Property Rights & Governance

Political Science 442

NDSU NORTH DAKOTA STATE UNIVERSITY

Competition and Cooperation in Markets

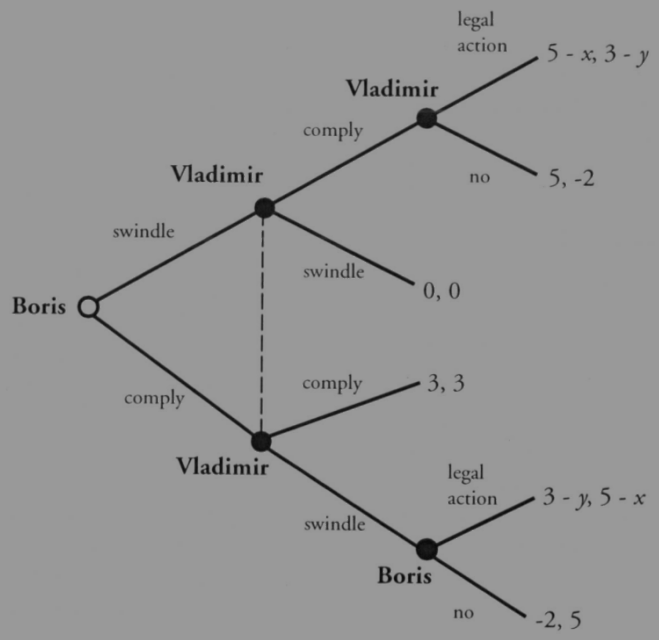
NDSU NORTH DAKOTA STATE UNIVERSITY

- Free markets are highly competitive, but they are also highly cooperative
- Cooperation, in equilibrium, is a lynchpin of market success
- Encouraging cooperative behaviors in markets is a political problem; how do we encourage such behavior?
  - Institutions, rules of the game
  - Property rights, contract law, civil courts

Russian Shock Therapy

- Rapid privatization
- Assumption that markets $\rightarrow$ institutions
- Inflation
  - Attempted preservation of state industy
  - Large savings
- Little new competition
- New private managers of state firms canibalized assets
- People sold state firm shares

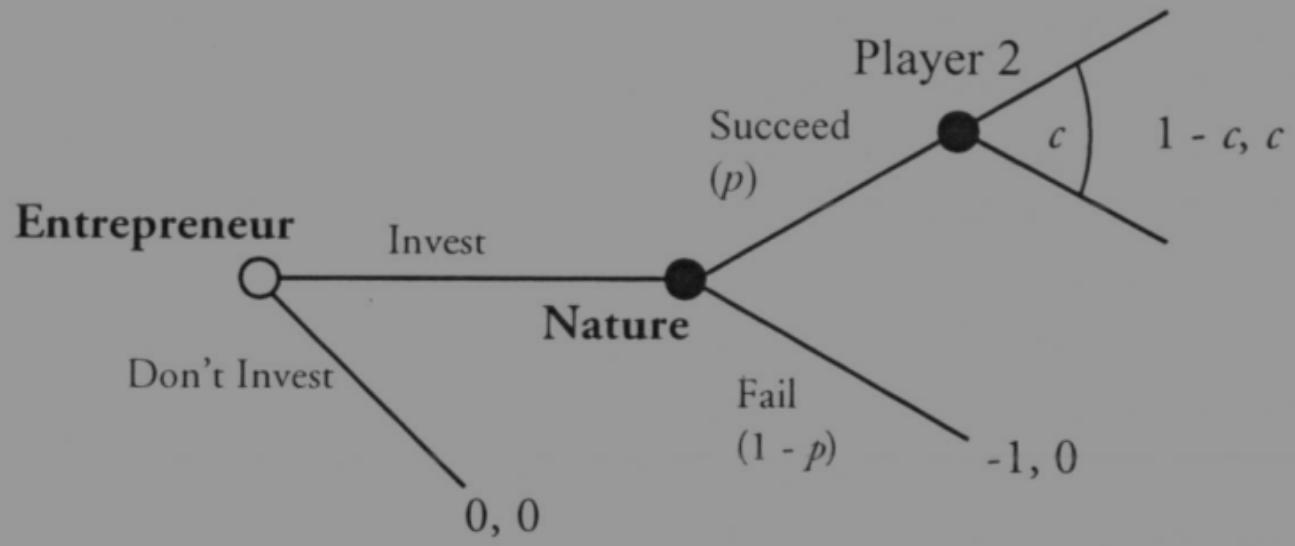
Legal Institutions and Economic Exchange



- What's the story behind this game?
- What do the variables mean?
  - x: punitive power, y: legal efficiency
- When is exchange in equilibrium?
  - $x \geq 2$ & $y \leq 5$
  - Legal institutions are efficient and sufficiently punitive

Property Rights & Investment

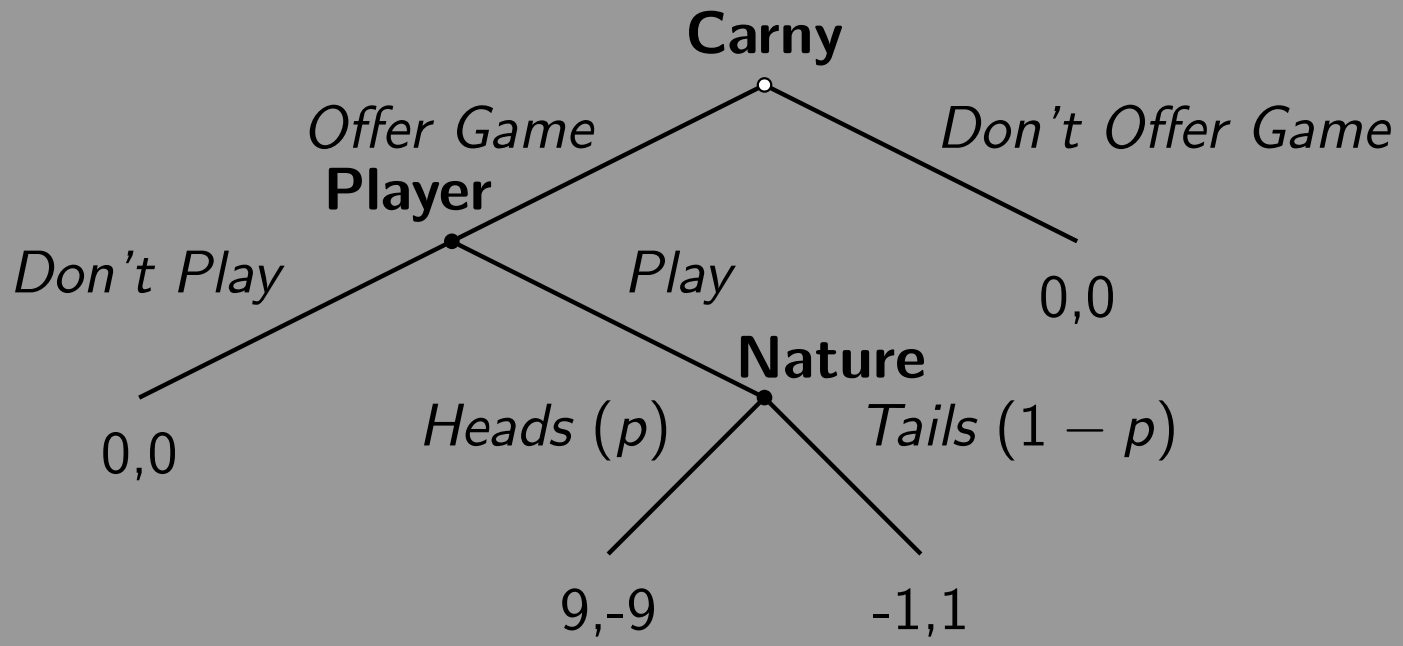
- Right to use, alter, and appropriate returns from an asset
- Potential threats to returns: Neighbor, thief, mob, corrupt officials, taxes



Expected Value "Review"

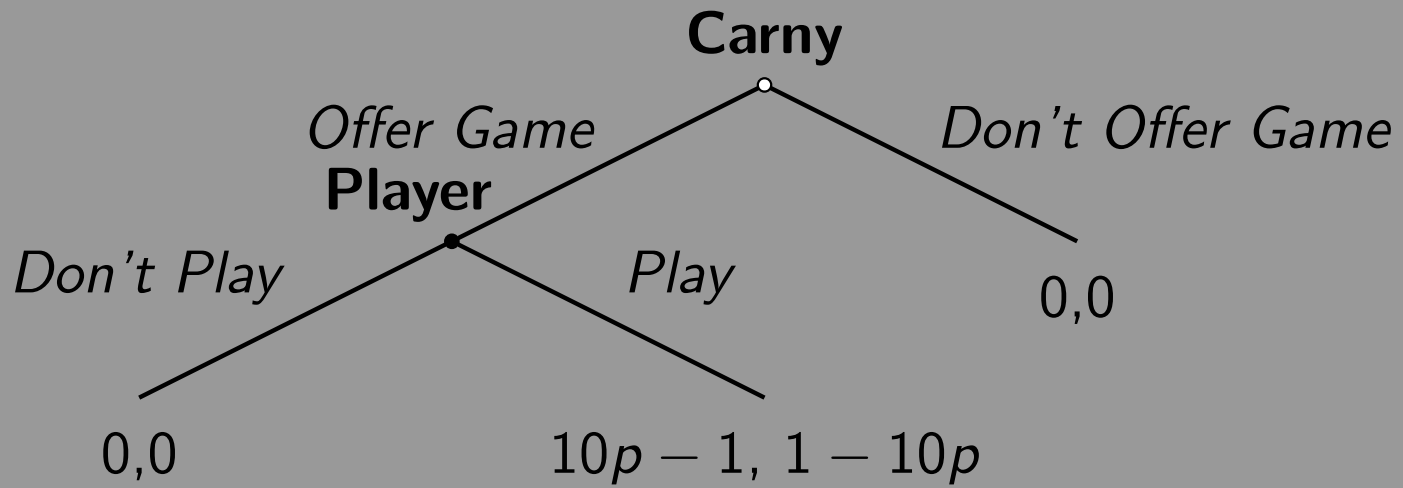
- The expected value of a probabilistic action is the sum of each potential payoff of the action times the likelihood of that payoff.
- Example: Flip a coin, win a dollar if it lands on heads, lose a dollar if it lands on tails
  - Probability of heads is 0.5, probability of tails is 0.5
  - Payoff of heads is 1, payoff of tails is -1
  - $EV(\text{flip}) = .5 \cdot 1 + 0.5 \cdot -1 = 0$
- Example: Roll a die and win \$1-\$6, depending on where the die lands
  - Probability of each possible outcome is 1/6.
  - Payoff of outcome 1 is \$1, 2 is \$2, and so on.
  - $EV(\text{roll}) =$
    $1(1/6) + 2(1/6) + 3(1/6) + 4(1/6) + 5(1/6) + 6(1/6) = 3.5$
- Rationale: if you played the dice game many times, you'd make an average of \$3.5 per play.

Solving Probabilistic Dynamic Form Games



- What's player's expected value of playing?
- What's the carnie's expected value of offering if player plays?

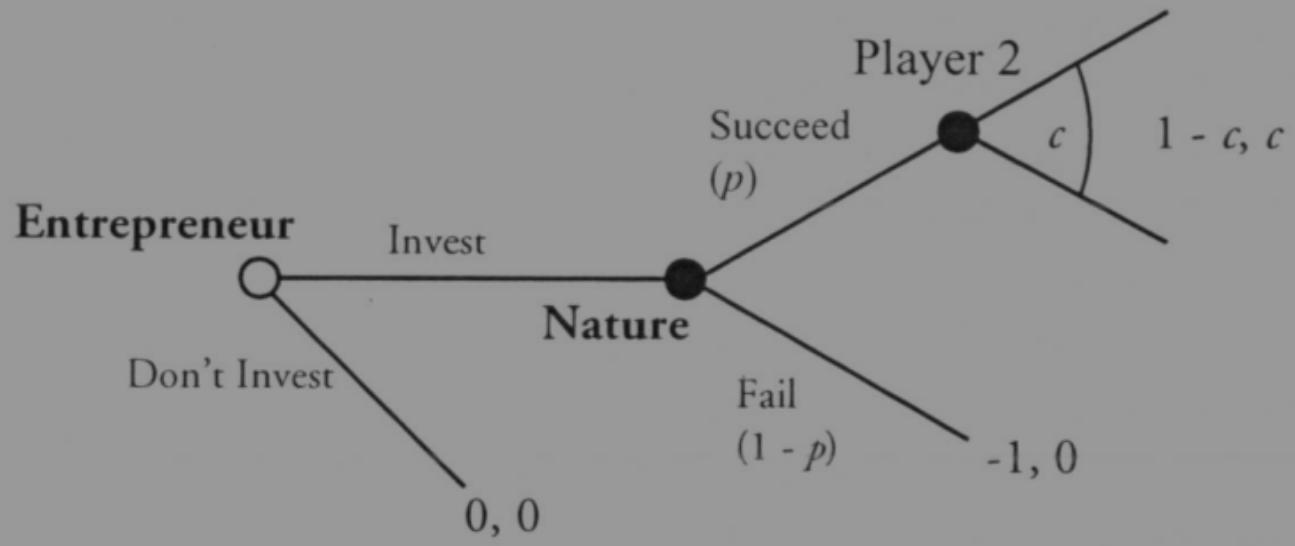
Solving Probabilistic Random Form Games



- What is the equilibrium when $p = 0.5$?
- For what values of p will the player play?
- For what values of p will the carnie offer?
- Are there values of p where this game will be played?

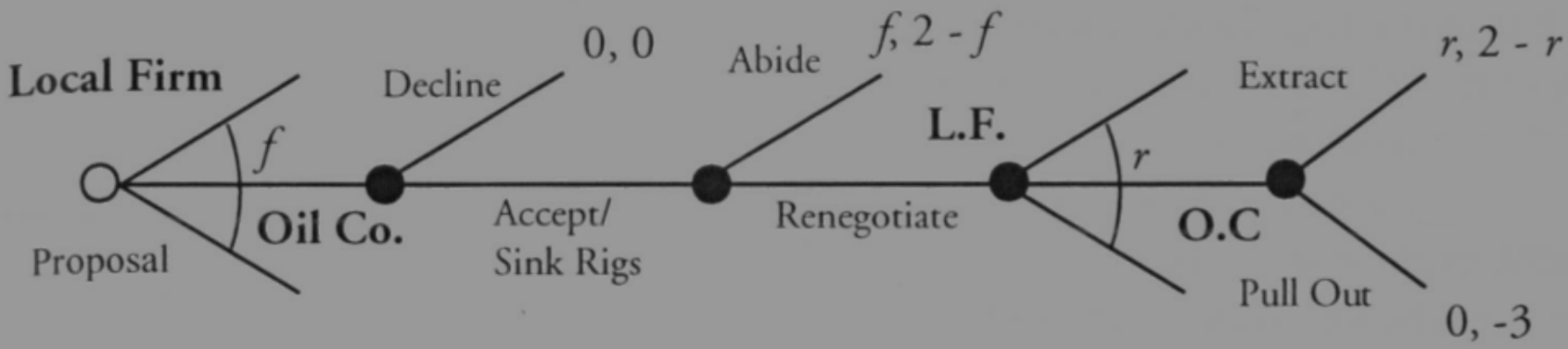
Property Rights & Investment

- Right to use, alter, and appropriate returns from an asset
- Potential threats to returns: Neighbor, thief, mob, corrupt officials, taxes



Investment is a function of risk, rights to returns

Property Rights & FDI



Property Right Emergence

NDSU NORTH DAKOTA STATE UNIVERSITY

- Difficult to create property rights through laws
- Role recognition, hawk/dove
- Expectations, division game
- Why did property rights evolve some places and not others?