

## Chapter 6

# Rules of the Game

- “Every economic system requires a set of rules, an ideology to justify them, and a conscience in the individual which makes him strive to carry them out.”

Joan Robinson

- Economic system is a matrix of social institutions, agents, organizations and society
- Function of an economic system is to coordinate the activities (behavior) of individuals and organizations in the processes of provisioning and allocation
- Heilbroner identifies tradition, command and market as the three basic types of economic system

# Traditional Economies

- Based on solutions that have worked in the past
- Solutions are preserved and communicated by tradition, myths, custom, mores, institutions
- May be some components of the economy that are command or market, but emphasis is tradition
- Reciprocity is often used as a primary allocative mechanism in traditional economies

# Problems of Traditional Economies

- Larger, more complex societies make it more difficult to communicate and enforce general acceptance of traditional methods
- Traditional economies do not adapt to change effectively
  - Changes in natural environment
  - Changes in technology
  - Changes in other aspects of built environment
- Failure to adapt may result in collapse of the economy and/or society

# Command Economies

- Eminent domain is primary allocative mechanism
- Tradition and markets may be present, but emphasis is on command
- Planned Economies are example
- Requires an authority to establish and enforce objectives
- Command can be within an organization
- Command can alter objectives quickly

# Market Economies

- Focus of Neoclassical microeconomics
- Based on *Quid Pro Quo*
- Requires voluntary transactions and nonattenuated property rights
  - Voluntary exchanges are Pareto Improvements
- Information requirements are lower than for command
- Incentives are more explicit
- Market systems tend to adapt more quickly

# Markets and Behavior

- Economic behavior is within a social context
- Friedrich Hayek (1899-1992)
  - Markets require legal framework
- Adam Smith (1723-1790)
  - Morality (*Theory of Moral Sentiments* 1759)
  - Markets (*An Inquiry into the Nature and Causes of the Wealth of Nations* 1776)
  - Jurisprudence (*Lectures in Jurisprudence* 1762-63)

# Roles of Government

- Smith, Locke, Hayek and Physiocrats generally agree about roles; disagree on the nature and extent of the roles.
  - Define and enforce property rights
  - Enforcement of domestic justice
  - National defense
  - Provision of Collective or public goods
  - Promote competition
  - Safety net for citizens

# Property Rights

- *Property rights are understood as sanctioned behavioral relations among men [sic] that arise from the existence of goods and pertain to their use. These relations specify the norms of behavior with respect to goods that each and every person must observe in his daily interactions with other persons, or bear the cost of non-observance. The term "good" is used here for anything that yields utility or satisfaction to a person. Thus, and this point is important, the concept of property rights in the context of the new approach applies to all scarce goods. The concept encompasses both the rights over material things (to sell my typewriter) as well as 'human' rights (the right to vote, publish etcetera). The prevailing system of property rights in the community is, then, the sum of economic and social relations with respect to scarce resources in which individuals stand to each other. (Furubotn, p 3)*

## Property Rights - Hayek

- *Where the law of property is concerned, it is not difficult to see that the simple rules which are adequate to ordinary mobile “things” or “chattel” are not suitable for indefinite extension. We need only turn to the problems which arise in connection with land, particularly with regard to urban land in modern large towns, in order to realize that a conception of property which is based on the assumption that the use of a particular item of property affects only the interests of its owner breaks down. . . . .*

# Property Rights - Hayek

- *Private property rights of individuals are not the same as private property rights for legal entities such as corporations.*
- *It seems to me that, in general, the freedom of the individual by no means need to be extended to give all these freedoms to organized groups of individuals, and even that it may on occasion be the duty of governments to protect the individual against organized groups. It appears to me also as if historically in the field of the law of corporations we had a situation rather analogous to that in the field of the law of property to which I have already referred. As in the law of property the rules developed for ordinary mobile property were extended uncritically and without appropriate modifications to all sorts of new rights; and thus the recognition of corporations as fictitious or legal person has had the effect that all the rights of a natural person were automatically extended to corporations. (Hayek, p 116)*

# Nonattenuated Property Rights

- Exclusivity
  - Negative externalities impose costs on individuals who are not part of the contract or voluntary exchange
  - Positive externalities confer benefits on individuals who are not part of the contract or voluntary exchange
- Markets tend to produce “too much” of goods with negative externalities and “too little” of goods that have positive externalities

# Nonattenuated Property Rights

- Public or Collective goods
  - Cannot exclude individuals from consumption
  - The marginal cost (additional cost or opportunity cost) of an additional user is zero
  - Individuals tend to become “free riders” (can be “forced rider”)
- Quasi-Public goods
  - Can technically exclude user
  - User Marginal cost is zero

# Common Property

- “Tragedy of the Commons” Garret Hardin
- Fugitive resources – agent that captures the resource has ownership rights
- Tend to capture as fast as possible
- User Marginal Cost is not zero (different from public good)
- Resources are “overused” and may be driven to extinction
- Need to restructure property rights

# Future Problems in Property Rights

- Enforceability of intellectual property
  - Mokyr's propositional knowledge as a base for prescriptive knowledge
  - Progress and advancement of knowledge
- Transferability
  - Organs
  - Blood
  - children

# Lawrence Lessig

- Property rights laws need to balance the incentives of private property with the source of creativity; the intellectual commons.
- Creators here and everywhere are always and at all times building upon the creativity that went before and that surrounds them now. That building is always and everywhere at least partially done without permission and without compensating the original creator. No society, free or controlled, has ever demanded that every use be paid for or that permission for Walt Disney creativity must always be sought. Instead, every society has left a certain bit of its culture free for the taking—free societies more fully than unfree, perhaps, but all societies to some degree. (Lessig, Free Culture, p 29)

# Lawrence Lessig

- **A free culture is not a culture without property; it is not a culture in which artists don't get paid. A culture without property, or in which creators can't get paid, is anarchy, not freedom. Anarchy is not what I advance here. Instead, the free culture that I defend in this book is a balance between anarchy and control. A free culture, like a free market, is filled with property. It is filled with rules of property and contract that get enforced by the state. But just as a free market is perverted if its property becomes feudal, so too can a free culture be queered by extremism in the property rights that define it. (*Lessig, Free Culture, p xvi*)**