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TIME PREFERENCES AND THE PROPERTY RIGHTS PARADIGM

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Abstract

Capitalism relies heavily on property rights to resolve conflicts over the use of scarce resources. Property rights are defined in the literature as the expected ability of an economic agent to use an asset (Allen 1999; Barzel 1997; Lueck and Miceli, 2005; Shavell, 2002). A systematization of the economic analysis of property rights is due to Demsetz (1967) and Alchian and Demsetz (1973), whose ‘property rights paradigm’ has become, among contemporary economists, the ‘classical view’ on property rights and economic incentives. According to Alchian and Demsetz private property rights represent always a social institution that creates incentives to efficiently use assets, and to maintain and invest in assets. In particular private property rights allows for the internalization of the externality existing in the communal right system, where any owner cannot exclude the others from enjoying the fruits of her effort and hence no one has any incentive to use inputs that have a future payoff. This view has a strong appeal among contemporary economists (see for example Glaeser and Schleifer, 2002; Djankov et al, 2003). As a consequence, the role of the State in codifying and enforcing the property rights on productive assets is generally considered as crucial to promote investment and growth, even if it may entail some public costs. In this work I question the conclusion that (private) property rights security, defined as the expected ability of an economic agent to use an asset, has always a positive effect on investment incentives. Time preferences matter. I develop an analytical framework to analyse the interactions of property rights and investment incentives grounding on the model of quasi-hyperbolic discounting originally proposed by Phelps and Pollak (1968) in the context of intergenerational altruism and then used by Laibson (1994, 1997) to model time-inconsistency within an individual. Moreover, I adopt a general solution concept called ‘perception-perfect strategy’ proposed by O’Donoghue and Rabin (1999, 2000). In this setting I show that while the expected ability to enjoy the benefits from the investment (what we call property rights security on investment) always affects positively investment incentives, the expected ability to use an asset (what we call property rights security on asset) has a non-negative effect on investment incentives only under the hypothesis that investors are time-consistent exponentially discounters. Instead we show that, under the more general and empirically supported hypothesis of hyperbolic discounting, property rights security on investment but property rights insecurity on asset maximize investment incentives.

Keywords: *Assets, Investment, Property Rights, Time Preferences*

JEL Classification: *A12, C70, D21, D23, D92.*

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