crimes, and regulation. A typical result is that the concept of strict liability in tort represents a price, whereas the concept of negligence represents a sanction.

Sometimes it is difficult to determine whether a law imposes a price or a sanction on an activity. To classify such a law, it is useful to note that a price is invariant with respect to the actor's state of mind but usually variable with respect to the harm caused by his action, while a sanction is usually variable with respect to states of mind and does not necessarily vary with respect to the harm caused. A price depends only on the extent of harm because its purpose is to internalize the cost of an activity. By contrast, the purpose of a sanction may include not only compensation but also deterrence and punishment, both of which often hinge on the state of mind of the offender; intentional or malicious harms get more severe punishment.

Ignoring the roles of prices and sanctions may contribute to heavy-handed regulation on the one hand, or the trampling of genuine moral values on the other. Cooter believes a unified theory of the two will advance lawmakers' understanding of how government controls behavior.