

Law and Economics for Dummies

By Feisal Naqvi

Laws have economic consequences. Laws which have undesirable economic consequences are bad laws.

Capitalism is the belief that societies benefit most when decisions about the allocation of capital are made by individuals, and not by governments. This means people should be able to do whatever they want with their capital.

If a society wants to encourage capitalism then the laws of that society should ensure that transfers of capital are as easy, safe and risk-free as possible so that people can do whatever they want with their money.

“Capital” is a vague term but it basically means anything which has value. Another word for capital is “wealth.” In Pakistan, the most common form of wealth is land. In other words, if everybody in this country filed an honest wealth tax return, the most common form of wealth would be land. One fairly reasonable estimate is that more than 90% of capital in Pakistan is in the form of land.

If the Pakistani government wants to encourage capitalism, it should ensure that transfers of land (or of interests in land) are as easy, safe and risk free as possible. Unfortunately, all governments in the history of Pakistan have failed miserably at this task. Transfers of land in Pakistan are difficult, unsafe and highly risky.

Normal forms of transfers in land include the sale of land, the lease or rental of land and the mortgaging of land as security for a loan.

The sale (and purchase of land) is difficult, unsafe and highly risky in Pakistan for the fundamental reason that there is no single centralized record maintained by the state which is conclusive proof of title so that people can know who owns what. The records which are maintained by public agencies, such as the land revenue department, are not conclusive proof of title but only evidence of title. This means that no matter what the patwari’s record says, somebody can claim that they own a particular piece of land and litigate the matter all the way up to the Supreme Court.

The first recorded state survey of land ownership was carried out in 1086 in England under the orders of William the Conqueror. In 1858, Sir Robert Torrens developed a system of definitively recording land title which is now used worldwide. In all those countries, the amount of litigation over land title, at least as compared to Pakistan, is minimal.

Unlike many other countries, Pakistani law also recognises oral gifts as valid transfers of property. Since oral gifts are, uh duh, oral, there is no record of such gifts. The only way to prove an oral gift is to sue everybody else who would otherwise have had an interest in

the property being gifted. Which is not such a big handicap because all those people who have been deprived by virtue of the gift normally winding up suing the recipient of the gift in any event. And the title of the land therefore stays in dispute until the Supreme Court decides the matter. In most cases involving oral gifts, properties are gifted so as to ensure that women do not get their Islamic shares of inheritance.

England has not allowed oral gifts of land since 1604. There is no litigation in England regarding the validity of oral gifts. Uh duh.

Pakistani law also recognises the right of pre-emption of neighbours. This means that if you try and sell your land, your neighbour (and various other people) have a right of first refusal, that is, to buy your land at the price being offered by the prospective buyer. Courts do not like pre-empt suits and therefore these suits are rarely successful. But as a blackmail tool, pre-emption suits are very effective. One reason that pre-emption suits are so effective is that people understate the declared value of their properties so as to avoid tax. Pre-emption laws serve absolutely no economical valid purpose.

The short version is that if you want to buy property, you don't know what you are buying. You could be buying your dream house or you could be buying a giant headache. This has verifiable and very serious economic costs.

In most Western countries, it is possible to get up to 90% of the value of your property as a loan. In Pakistan, bankers are reluctant to take a risk of more than 50% of the value of a property. That 40% differential is dead property, a handicap imposed on its citizens by the legal system of Pakistan.

Pakistan's laws relating to property are not just dysfunctional and outdated but actually harmful. These laws hurt economic development because they make the transfer of wealth difficult. These laws hurt both rich people and poor people by retarding economic development, but poor people are affected more by such laws.

It is about bloody time that these laws were changed.