

Economic Analysis of Property Rights

Third Edition

The standard neoclassical model of economics is incapable of explaining why one form of organization arises over another. It is a model where transaction costs are implicitly assumed to not exist; however, transaction costs are here defined as the costs of strengthening a given distribution of economic property rights, and they always exist. *Economic Analysis of Property Rights* is a study of how individuals organize resources to maximize the value of their economic rights over these resources. It offers a unified theoretical structure to deal with exchange, rights formation, and organization that traditional economic theory often ignores. It explains how transaction costs can be reduced through reorganization and, in the end, how the distribution of property rights that exists is the one that maximizes wealth net of these transaction costs. This necessary hypothesis explains much of the puzzling organizations and institutions that exist now and have existed in the past.

Yoram Barzel (1931–2022) was Professor Emeritus of the University of Washington. He published extensively and helped create the field of economic property rights. He published *A Theory of the State* (Cambridge, 2002), was president of the Western Economic Association in 2001, and winner of the Elinor Ostrom Lifetime Achievement Award in 2017.

Douglas W. Allen is Burnaby Mountain Professor of Economics, Simon Fraser University, British Columbia. He has contributed to the theory of transaction costs and property rights in over ninety publications. His books include *The Institutional Revolution* (Chicago, 2012) which won the Douglass North 2014 book prize.

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Preface to the Third Edition

When I wrote the first edition of *Economic Analysis of Property Rights* in the mid-1980s, I was Douglas Allen's PhD supervisor. He had been taught as an undergraduate by another former student – Chris Hall – and had arrived in Seattle already well versed in the University of Washington School of Property Rights thought. We met in the spring of 1985 after I returned from a sabbatical in Israel, and we have been friends, colleagues, and co-authors ever since.

Doug was heavily involved (and thanked) in the first edition of the book. He read every page and critically commented on my ideas. At the time he was formulating his own ideas on transaction costs, and his 1988 thesis explicitly linked these costs with the concept of property rights for the first time (later published in Allen, 1991a). He has gone on to publish over ninety articles utilizing the economic property rights approach, and he has published two significant books demonstrating how operational it is: *The Nature of the Firm* (with my former student Dean Lueck) and *The Institutional Revolution* (which won the Douglass North prize).

It was only natural, then, that I would ask Doug to help with a third edition of the book. I asked ten years ago, but it took some time for him to relent. The result is a significant change from the second edition. The book has doubled in size and so the number of chapters. Much of this additional material is up front, where we now spend five chapters developing the fundamental ideas behind an economic analysis of property rights. Every chapter has new material, and there is a new chapter on the relationship between property rights and institutions.

One thing that has not changed is the target audience. Like the first two editions, there has been an attempt to “appeal both to those with little training in economics and to specialists.” For students in both economics and related fields, the mostly verbal text should allow easy access. For those well versed in institutional economics, the detailed discussion of fundamental property

right ideas and the linkage of these ideas to the concepts of organizations and institutions should also provide some utility.

We would like to thank Lee Alston, David Friedman, Jonathan Greenacre, Avner Greif, D. Bruce Johnsen, Ennio Piano, and last (but never least) John Wallis for all of their comments. We might not always agree, but everyone helped us in articulating our own ideas better. Special thanks are due to Aurora Stephany (MA, Economics, University of Washington) for her extensive discussions with Barzel on the theory of information and the marriage contract.

Preface to the Second Edition

Since the publication of the first edition of this book, I have continued to conduct research regarding economic organization and political economy. This work is reflected primarily in Chapters 5 and 6 of the current edition. I have also separated the discussion of divided ownership from that of the firm. The former now occupies Chapter 4, whereas in Chapter 5, I offer new thoughts on the latter. In Chapter 6, I briefly speculate on the emergence of property rights and the state.

Teaching property rights courses over the last few years has led me to discover in the first edition some errors, many ambiguities, and several instances that call for elaboration. I have attempted to correct the mistakes, clarify the exposition, and elaborate when necessary. I have also added a number of illustrations, some of which derive from new research on property rights.

I wish to thank Dean Lueck, who read the entire manuscript, for his helpful comments; my daughter Tamar, for enlivening the presentation and protecting the English language; and the Earhart Foundation for its generous financial support.

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Preface to the First Edition

The intellectual content of “property rights,” a term that has enchanted and occasionally mesmerized economists, seems to lie within the jurisdiction of the legal profession. Consistent with their imperialist tendencies, however, economists have also attempted to appropriate it. Both disciplines can justify their claims, since the term is given different meanings on different occasions. Perhaps economists should initially have coined a term distinct from the one used for legal purposes, but by now the cost of doing so is too high. I attempt, however, to make clear the meaning I give to “property rights” and to demonstrate why property rights so defined are an appropriate subject for economic analysis.

The material of the book is at the heart of a course I have taught in recent years. Undergraduate students take my approach in stride. Graduate students often vigorously resist my dissatisfaction with the zero transaction costs model; converting them is, however, rewarding. This book is influenced by the diverse classroom reactions. It is an attempt to appeal both to those with little training in economics and to specialists.

I am grateful to my former students Douglas Allen and Dean Lueck and to my colleague Paul Heyne, who read early drafts of the book and forced me to reformulate many of my ideas and to clarify their presentation. Douglass North, who supported the project from its infancy, also read the entire manuscript and made numerous valuable suggestions. Victor Goldberg and Levis Kochin provided useful comments as well. I also thank Elizabeth Case and my daughter Tamar for excellent editing; they demonstrated that clear writing enhances clear thinking. Finally, I wish to thank the Earhart Foundation for financial support.

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