Welfare Theories of Private Property

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Standard Theory of Economic Advantages of Property Rights

a) Incentives to improve resources

b) Incentives to conserve resources
   - avoid “tragedy of the commons”

c) Facilitate minimization of negative externalities (cf. “Coase theorem”)

d) Minimize “rent seeking”
   - Modern meaning of “economic rent” = a payment not counterbalanced by an increase in productivity
   - Most common and economically pernicious example of “rent seeking” = lobbying government for a subsidy or tariff protection

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Historical implication: private property rights emerge with respect to a particular resource when the total social benefits of these sorts exceed the costs of creating and enforcing such rights (Demsetz)

Normative implication: the law should establish clear, alienable, absolute, private property rights in all scarce resources

Why “clear”?

- Minimize litigation
- Enable all parties to plan their activities with confidence
- Minimize use of administratively costly insurance system

Why “alienable”?

- Allow resources to flow to the person or firm that values them the most highly
- Facilitate private transactions that will minimize negative externalities (Coase; Demsetz)

Helps explain strong hostility in Anglo-American law to restraints on alienation

“Absolute”

- Rights should be concentrated in a single person or firm
  - Communal rights are inefficient
- Backed in unqualified fashion by state power:
  - Damages;
  - Injunctions;
  - Criminal sanctions

William Blackstone, Commentaries on the Law of England, Book II, p. 2 (1765-1769):

“There is nothing which so generally strikes the imagination and engages the affections of mankind, as the right of property; or that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe”

Takings Doctrine

- Property rights must be shielded from expropriation or abridgement by the state
- Crucial to owners’ willingness to invest
- Qualifications:
  - Logrolling
  - Perverse incentives to build

World history supposedly confirms these principles

- Nations or communities that adhere to these principles prosper; those that do not stagnate or collapse
- Examples:
    - Fur trading among Native Americans in Canada (Demsetz)
    - Ejidos in Mexico
    - World fisheries
    - Land tenure in Nicaragua

Sore points (of the standard theory) include:

1) Unrealistic psychology
   - inattention to bounded rationality (Kahneman & Tversky)
2) Unrealistic sociology
   - Failure to appreciate the ways in which <u>groups</u> can promote social welfare (Ostrom)
3) Difficulty in addressing large-scale or long-term externalities
   - E.g., climate change; exhaustion of a resource
4) Limitations of the ”Coase theorem”
   - “Offer-asking problem” (e.g., Demsetz, footnote 2)
   - Ubiquity of “transaction costs”