



AMBO UNIVERSITY
WOLISO CAMPUS
SCHOOL OF GRADUATE STUDIES
COLLEGE OF BUSINESS & ECONOMICS
INSTITUTIONAL ECONOMICS
LECTURE 3
PROPERTY RIGHTS

1/23/2019

Admassu Tesse (PhD)

1

Lecture content

1. Common Property Problem
2. Coase Theorem (1960)
3. Alternative approaches to Coase Theorem
4. Criteria for efficiency of property rights
5. Economic advantages of property rights
6. Changing property rights

-

Common Property Problem

1. Why people pollute their living environment?
2. Why firms surrounding Finfine town pollute downstream rivers with their byproducts?
3. Why farmers overgraze common lands?
4. Why illegal hunting is so rampant in Ethiopia?

Common Property Problem...

□ Because of:

- Lack of property rights!
 - everybody's land is no one's land!
 - Marginal benefit of using a resource is always greater than marginal costs to the users!

Coase Theorem

- If no one “owns” a resources, no one benefits from managing (pricing) its usage and hence becomes everyone’s resources.
- The solution is to assign the property right to one party and allow them to trade its use in the marketplace.

Coase Theorem...

- If property rights exist and transaction and information costs are low:
 - Then parties will be able to bargain among themselves (without government intervention) to obtain an efficient outcome (Coase, 1960).
 - Call for reducing government interventions in the name of controlling and monitoring resource uses!

Coase Theorem...

□ An Example of the Coase Theorem:

- Marketplace

- ✓ Consider a firm upstream from a farmer:

- Firm produce a good valued by consumers but dumps pollutants into the river as a byproduct.
- Cost of using the river to the firm is zero (0).
- Assume that cost of pollution abatement equipment \$3million.

Coase Theorem...

- ✓ For a farmer who lives:
 - Downstream from the firm
 - Uses water to irrigate his agricultural products
 - Pollution affects/degrades his product
 - Assume crop damage estimate to be \$8million.

Coase Theorem...

1. If ownership to the river is assigned to the firm:
 - Farmer is willing to pay the firm to reduce pollution (bribing?)
 - Willing to pay firm to reduce gallons discharged up to marginal value of crop damage due to pollution
 - Firm will be willing to accept payments that are $> =$ marginal costs of treatment/reduction.

Coase Theorem...

- ✓ Farmer will be willing to pay \leq \$8million.
 - The firm can buy equipment for about \$3million.
 - Some saving to both parties: (\$8 M-\$3M~\$5M)?

Coase Theorem...

2. If ownership to the river is assigned to the farmer:
 - √The firm will be willing to pay the farmer up to the marginal value of “avoided” treatment costs and value of lost output ($\sim \$3M + ?\$$), or install pollution abatement equipment.
 - √The farmer will be willing to accept payments \geq marginal cost of crop damage.

Coase Theorem...

- Either way: socially efficient (marginal value = marginal cost) solution.
 - However, there are different income effects
 - Concluding which is best => normative statement

Alternatives to Coase Theorem

- Criticisms of Coase Theorem:
 1. Higher transaction costs.
 - ✓ Transaction costs of getting all affected parties together may be too great to get to optimal solution if rights assigned to firm.
 2. Strategic behavior.
 - ✓ Offering lower bribe/demanding more payments by the parties involved.
 - ✓ Individuals are not rational!

Alternatives to Coase Theorem...

□ Alternative approaches:

1. Standards

- Set same standard for all firms,
 - ✓ But not all firms are productively efficient.
 - ✓ Different firms need different cost minimization strategies.
 - ✓ To set individual quotas: requires knowledge of each firm's costs.
- Have higher administrative costs
 - ✓ Not only have to monitor emissions
 - ✓ Enforcement costs: legal proceedings (time delays and expense)
 - ✓ Provide no incentive for firms to reduce pollution below current “authorized” levels

Alternatives to Coase Theorem...

2. Taxes

- ✓ Can produce “optimal” amount of pollution at minimum costs and lower administrative costs
- ✓ Automatically allocates pollution levels among firms based on their costs
 - Provides incentive for firms to reduce pollution levels through technological innovation
- ✓ Easy to adjust/”tune”
- ✓ Tax revenues can be used finance admin costs

Alternatives to Coase Theorem...

3. Tradable Permits

✓ Cost efficient

- Firms will purchase permits from more efficient firms if permit cost $<$ abatement (technology) costs

✓ Technological incentive to reduce pollution

- Marginal cost of abatement = permit cost

✓ Administratively simpler

- Require less information about the firms' cost
- Better able to handle “spatial” variation in pollution
- Adjust “automatically” for changes in inflation and growth

Criteria for efficiency of property rights

- Three important criteria for efficiency of property rights:
 1. Universality: all scarce resources are owned by someone;
 2. Exclusivity: property rights are exclusive rights; and
 3. Transferability: to ensure that resources can be allocated from low to high yield uses.

Case studies

- In light of these criterion, evaluate the efficiency of:
 1. Federal Democratic Republic of Ethiopia. (1997). *Rural Land Administration Proclamation of the Federal Government of Ethiopia. Proclamation No. 89/1997.*
 2. Oromia National Regional State rural land use and land administration policy N0130/2007.

Case studies...

- Evaluate the policies in terms of effects on:
 - Tenure security,
 - Investment in land improvement technologies,
 - Transferability of land and other fixed assets built on the land,
 - Access to finance collateralizing the fixed assets,
 - Mobility of people from rural to urban,
 - Farm sizes and land fragmentations
 - Agricultural productivity and rural transformation

Case studies...

- Proclamation N0130/2007 article 6
 - It states “selling of products of fixed assets like product of coffee, mango, avocado, papaya, orange etc. shall be possible if and only if the following conditions are fulfilled:”
 - a. The land occupied by the product to be sold shall not exceed half of the total land holding of the individual.
 - b. The product shall be sold for three (3) years only, after which the buyer should return the land to its original holder.
 - c. the rural land use right shall be terminated if the land is required for more important public uses.

Case studies...

- Proclamation N0130/2007 article 10 sub article 1 and 2 :
 - a. one can rent only half of his land holding and for the period of maximum of three years.
 - b. Rent agreement to be made in the presence of government representative in writing.

Criteria for efficiency...

- Proclamation N0130/2007 article 9 (1-2)
 - ✓ Farmlands whose holders are deceased and have' no heirs or are' gone for settlement or left the locality on own wish and stayed over a given period of time shall be distributed to others.
 - ✓ Land distribution may be undertaken on irrigable land in order to use irrigable land properly and equitably.

Mandatory reading

- De Soto H. (2000) *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else, Richmond: Black Swan*

A graphic of a spiral-bound notebook with a brown cover and a light beige page. The spiral binding is on the left side. A horizontal line is drawn across the page, just above the text.

THANK YOU

1/23/2019

Admassu Tesse (PhD)

24