



Property Rights: An Institutional Perspective

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What Are Property Rights?

- 1) User Rights
- 2) Service/Income Rights
- 3) Rights to transfer or exchange

Property Rights and Economics

- Most neoclassical theory simply assumes well defined rights
- But Ronald Coase taught us that rights are costly so the choice to define and enforce those rights has important implications for economic behavior

Government as Enforcer

- Because of the state's power, its capacity and willingness to create, enforce, or change existing rights determines a large part of the success or failure of an economy

Where Do Rights Come From?

- A simple efficiency view
- Given enough open competition there is pressure to define and enforce rights wherever the costs of right creation exceeds its benefits
- Most clearly articulated by Alchian and Demsetz

Example: Resource Conflict

- The work of Libecap on the development of mineral rights and grazing rights in the U.S. shows how a lot of rights that emerged in the undeveloped parts of the Western USA emerged as demand for those goods developed.
- Rights were adjusted to take into account high enforcement costs and sparsely populated lands.

But Why Are Good Prop Rights So Rare?

- Much of the time conflict arises
- The forces that emerge don't often do a good job of maximizing general welfare
- Often the political authorities aren't interested in promoting economic growth
- For most of human history people were poor

Stateless solutions exist

- Ostrom shows how local arrangements of common property in conditions of high transactions costs can allow for joint ownership that is sustainable
- Easier with few people
- But harder to do the more complex the relationships and the larger the number of people

Coase and Cooperation

- When transactions costs are low and cooperation is easy the Coase theorem says that the initial allocation of rights is unimportant

Example: Sharing Rooms with a Smoker

- Adam & Bob can live separately and pay 1000 dollars each for a flat each month
- Bob smokes but Adam dislikes it
- If they shared a big apartment they would only spend $1400 = 700$ each
- Adam would rather spend an extra \$300 than accept smoking?
- Can they make a deal?

The New Institutional Insight

- Any party or organization such as the state which is powerful enough to promote and maintain property rights leading to voluntary exchange is powerful enough to abuse those rights

Hobbes vs. Smith

Make or Take

- How do we solve the credible commitment problem?
- Why should a powerful ruler only act in the public interest?

States That are Too Strong

- If A Ruler Must be Obeyed It is Harder for Him to Make Credible Commitments
- Anyone strong enough to promise something like private property cannot be trusted to maintain it in the future without competition or other constraints
- For example, sovereign borrowing

Modern States and Rights

- Modern states, especially democratic ones, are constrained by competition
- Nonetheless, the courts and governmental bodies such as Congress or Parliament often take away or create new rights by adding on rules and regulations as well as outright confiscation
- Taxation is supposed to be a fee for public goods but is often just a means of redistribution

Example: Rent Control

- Fixing the maximum price that a flat can be rented is a transfer of rights from the owners to existing renters
- But in the long run this tends to hurt most renters especially those entering the market after the law is created
- Disincentives to invest in flats, to improve them, or to build new ones
- Use of non-monetary discrimination to pick tenants

Tying the King's Hands

- A sovereign that is known to have constraints on its ability to borrow and spend is going to find it easier to borrow and spend when it tries to do so.
- The more likely people are to be repaid, the more they will willingly lend
- Think of loans but also rights, paper money, and long term government promises

Worst Case: Tragedy of the Commons

- When something is jointly owned with no customary constraints (e.g. lake, fishery, forest), everyone has an incentive to use the good or service until $AP = AC$
- But optimal is $MP = MC$
- So you get overuse
- Fisheries, freeway, etc.

Even Worse Case: Violent Disorder

- The fear of violence and chaos leads people to accept leaders who can maintain order
- Sometimes those leaders extract rents that offset most of the gains of order. E.g. Mafia
- The worse the threat of violent conflict the more people accept dictators

Democratic States Can Spend and Save More

- If we successfully constrain states through rules, votes, and constitutions it is easier to trust in the state to tax and spend for the public good
- Most successful welfare states are often well-functioning governments in homogeneous societies such as Japan or Denmark
- But homogeneity has costs
- Republican rules are designed to limit governmental power while preserving democracy