

On the macroeconomic effects of establishing tradability in weak property rights*

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Abstract. The New Economy is closely associated with computing & communications technology, notably the Internet. We discuss property rights to, and trade in, the difficult-to-define intangible assets increasingly dominating the New Economy, and the possibility of under-investment in these assets. For a realistic analysis we introduce a Schumpeterian market environment (the *experimentally organized economy*). *Weak property rights* prevail when the rights to *access, use, and trade* in intangible assets cannot be fully exercised. The trade-off between the benefits of open access on the Internet, and the incentive effects of strengthened property rights, depend both on the particular strategy a firm employs to secure property rights, and the protection offered by law. *Economic* property rights can be strengthened if the originator can find innovative ways to charge for the intangible assets. The extreme complexity of the New Economy and the large number of possible innovative private contract arrangements make it more important to facilitate the use and enforcement of private individualized contracts to protect intellectual property than to rely only on standard patent and copyright law. *Enabling law* is one proposed solution. Current patent legislation in the US has led to costly litigation processes weakening the position of small firms and individuals in patent disputes. The property rights of such firms and individuals could be strengthened with insurance or arbitration procedures.

Key words: Competence bloc theory – Enabling law – Experimentally organized economy – New economy – Weak property rights – Tradability – Underinvestment

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I. Introduction

The existence of markets depends on the establishment of property rights. The reallocation of property rights through trade is central to the capacity of the economy to enhance economic welfare. Since at least Arrow (1962), we have had an academic debate on a presumed under-investment in knowledge and information assets with high social, relative to private, returns. Under-investment has been linked to a possible lack of incentives and badly-defined property rights (Kremer, 1997). Hence, the proper design of, and the support of, property rights should be a major concern of any central authority or Government. North and Thomas (1973) argue that not until a good institutional foundation (read legislation and conventions supporting property rights) had been laid in Western Europe did the industrial revolution begin, based on technology and knowledge that had accumulated during the previous centuries. Implicit in their argument was that nations that did not get their institutions right, could not benefit from the technology of the industrial revolution, despite a sufficient endowment of technology and production knowledge.

The evolving structures of the New Economy are, to an increasing extent, composed of digital abstractions of intangible assets with difficult-to-define property rights. Although the social value of these assets can be high, and may be enhanced by the Internet, the originators may not be able to charge a price for individuals' access to the assets. The Internet is a "double-edged sword": On the one hand, it enhances the social value of these assets, while on the other hand, it makes them increasingly accessible for potential users and, hence, difficult to charge for. The analysis of difficult-to-define property rights within endogenously-changing structures of intangible assets requires a dynamic, Schumpeterian-type model framework. To that end we introduce the Experimentally Organized Economy (Eliasson, 1992) populated by ignorant rather than fully, or marginally, uninformed actors.

The industrial policy debate has often focused on a presumed under-investment in knowledge creation due to a lack of incentives, notably in investments with a high social return. Incentives to do so are, in turn, closely related to the design and enforcement of property rights. Thus, for instance, investment rich in spillovers, but with a low private return, may not be made, even though the social return is very high, because the originator cannot appropriate the value of the spillovers privately (Eliasson, 2001b).

Property rights are more or less easily established depending on the type of assets. You can exercise your (property) right to an apple by holding it in your hand, and selling it to your neighbor who knows that it came from your garden. The (property) right to residential property and land is more complicated since it stretches over time. In the distant past this right was upheld by physical presence – living on the property and defending the lot with weapons. Today such property rights in civilized countries are enforced by elaborate registers and the legal system.

The difficulties of exercising property rights escalate with the degree of abstraction of the assets. The highly abstract rights in securities markets to the future profits from an investment commitment today took a long time to establish (Eliasson, 1993). In a very obvious way, the world political system was being overtaken during the last decade of the millennium by trading in financial abstractions (math-