

# ERSA Research Brief

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## Why local context matters: *de jure* and *de facto* property rights in colonial South Africa

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Property rights remain important for economic growth and development, but more recent research have started to show that it is more complex – the local conditions also matter. We gave another example, here, of how local conditions and how these rights are perceived matters as well. Besley (1995) said “...formal (*de jure*) rights might have very little to do with the ability to exercise these rights (*de facto*).” If the answer of institutional economics is to give *de jure* property rights in land to individuals, without taking into account the local *de facto* conditions, property rights might not lead to the expected gains in economic growth. Schlager and Ostrom (1992) already called for investigation into “how various types of institutional arrangements perform comparatively when confronted with similarly difficult environments”. In line with the literature, we attempt to show the perception of property rights at the Cape, or the *de facto* mattered more than *de jure* property rights delineated by laws.

Economists suspect that property right regimes are rooted in the history of the region, but it has been difficult to proof the effect of this on economic development empirically. We do this by investigating property rights’ role in the debt market of the Cape colony. The Cape offers an alternative to the development of *de jure* and *de facto* property rights. At the Cape, property rights of loan farms were developed from *de facto* property rights to *de jure* property rights, while other case studies like the United States, Australia and Brazil developed from *de jure* property rights to *de facto* property rights. The two land tenure systems, freehold and loan farms, of the Cape enabled us to study individuals with the different types of property and to compare them one another. The contribution of this research has been to focus on a microeconomic outcome, individual debt levels, rather than macroeconomic outcomes.

Economic theory would suggest land is only valuable for debt transactions if there is no asymmetry and uncertainty regarding land rights. Historians of the Cape have suggested the *de facto* property rights of the loan farms were the same and as secure as the freehold farms, even though the *de jure* rights between the systems differed. Our hypothesis was that individuals with freehold farms had more secure *de jure* property rights and freehold farms should therefore be more valuable for debt transactions. On this basis, individuals with freehold farms should have more debt. The descriptive statistics certainly supported this hypothesis; individuals with freehold farms had higher correlations with debt relative to individuals with loan farms or individuals with no farms. However, after accounting for endogeneity concerns regarding the relationship between debt and land rights, the significance of owning a freehold for debt transactions disappears. We tested the assumption by using an instrument of the oldest son, who had a higher probability of owning a freehold farm. These results support the historiography which suggested that property rights between freehold and loan farms were similar in *de facto* regimes, and also that individuals in a society would rather rely on these *de facto* rights when considering economic transactions. Our results provide empirical evidence for what historians have suspected: that the institution of property right depends on the society in which it is embedded. Instead of formal *de jure* rights, how rights are perceived and used by individuals (*de facto*) is likely to have a bigger influence on economic transactions.