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The Allocation and Exchange of Property Rights as a Way to Understand Comparative Economic Systems and Managerial Economics

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Abstract
The allocation of property rights to individuals, to government, or to interest groups effectively determines an economic system. Property rights entail control of asset use, claim on the income from assets, and transferability. Economic systems (e.g., capitalism, socialism) are characterized by who holds these rights, which in turn determines the success or failure of an economy. A related analysis applies to understanding business organizations (e.g., corporations and franchises). Each involves a (voluntary) division of property rights and each has benefits and costs. Several examples are discussed that illustrate the importance of private ownership of property rights, where parties may trade and divide them.

JEL Codes: P51, P14, M2
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I. Introduction

This paper analyzes comparative economic systems and managerial economics with a unifying theme of the allocation and exchange of property rights. It is argued that all economic systems (capitalism, socialism, and so on) are understood as different ways in which three basic aspects of property rights are allocated. Additionally, I discuss how the allocation of the same three aspects of property rights sits at the core of much of managerial economics.

Section 2 describes the three aspects of property rights: control over the use of assets, claim on the net income (or enjoyment) from the assets, and transferability (alienability) of the previous two. Section 3 examines a number of economic systems and shows how

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each is described by the manner in which property rights are allocated. So, for example, in a capitalist system, each of the aspects of property rights is held predominantly by individuals (or their designees). With socialism, these rights are largely held by the government. In welfare states, such as those in the Scandinavian countries, these rights are divided: the government (through taxation) holds much of the rights to income.

In part A of section 4, the importance of the private ownership of property is discussed, with a focus on how it enables the unification of decision-making rights regarding how assets are used on one hand, with incentives and relevant knowledge on the other. Though I do not discuss how or why different economic systems emerge, the analysis provides a unifying way of analyzing such systems.[1]

Part B of section 4 works through a number of examples of how private owners may divide the three aspects of property rights. Examples include sole proprietorships, corporations, franchising, and employee compensation. Each organizational form divides property rights differently, and the nature of the division characterizes the organization. Each has its benefits and costs and, in a competitive market, those that are most efficient survive and thrive. The survival of efficient organizational forms further illustrates the importance of private ownership of each aspect of property rights, along with competition among different styles of organization.

Section 5 concludes. It is noteworthy that capitalism is the only system that allocates property rights predominantly to individuals. A commonality of all other systems is that they remove property rights from individuals in significant ways and award them to the government, to government-aligned entities, or to heavy influencers of government.

II. What Are Property Rights?

The terms "property rights" and "ownership" are often used interchangeably and are closely linked. Ownership of a good or asset–

[1] There is substantial literature regarding how economic systems and the allocation of property rights arise. See Salter (2016) for recent work, as well as the references cited therein. Also, for a recent empirical work concerning this issue, see Lipford and Yandle (2015).

whether the asset is tangible or intangible–consists of three rights, equivalent to property rights:[2]

1. Control over use of the good or asset. Owners decide how assets are deployed. It is implicit that each owner's deployment does not interfere with another owner's. Otherwise, one's deployment partly determines another's, in contradiction to this aspect of ownership.

2. Claim on the residual income (e.g., net income) from an asset or the enjoyment from use of the asset. Owners have claim on the net income from the asset or may enjoy its use.

3. Transferability (alienability) of the above two rights. Owners may sell the rights of control and of residual claims. They may divide each of them into parts and/or divide them from one another. Also, transferability itself may be retained or sold by owners.

Thus, to say that you "own" an asset is to say that you control how it is used, have claim on income it produces and/or nonpecuniary enjoyment from the asset, and may sell either of these two claims. To illustrate how these rights may be sold or divided, consider these examples in the familiar context of individual ownership of these rights.

Example 1: Owners of firms sell common stock. This is the sale of residual income claims (right 2) with very little, if any, control rights (right 1). Managers retain most control rights. If the stock is traded on an exchange, stockholders have transferability of right 2.

Example 2: Investors who make large loans to a small firm may also require that they be awarded some decision-making power in the firms they invest in. Thus, some control rights are transferred, but not residual claims, since debt requires a fixed payment, not a share of the net residual income.

Example 3: In privately held corporations, those who become owners gain some control rights and residual claims, but the purchase agreement may restrict reselling these rights. Thus, transferability is restricted, and even though rights 1 through 3 are in private hands, they may be voluntarily separated.

There are various reasons why organizations divide ownership in various ways, and some of the basics are discussed below.[3]

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[2] These aspects of property rights are discussed in several places in the literature. See, for example, Alchian (n.d.), Alchian and Allen (1969), and Blair (1995).

[3] Regarding rights of control, Grossman and Hart (1986) make a noteworthy distinction between contractual rights and residual rights. The latter are

The same basic ideas apply to human resources, though there are some differences. Buyers of labor services essentially rent the skill sets and brainpower from the workers in question for a specified time and rate. In many employment settings, employees cede the right to direct their deployment to employers, within certain bounds. Employees sometimes contract for part of the residual claims from the use of their services, though they often do not. For example, there may be profit sharing, commissions, and piece work. Human assets are not directly bought and sold, but there is transferability. By quitting and taking another job, a worker transfers from one employer to another the control and residual claims due to the worker's skills.

A firm that raids another's employees accomplishes the same thing. If one firm acquires another, the control rights and residual claims from extant human resources are transferred to the acquiring firm.

Also, workers may decide to be self-employed and direct their own efforts and retain residual claims. Thus, even with labor services, there is a substantial aspect of transferability.

III. The Division of Property Rights Defines Economic Systems

All economic systems allocate rights one through three in various ways. Each is characterized by the way these rights are allocated. Here, a number of leading examples are discussed.

A. Capitalism

Under capitalism, rights one through three are privately held. A single individual may hold all three or they may be contractually divided among multiple private parties. However, they remain privately held.

It is difficult to have 100 percent private ownership. With capitalism, the establishment and enforcement of the above rights requires property and contract law that are understood and largely accepted by parties. The first—property law—determines an accepted set of rules about which private party owns what. The second—contract law—guides how private transfers and trades are made. Many advocates of a capitalist economy indicate that establishing property and contract is the role of government.

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noncontractible control rights. Both refer to the same element of ownership, though.

Naturally, some level of taxation and government expenditure is required for a government to undertake these functions. Taxation makes a claim on the income from assets, both human and nonhuman. Thus, even a capitalist system does not allocate all of right two (residual claims) to individuals.

There are situations where property rights are difficult to define, enforce, and trade.[4] A typical example is environmental pollution. Failing to resolve this with use of property rights generates externalities. In this setting, governments might step in to control use of pollution-generating assets even in a largely capitalist economy.

A strong form of capitalism is that rights one through three are presumed to be held by individuals and removed from individuals only in special circumstances, such as in the example of environmental pollution or in the cases of theft, violence, or fraud. In the latter cases, individuals engaging in those acts violate the property rights of others, so might be punished by fines or imprisonment. These entail loss of individual residual claimancy and control rights. However, in the strong form of capitalism, government is empowered to do this only if there is demonstrable violation of another's rights.

A weak form of capitalism is the presumption that rights one through three may be awarded to individuals with permission from government and the government, in turn, allows individuals to hold these rights. This is a weak form of capitalism since the power to remove rights one through three fundamentally gives government underlying control of those rights.

Political economy and public choice considerations determine whether government has the limited powers in the strong form of capitalism or the greater powers of the weak form and, in the latter case, how those powers are exercised.

B. Socialism

Under socialism, rights one through three are held by a central authority: "the government." This authority determines how assets are used, who has claim on production and use, and how these may be transferred across individuals.

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[4] Demsetz (1967) indicates that property and contract law will emerge only if the resources in question are scarce enough that their value exceeds the cost of establishing and enforcing relevant law. Thus, for some goods, ownership may be ill-defined even in a capitalist setting.

Socialism is the polar opposite case of capitalism. Here, individuals hold none of the three rights; the government holds them all. This system entails some form of central planning of output, the distribution of goods and services, the allocation of resource inputs, and of prices, wages, and incomes.

Just as 100 percent individual ownership is not achievable, nor is 100 percent government ownership. Governments cannot feasibly control all uses of assets. For example, equipment and land might be surreptitiously utilized by farmers and manufacturers for personal use. Human capital can be privately directed by neglecting official duties and working for other purposes.[5] Also, black markets may emerge where individuals determine trades and income claims.

Socialism can take various forms. Authoritarian socialism is where the government holds rights one through three with absolute power. Communism is where private ownership is abolished and ownership is awarded to a specific collective entity: the proletariat. Whatever form of government that emerges from "the proletariat" holds rights one through three. It is thought that socialism can emerge from a democratic/majoritarian process as well; i.e., democratic socialism.[6] This presumably occurs where a pluralistic voting process opts for government ownership of rights one through three. Of course, there is no guarantee that a pluralistic voting process would support socialism. Also, in each of these, the specific political and economic forces at play determine what form of socialism (or other economic system) occurs.

In practice, socialist governments limit their ownership to the "commanding heights" (key major industries) of an economy. This is due to the difficulty a central authority would have in controlling the vast number of goods and transactions of any large economy. Thus, some measure of private ownership is allowed for assets and transactions outside the commanding heights.

Another version of socialism is "market socialism," where firms are state owned, but government planners are supposed to set prices to clear markets and consumers are allowed make purchases as they wish.[7] Thus, there is a degree of private ownership regarding transferability (buying and selling) of final consumer goods.

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[5] The issue of diverting asset use away from that desired by the owner is a problem confronted by capitalist owners as well. It is an issue of enforcing property and contract rights and pervades all transactions, regardless of the economic system.

[6] This differs from "social democracy," which is discussed below.

[7] This is the Lange model. For an overview of it, see Gregory and Stuart (2014).

C. Fascism

Under fascism, rights one through three are held by a ruling group of major entities in the economy and society: the government, big business associations, and major labor unions. Decisions are made by this group, though the government has final approval.

Decision-making authority is awarded to industrial associations and labor unions regarding production, prices, and wages. Thus, use of assets and income claimancy are determined by these groups, and so it seems that private parties hold property rights. However, this is largely an illusion. One reason is that decisions must be approved by the government. Thus, fundamentally, the government controls production, prices, and wages and so indirectly holds rights one through three. The government may approve the business associations' and unions' plans and allow private decision makers to get their way, giving the appearance of private ownership. However, the government's power to negate those decisions means that government holds the rights. This is a case where the presumption is that the rights are held by the government, but they may be granted to others.

There is a second reason why this system is illusory private ownership. Even if the government allows private associations and unions to implement their plans, this allowance does not enable general private holding of rights. For example, if an entrepreneur wishes to use assets to enter a market and produce a good or service, the government prevents this activity since it does not follow the approved plan. Similarly, the government thwarts attempts by companies to cut prices or by workers to accept lower wages. Thus, individuals are not allowed to control the use of their assets nor to gain income for those uses. The private holding of rights is not upheld generally. In effect, the ruling group, and not individuals or their assignees, holds rights one through three.

D. The Welfare State

The welfare state is characterized by very high levels of taxation that support very high levels of subsidization of certain goods, typically food, housing, education, medical care, and leisure. Private control of assets is largely retained, as is transferability. However, claims on net income are deeply abrogated due to high levels of taxation.

While rights one and three largely remain in place, the attenuation of right two—residual income claimancy—removes a great deal of the incentive to effectively create and deploy assets (e.g., to invest and work), as well as to seek out value-increasing asset transfers. If income claimancy is eroded enough, there is little to be gained by efficiently exercising rights one and three. This scenario is often blamed for the persistent low economic growth of many European countries that approximate the welfare state.

Sweden, and a host of other countries, have adopted welfare state-like economies and one often hears the question, "Is Sweden socialist?" The above analysis implies that the answer is no since rights one and three are still largely in private hands. However, it is clear that Sweden—and countries with similar economic systems—removes a great deal of the right to residual income claims from individuals and awards it to government.

The term "social democracy" is often used almost synonymously with the term "welfare state." However, many modern definitions of social democracy indicate that the term also entails a good deal of regulation of the private sector.[8] This involves government activity beyond enforcement of privately held rights and private contracts. It potentially includes government control or influence over pricing, employment, wages, production, and entry into markets. These latter items pertain to how assets are used and transferred. Thus, as the scope of government regulation grows and deepens in these respects, it becomes more and more like government ownership of rights one and three, i.e., socialism.

E. Interventionism

Interventionism is a term coined by Ludwig von Mises ([1952] 2008) that is little used but captures a good deal of government activity. It refers to a host of partial and piecemeal government controls over markets, firms, workers, and consumers. These include entry barriers, wage and price controls, limits on profits, interest rate restrictions, regulations, taxes, subsidies, tariffs, and quotas. Each represents moving some aspects of rights one through three from individuals to government.

Consider the case of barriers to entry into markets, which prevent potential entrants from deploying their assets to serve certain markets. Thus, some individual control of asset use is lost. Wage, price, and interest-rate controls disallow some private transactions to transfer assets or goods, and thus remove parts of transfer rights

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[8] See, for example, Encyclopedia Britannica's entry for social democracy. Also, there is a political dimension to modern definitions: a pluralistic voting process to select political leaders.

from individuals. Regulations typically impinge on individual rights to use assets and to engage in trades or transfers. Profit and price limitations reduce individual income claimancy. Tariffs and quotas limit individual rights to trade or transfer assets with foreign parties. The effects of these policies and other government interventions have been fruitfully analyzed, but the point is that each entails altering the allocation of rights one through three in specific markets and settings.

F. Cronyism

The term "cronyism" is often not carefully defined. Essentially, though, it refers to the case where a select group of government "cronies" has control or influence regarding the determination of rights one through three.

Holcombe (2013) defines cronyism as an economic system in which the profitability of business depends on political connections.[9] Aligica and Tarko (2014, 2015) define cronyism as the combination of rent seeking, populism, and use of personal relationships with government officials. These definitions are consistent with "cronies" having control or influence regarding rights one through three.

An extreme form of cronyism is the fascist economic model, where big businesses and large labor unions have a dominant influence over production, distribution, prices, and wages. Though government must approve these plans, rights one through three are not held by individuals, but by the "cronies" and the government.

Less-extreme forms of cronyism are cases where cronies have a strong influence over specific government policies. This includes the case of powerful special-interest groups that influence the host of government polices noted under interventionism, such as entry barriers, favorable regulation, taxes, subsidies, and so on. Cronies have, indirectly, a degree of control over these policies. Thus, they gain rights one through three in partial and piecemeal ways. Those who are not cronies partially lose these rights.

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[9] Holcombe and Castillo (2013) argue that all economic systems that do not embed property rights with individuals essentially become crony systems. Such systems, whether socialism, communism, fascism, or any other, entail political influence to acquire and use resources. Also see Holcombe (2013).

G. The Chinese Economy

There is no convenient term to denote the current economic system in China.[10] It seems to be an amalgam of the above systems. Many major industries have a good deal of state ownership. However, these industries seem to experience substantial influence from private parties and investors and thus have similarities to the fascist and cronyist economic systems. Other economic sectors in China experience a good deal more private control, residual claimancy, and transferability, though there are also many regulations. Thus, outside major industries, China has mixture of capitalism and interventionism.

There are other economic systems one might consider, as well as hybrids of the above. In each case, which system emerges depends on political economy and public choice considerations in each particular setting.[11] This paper does not explain which system occurs where. But regardless of the system, it can be characterized by which parties hold rights one through three. Capitalism is the only system where individuals hold these rights. A unifying theme of all others systems is that, to one degree or another, these rights are attained by a ruling or politically influential group.

IV. Property Rights and Economic and Business Organization Success

A great deal has been written about the success or failure of economic systems and of individual organizations. Part A of this section reviews some underlying principles to understand these, illustrating the importance of property rights and the success or failure of economic systems. Part B provides several examples to show how the private allocation of the above three rights is often the key to a business's success.

A. Property Rights and Economic System Success

Regarding economic organization, Hayek (1945) emphasized the importance of combining decision rights over the use of assets with knowledge of the situation. He noted that a great deal of knowledge

[10] Aligica and Tarko (2012) define "state capitalism" as the state being the leading economic actor and using markets for political gain. This term perhaps fits the Chinese economy.

[11] A related and intermingled issue is the how the political system emerges, e.g., authoritarian rule or majority driven.

is embedded in particular circumstances and is not easily transmitted to third parties. Thus, in order to utilize the relevant knowledge to allocate assets efficiently, decision making must be devolved or decentralized to those "on the spot." This is Hayek's essential argument as to why government central planning results in poor outcomes: the central planners making the decisions cannot obtain a great deal of the relevant information.

This line of argument is expanded on by Jensen and Meckling (1992), who incorporate the importance of incentives. They argue that decision rights, incentives, and knowledge are ideally united (or co-located, to use their term) in order to attain efficient asset use. The basic idea is that if those who decide how assets are used also have the relevant knowledge and the appropriate incentives, then assets are likely to be used efficiently.

Jensen and Meckling (1992) indicate that markets tend to unite decision rights, incentives, and relevant knowledge; note the close relationship to property rights one through three. Decision rights regarding how assets are used is right one. Transferability (right three) entails that those who are the most knowledgeable about specific markets can acquire the assets that they are knowledgeable about. Residual claims (right two) provide the incentive to do these in value-increasing ways.

This illustrates a further contrast with centrally planned economies. Central planners typically have neither the knowledge of particular circumstances about how assets should be used nor the incentives to allocate them effectively. These are the essential reasons why market economies outperform centrally planned ones.[12] Moreover, the same logic applies to situations where control of rights one through three is removed from private parties on a piecemeal basis, such as with entry restrictions, price controls, taxes, and subsidies. The end result is poorer economic performance in those markets.

Though markets tend to unite decision-making authority, knowledge, and incentives, they also allow private parties to divide them. This division is accomplished by using right three (rights to

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[12] This has been studied a great deal. For example, see O'Driscoll and Hoskins (2003) and Williamson (2017) on the importance of good private property rights for economic development. Also, private property rights are an important element of economic freedom indices, and the latter has been shown to be important for economic prosperity. See, for example, Gwartney et al. (2018) and Bennett et al. (2016).

transfer) to engage in exchanges of rights one and two. Though there are strong forces to unite ownership of rights one through three—thereby uniting decision rights, incentives, and knowledge—private ownership also enables them to separate. An important and interesting issue is why private parties would separate these rights.

B. Organizational Form and Dividing Property Rights

Jensen and Meckling (1992) and Fama and Jensen (1983a, 1983b) discuss conditions under which separation or division of decision rights from incentives and/or knowledge might occur. This implies dividing rights one through three. There are various ways to do this and the manner in which it is done often implicitly describes different organizational forms. Some work well in certain circumstances and others in different circumstances. Those organizational forms that work well provide the good or service in question at lower cost and/or provide something of higher value to the consumer. In a competitive world, these organizations will outcompete organizational forms that do a lesser job in these respects. Thus, the benefits of dividing rights one through three must outweigh the costs in specific situations. Otherwise, firms that did so would not survive.

This implies that a key to good management—and to long-term survival in a competitive marketplace—is selecting the appropriate organizational form that suits the particular situation. Indeed, if management fails to do so, the competitive process will implicitly do so by replacing inefficient firms with efficient ones. Below are discussions of several examples of organizational forms, how they divide rights one through three, and why they may be efficient in certain circumstances.

1. Sole Proprietorships

In a sole proprietorship, rights one through three are held by a single individual. Clearly, this arrangement unites decision rights and incentives. Those with the most relevant knowledge about a market setting have strong incentives to acquire the decision rights and residual claims of assets they are most knowledgeable about. Small, private partnerships are similar to sole proprietorships except that rights one through three are held by a small group of individuals.

2. Corporations

Consider the large, publicly traded corporation. Decision rights over the use of assets are (mostly) separated from claims on residual income. Managers of big corporations hold most of the decision rights, and stockholders hold most of the residual claims This division of rights separates, to a significant degree, decision rights from incentives. Managers who deploy assets have the everyday knowledge of the companies they manage, but do not feel most of the effects of their decisions.[13] Their decisions affect the stock price, and it is mostly the stockholders who enjoy the benefits or bear the costs of changes in the stock price caused by managers. Thus, manager incentives are abated and agency costs are incurred.[14]

This has been recognized for a long time, and its modern analysis was launched by Jensen and Meckling (1976). They point out that there must be a reason for diluting the incentives of managers. The dilution incurs agency costs, so there must be more-than-offsetting benefits. There are several possibilities. For example, if a lot of capital is required for efficiency, one can draw upon many people as shareholders who have funds to invest but no expertise in management of the firm in question. Those with expertise but limited funds can remain as managers. Thus, it may be worthwhile to incur some agency costs of the large corporate form if the greater efficiency from the additional capital is more than offsetting.

A successful business will adopt the corporate form if this greater efficiency outweighs the agency costs and will not if it doesn't. A competitive economy with privately held property rights thus incentivizes finding the most efficient business form.

As an aside, consider the phrase "the separation of ownership and control" that is often used to describe large corporations. This description is misleading. Control is an aspect of ownership and is not distinct from it. Those who use this phrase are really referring to the separation of residual claims from control of asset use. The key questions in this literature are: (1) whether the benefit of separating the two is worth the cost, and (2) whether private parties are enabled to make those calls, which are then put to the market test. Under a capitalist system, private parties are enabled to make those calls and are incentivized to make decisions where the benefits exceed the costs.

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[13] Managers feel some of the effects of their actions if they retain some stock ownership, but far less than 100 percent since outsiders own most of the stock.

[14] A substantial literature analyzes practices that might limit these agency costs or restore manager incentives. These practices include manager performance bonuses, boards of directors to monitor managers, and corporate takeovers. For discussion, see Fama and Jensen (1983b).

3. Franchises

Franchising is another case where rights one through three are divided. Franchisees typically get a substantial share, but not all, of the residual income from the franchise unit. Franchisees have decision rights over some things (e.g., personnel, day-to-day operations), but the franchisor has control over others (e.g., equipment, business routine, branding). Franchisees may transfer their rights by selling the franchise, though typically only with approval by the franchisor.

This division or separation of rights generates benefits as well as costs. Granting decision rights to franchisees over day-to-operations makes sense, since they have the necessary everyday operational knowledge. Similarly, franchisors likely have the relevant knowledge of brand building and the business routine and so have decision authority in those respects. Thus, parties have decision rights over things that they know best, which unites knowledge and decision authority.

But how can one unify incentives with knowledge and decision rights? An important way to incentivize franchisees is to allow them to keep a large share of the net income of the franchise unit they operate.[15] However, a large share for franchisees means a lower share for the franchisor, thereby abating the latter's incentives. Ultimately, the division of net income depends on which party's incentives are most important, as well as other factors.[16]

The overarching point, however, is the following. Franchising is a system of transferring some degree of claim on net income and some decision rights to franchisees, with the franchisor retaining some. In a competitive setting, businesses that adopt this organizational form will succeed only if it is more efficient than the alternatives. Private ownership of the three aspects of property rights one through three enables businesses to select this or other organizational forms.

F. Workplace Organization and Compensation

Employee work routines and methods of compensation may differ greatly. For example, offsite sales personnel are often compensated by commissions and allowed set their own hours. In this setting, they likely have the best knowledge of how to make sales, know the best work routines to follow, and are rewarded for successfully acting on

15 Rubin (1978) was the first to analyze franchising in the context of the provision of incentives.

16 For empirical evidence in this regard, see Wimmer and Garen (1997).

their knowledge. Knowledge, decision rights (to some degree), and incentives are united.

However, there are employees for which such a uniting of incentives is not feasible. Consider the office clerical staff. They are usually paid by salary or by the hour because it is usually difficult to develop good, direct incentives. Do you reward keystrokes typed on memos and letters, number of calls taken, or similar criteria? These are problematic since they measure only the quantity and not the quality or value of the work done. Thus, direct incentives do not work.

Since there are no strong incentives, it is not sensible to award decision rights to employees over their hours, work routine, and equipment use. The costs of awarding decision rights to clerical staff exceed the benefits because they cannot be properly incentivized. The inability to unify incentives with knowledge implies that decision rights are held by another party. The same ideas apply in other job settings.[17]

An organization will achieve greater success if it is able to determine the appropriate decision authority and incentives for its employees. This is, in effect, transferring property rights in an efficient way. Competitive markets with private ownership of rights one through three enable and incentivize this transfer. The successful organization finds the compensation methods, work routines, and employee decision authority where the benefit exceeds the costs.

There are numerous other examples of business practices that involve dividing or uniting decision rights, incentives, and knowledge. Examples include establishing exclusive territories for retailers, use of resale price maintenance, use of joint ventures, financial cooperatives, and nonprofit organizations. This paper does not attempt to analyze each of these, but in each, the above ideas apply.[18] There are costs and benefits of uniting or dividing decision rights, knowledge, and incentives. Privately held rights in a competitive setting induce organizations to choose those for which the benefits exceed the costs.

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[17] See Holmstrom and Milgrom (1994) for a theoretical presentation of these ideas and Garen (2004) for related empirical work.

[18] For excellent discussions of these and related business practices, see Rubin (1990) and Fama and Jensen (1983a).

V. Conclusion

The analysis of property rights has proven to be an extremely fruitful approach to understanding a great deal about economic systems and business organizations. This paper reiterates the meaning of property rights and ownership—entailing control of use, claim on residual income, and transferability—and illustrates how it is a unifying theme that defines economic systems. How property rights are allocated to individuals, to government, or to selected interest groups—in whole or in part—essentially defines an economic system. Indeed, capitalism, socialism, and the host of hybrids between those two can be characterized by who holds these rights. Moreover, as emphasized by many authors, the allocation of property rights to private individuals versus government is a key to economic prosperity or lack thereof.

A related analysis applies the same reasoning to business organizations. This paper illustrates how various business practices unify or separate decision rights, incentives, and knowledge and that this unification or separation is determined by the allocation of property rights to different individuals. Each allocation has different benefits and costs and so is important in determining the success of an organization. Competitive markets ferret out business practices that do not pass the benefit/cost test. Thus, competition and private ownership of property, where owners are enabled to divide ownership, are keys to business success, which ultimately translates into success for the economic system.

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