

INSTITUTIONS AND INSTITUTIONAL DESIGN

Erling Berge

Part VIb : Explaining property rights Eggertsson 1990 Ch 8-10

NTNU, Trondheim

Fall 2004

Fall 200409-04-2002

© Erling Berge 2004

1

Eggertsson 1990 Ch 8 Emergence of property rights

– Basic: a state prefers to maximise the wealth
of the country, other things being equal

- The naive model of property rights
- When exclusive rights do not emerge
- Interest group theory of property rights
- Rent seeking

Fall 200409-04-2002

© Erling Berge 2004

2

The naive model of property rights

- Property rights develop to internalise externalities when gains of internalisation are greater than costs of internalisation.
- Only private benefits and costs are considered
- It emphasises exclusion costs and considers
- Internal governance costs of shared rights
- NOTE: Both are costs of collective action and depends on political institutions

Fall 200409-04-2002

© Erling Berge 2004

3

When exclusive rights do not emerge

Open access because of

- High exclusion costs
 - Fisheries
- High internal governance costs in a commons
 - Heterogeneous fishermen
- Open access enforced by the state
 - Value of equal access

Fall 200409-04-2002

© Erling Berge 2004

4

Interest group theory of property rights

- Case studies of
 - Regulations of the US oil industry
 - The agriculture of Norway
 - The bureaucracy of PeruDisproves the naïve theory
- The state is ruled by interest groups competing for maximum wealth

Fall 200409-04-2002

© Erling Berge 2004

5

Rent seeking

- Concerns the losses of (neoclassical) social welfare losses resulting from the restriction of trade through tariffs, monopolies, and the like, which special interest groups obtain from the government.
- When information is costly the cost of struggles may easily exceed the rent sought

Fall 200409-04-2002

© Erling Berge 2004

6

Eggertsson 1990 Ch 9

Property rights in stateless societies

- Origin of cooperation
- Order: violence and deterrence
- Order: customary law and ideology
- Evolutionary theory
- Insurance functions
- Iceland's commonwealth 930-1263
- International property rights

Fall 200409-04-2002

© Erling Berge 2004

7

Stateless societies (1)

Violence and deterrence

- Prisoners dilemma
 - External constraints
 - Internalised values
 - Repetition, no endgame
- Umbeck's model of the gold rush
 - Work on either mining or violence

Fall 200409-04-2002

© Erling Berge 2004

8

Choosing between aggression and non-aggression				
Payoff in cattle units	Family Y			
	A		N	
Family X	A	4	4	18 2
	N	2	18	10 10
Fall 200409-04-2002 © Erling Berge 2004 9				

Stateless societies (2)	
Customary Law and ideology	
– Vengeance groups collectively responsible	
– Systems of compensation payments often requires an arbitrator	
– Cross-cutting allegiances	
Insurance against hunger	
Blocking of development of a state = blocking wealth and power	
Breakdown of the Icelandic Commonwealth	
International property rights (no external constraints)	
Fall 200409-04-2002 © Erling Berge 2004 10	

Evolutionary models

How do particular personality traits emerge?

How do particular social customs emerge?

- Modelling by natural selection mechanisms
 - Genetic controls are “soft-wired”: learning
 - Both culture and genes are affected by selection
 - Culture change more rapidly than genes
 - Dominance, sharing, privacy
 - Defensive belligerence and reluctance to intrude may be “hard-wired” (the privacy ethic)

Fall 200409-04-2002

© Erling Berge 2004

11

Eggertsson 1990 Ch 10

The state in neoinstitutional economics

From informal rules, values and taboos to

- complex exchange among unrelated individuals and specialized production
 - North’s theory of the state
 - Investigations
 - Political coalitions and property rights
 - The state and its agency problems
 - Public finances, constrained optimisation
 - Democracy, information costs,
 - organisation of the US congress

Fall 200409-04-2002

© Erling Berge 2004

12

The state: a model

- Technical production frontier
 - Stock of knowledge
 - Endowment of resources
- Structural production frontier
 - Feasible organisation minimising costs, maximising output, defined by the
 - System of property rights depending on Political structure

Fall 200409-04-2002

© Erling Berge 2004

13

Formal model (Findlay&Wilson)

- Y = composite commodity made by inputs
- L = labour services and K = capital stock
- Output $Y=f(L,K)$ can be enhanced by a factor due to the public order: $p(G)$
- G = labour supplied by government workers
- $Y = f(L,K)p(G)$ where $G+L = H$ fixed
- $\Downarrow Y = y(G)$

Fall 200409-04-2002

© Erling Berge 2004

14

Figure 10. 1 National income and level of government employment

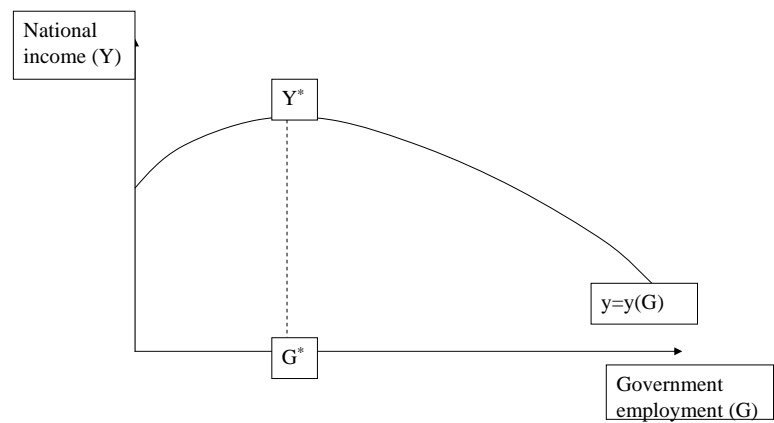
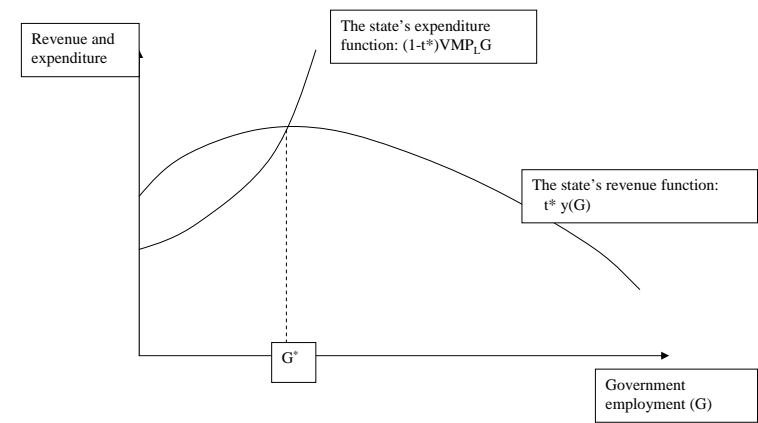


Figure 10.2 Equilibrium public employment



The state: Ability to tax

A ruler maximises income under constraints

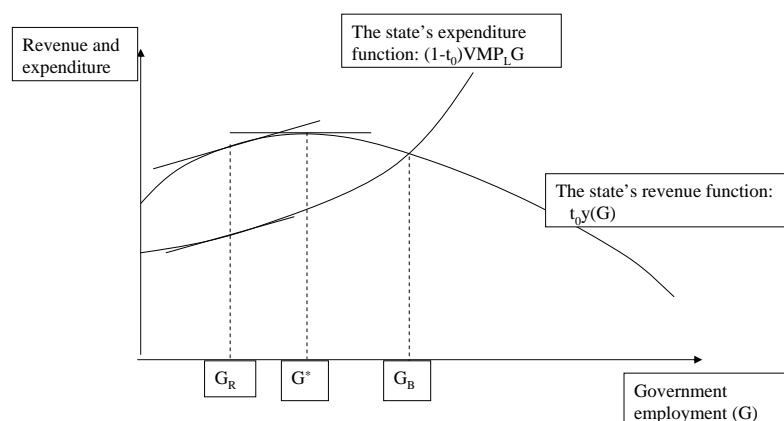
1. Threat of entry by rivals (have the ruler's subjects an alternative?)
 - Rational to tax with varying tax rates
2. Opportunistic behaviour of the state's agents
3. Measurement costs

Fall 200409-04-2002

© Erling Berge 2004

17

Figure 10.3 Failure to maximise income when the tax rate is exogenous (t_0) or bureaucrats out of control



Fall 200409-04-2002

© Erling Berge 2004

18

Investigations (1)

The structural production frontier depends on

- Decision-makers bearing the full costs and benefits of decisions
- Rights are secure and clearly defined, there is low cost conflict resolution mechanisms
- Lowering measurement and transaction costs
- Directly assigning property rights when TC prevents voluntary exchange

Fall 200409-04-2002

© Erling Berge 2004

19

Political coalitions and property rights

- Political power = $f(\text{economic base, } 1/\text{cost of collective action})$,
- Divide and rule by selective rewards,
- Ideological fervour lowers cost of CA, and increases political power
- Population growth, military technology affects bargaining power

Fall 200409-04-2002

© Erling Berge 2004

20

Agency problems in Soviet Type Economies

- Reforms may threaten the interests of the agents of the state
- High transaction costs may prevent side payments to ensure their loyalty to reforms
- STE: industry and agriculture managed by the state as one big firm
- Double structure: management and political controls (by communist party controlling appointments to management)

Fall 200409-04-2002

© Erling Berge 2004

21

Privileges of agents

- Nomenklatura privileges are system specific to STE (main beneficiaries are party apparatchiks and management bureaucrats)
- Military and police privileges are system specific to autocratic forms of governments

Fall 200409-04-2002

© Erling Berge 2004

22

Public finance and property rights

- Long-term investments only when future rights are seen as secure
- Predatory public finances may move the economy's structural production frontier away from the technical frontier
- Financing of early modern states faced
 - Political constraints
 - Measurement and other transaction costs in taxing
- Resulting in predatory financing

Fall 200409-04-2002

© Erling Berge 2004

23

Protection against confiscation of quasi-rents

- Vertical integration
 - In politics leading to soviet type economies (STE)
- Constraining potential appropriators
 - Credible commitments by hostages
 - Deprivation of power to appropriate

Fall 200409-04-2002

© Erling Berge 2004

24

Representative government Information costs and interest groups (1)

Denzau-Munger model legislators maximize

- V – votes constrained by
 - E - effort (a scarce resource); typically
 - » Actions benefiting her constituents
 - » Promoting policies for groups that do not vote, but may affect her constituents
 - » Advertising and informing voters
 - R – resources available from non-voting groups wanting policy P_i
 - » Allocating effort E_i to produce policy P_i
 - » With production function $P_i(E_i)$
- Resources are generated by $R(P_i)$, and votes by $V(R)$

Fall 200409-04-2002

© Erling Berge 2004

25

Representative government Information costs and interest groups (2)

- Assumptions about information of voters
 - Rational ignorance (all info from legislator)
 - Implies legislator is controlled by interest group constrained by political competition and news media
 - Full information
 - Advertising is not necessary, R is not needed, the legislator will represent only the interests of her voters
 - Real behaviour is somewhere in between

Fall 200409-04-2002

© Erling Berge 2004

26

Representative government Transaction costs

- Markets for votes (logrolling) has high transaction costs
 - Commitment, keeping promises (there is no third party enforcer), asymmetric information and changing circumstances
- The organisation of legislatures can be understood as lower these to an acceptable level (in the US – the committee system)

Fall 200409-04-2002

© Erling Berge 2004

27