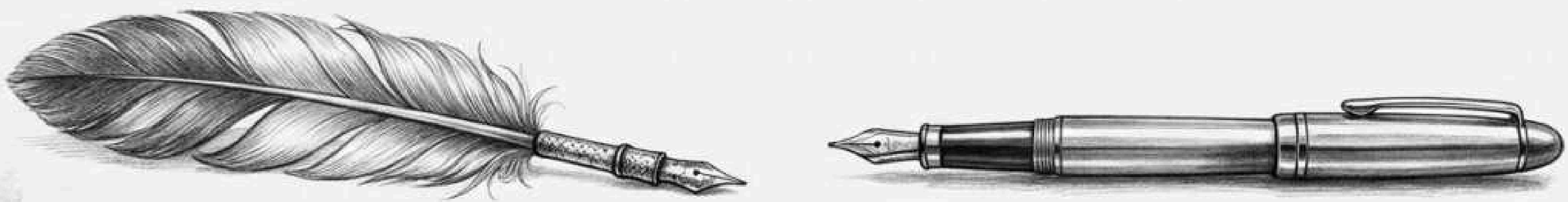
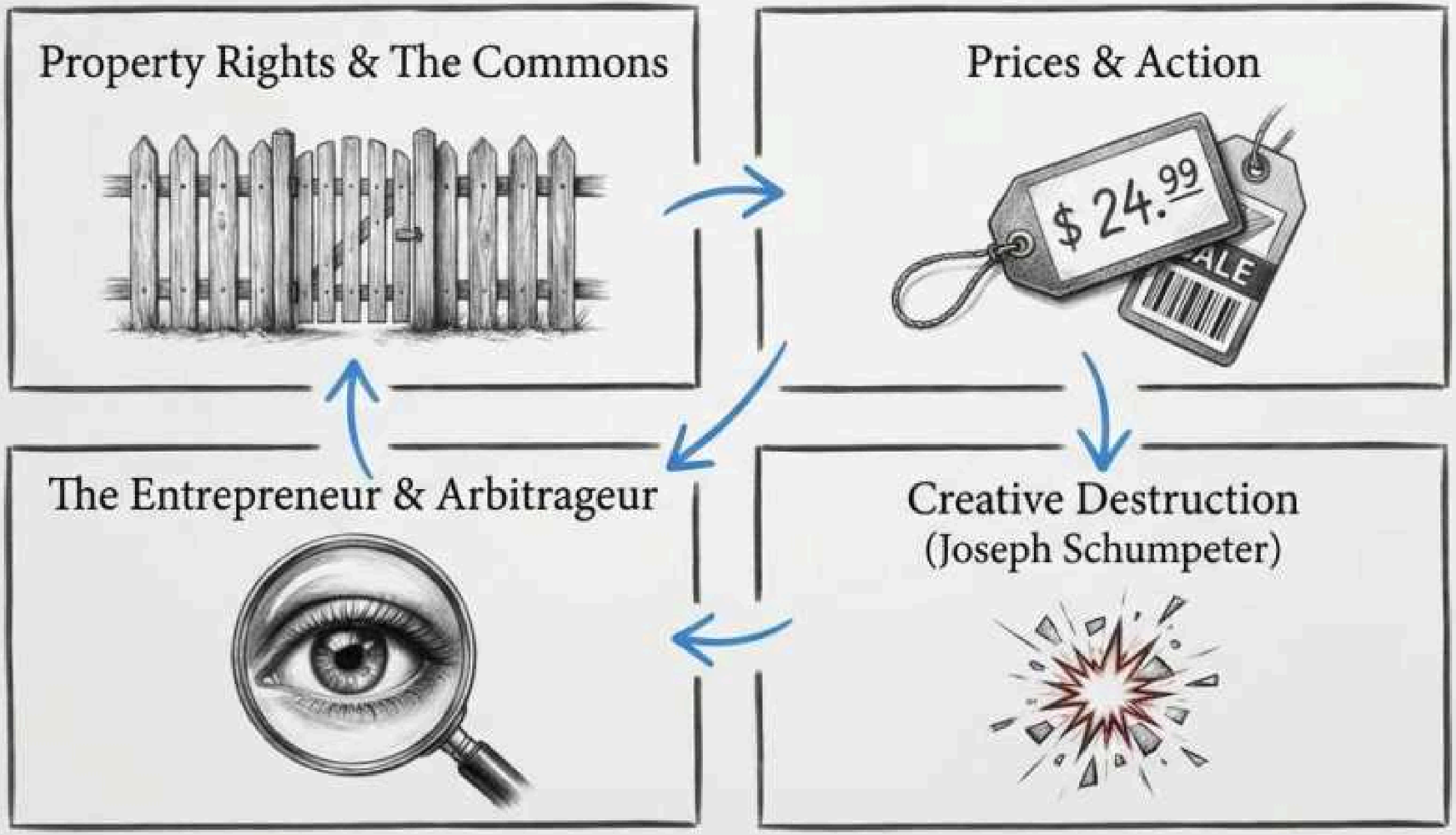
# ECON 110 B: Lecture 3
# Property, Profit, and Entrepreneurs



# The Conditions and The People




**"Prices tell people what to do, but someone has to act."**

# Defining Property Rights



Property Right =
(Right to Use)
+ (Right to Earn)
+ (Right to Sell)

Mara's Orchard (Millbrook): Secure ownership = Incentive to plant for an 8-year yield.

# The Millbrook Lake Experiment

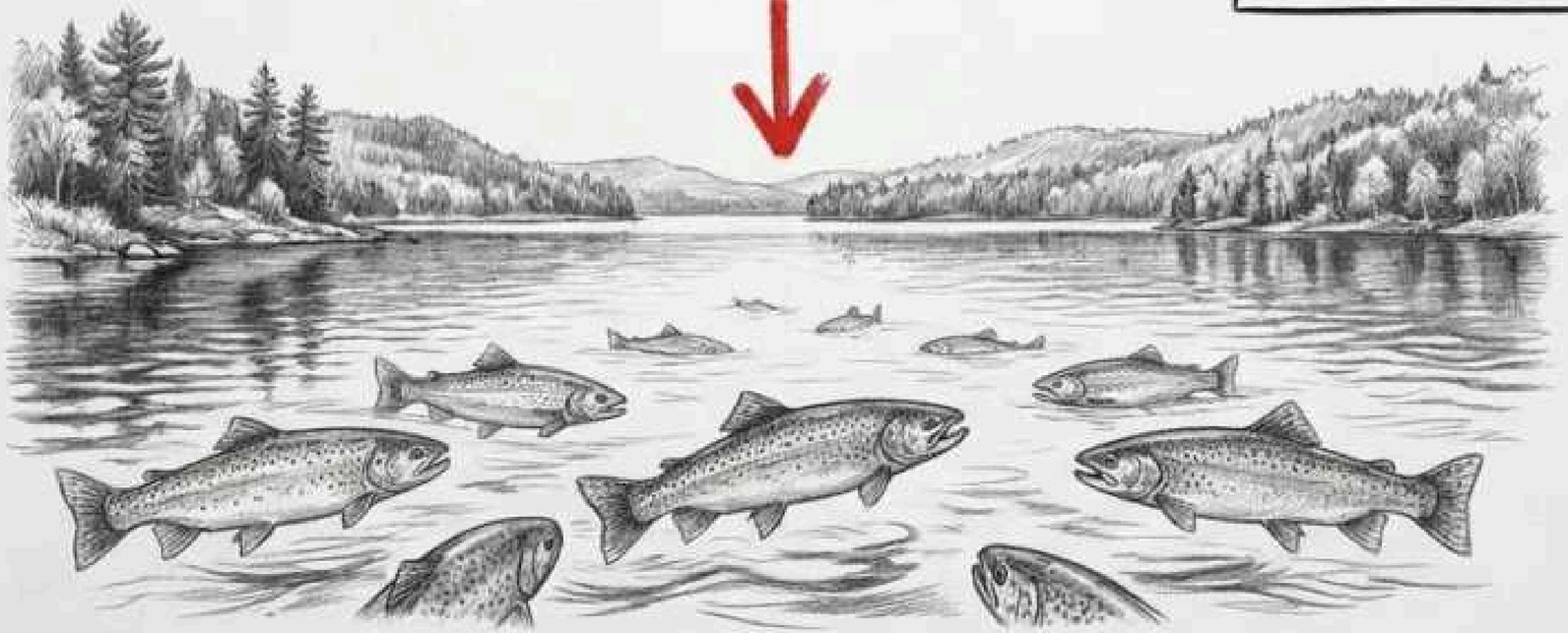


Sustainable Capacity = 100 fish/day

Actual Catch: 10 fishers x 15 fish = 150 fish/day

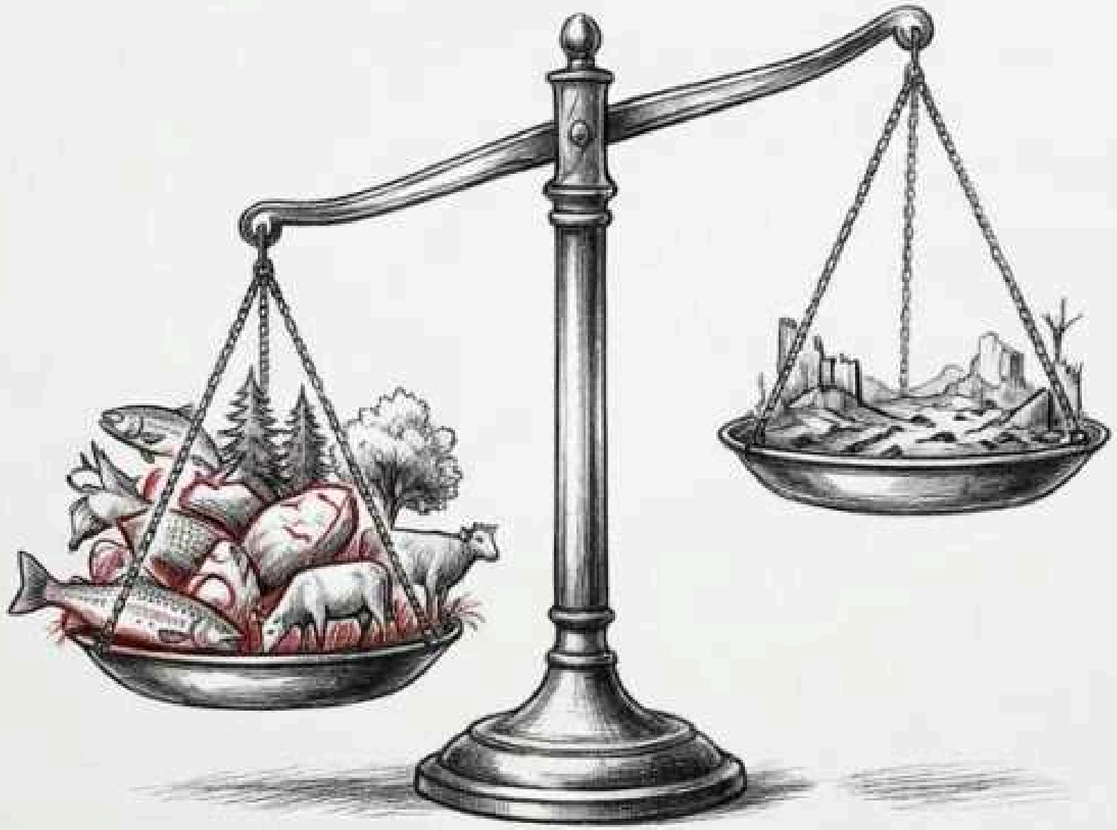
150 > 100

Full value of an extra fish goes to the individual; damage is shared by all ten.



# The Tragedy of the Commons
## (Garrett Hardin, 1968)

Individual Incentive: +1 (Takes more)



Group Outcome: Resource ruin

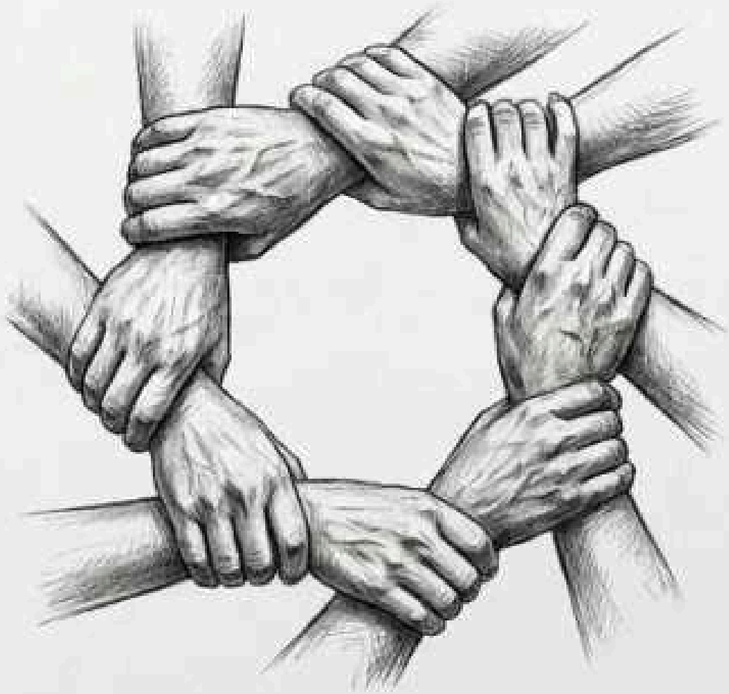
Missing property rights → Unowned resource → Rational individual overuse → Collective ruin

# Three Solutions to the Tragedy

| Private Ownership | Quotas | Community Rules |
| --- | --- | --- |
| Divide lake into 10 plots. Owners protect their own fish. | Limit 10 fish per fisher = 100 total. (Iceland's tradable fishing quotas) | Successful local management. (Elinor Ostrom) |





# Property Rights for the Poor
## (Hernando de Soto, Peru)

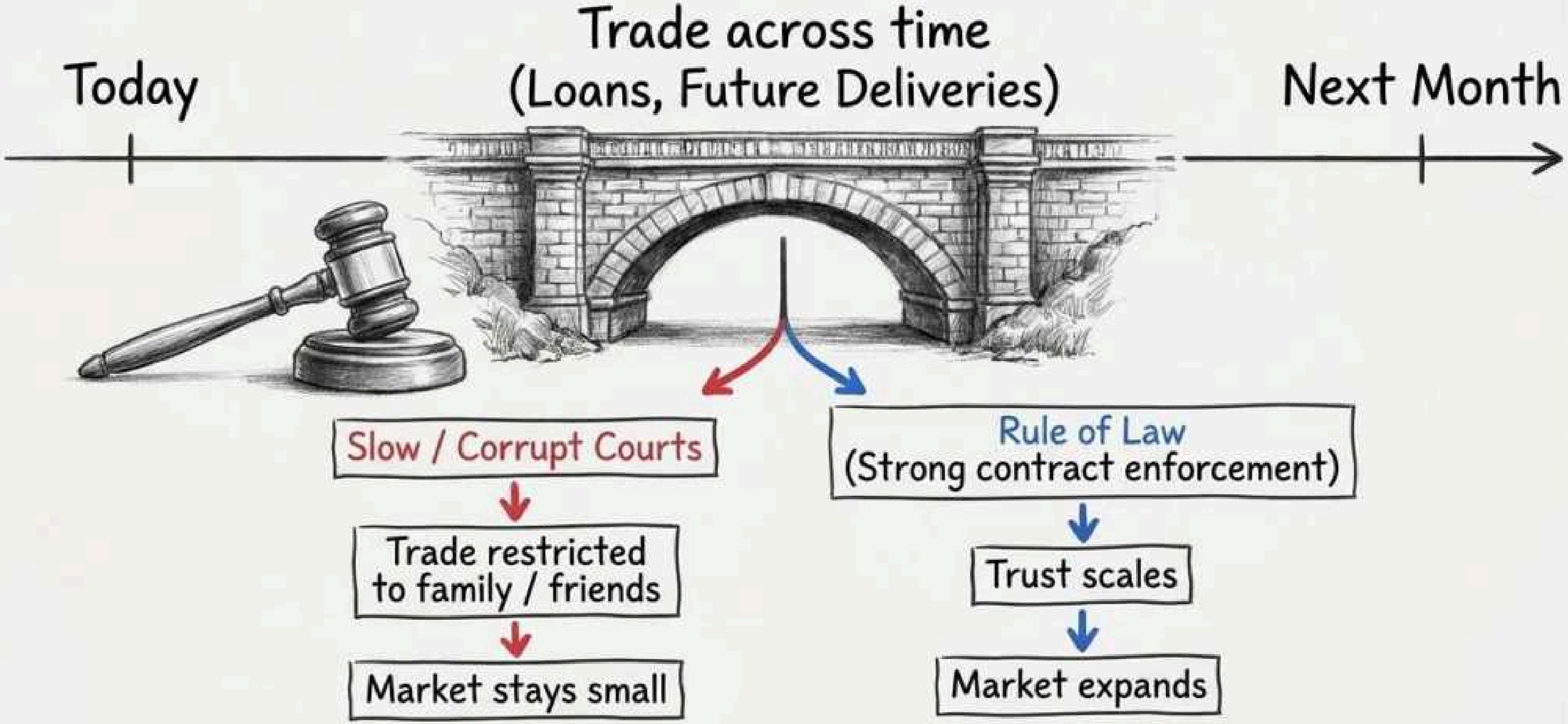






Giving legal title releases immense trapped economic value.

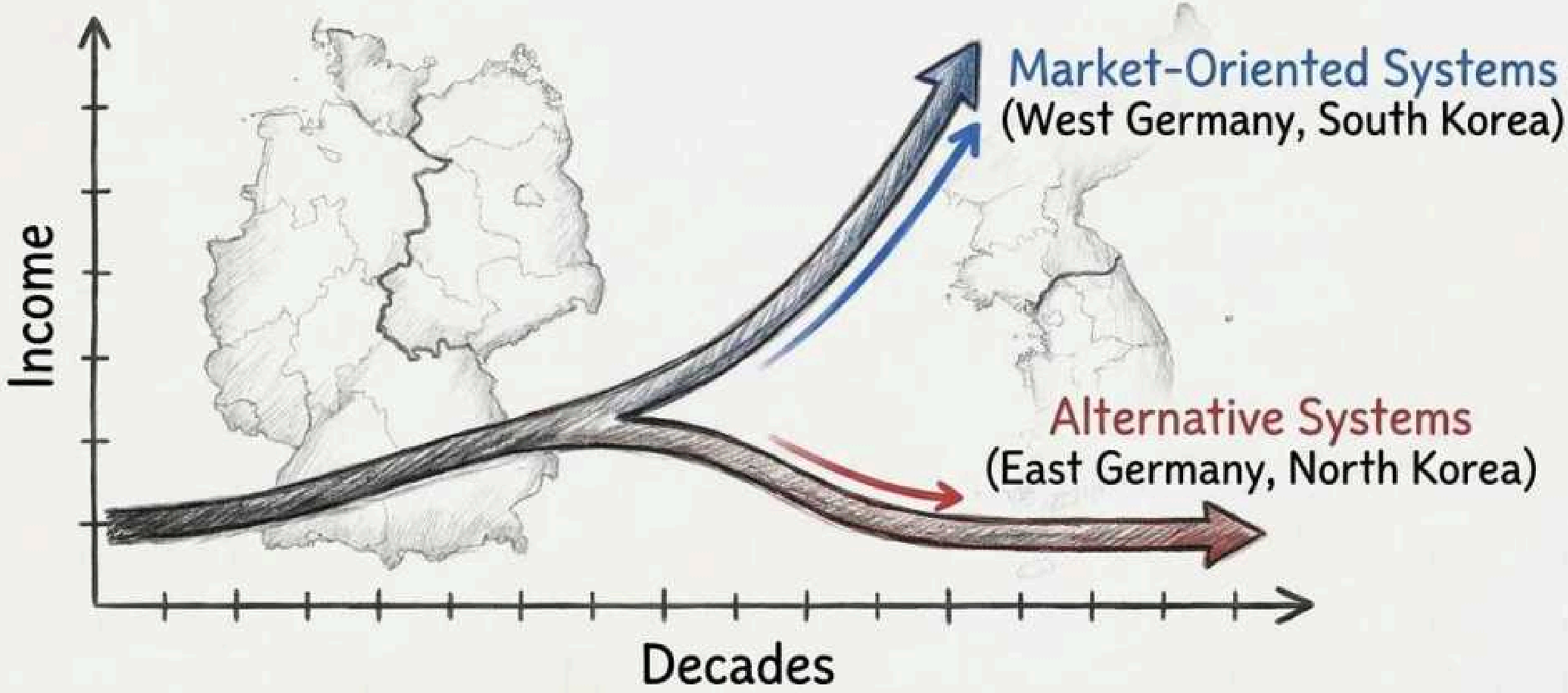
# Enforcing the Promise




The rule of law is the foundation of the free market, not an exception.

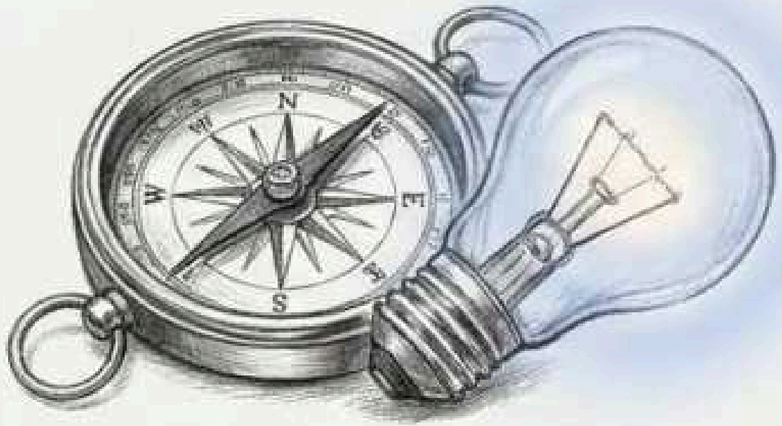
# Evidence from Split Nations

Baseline: Shared people, history, and culture.




Suggestive evidence. Treat with care—other variables also differed.

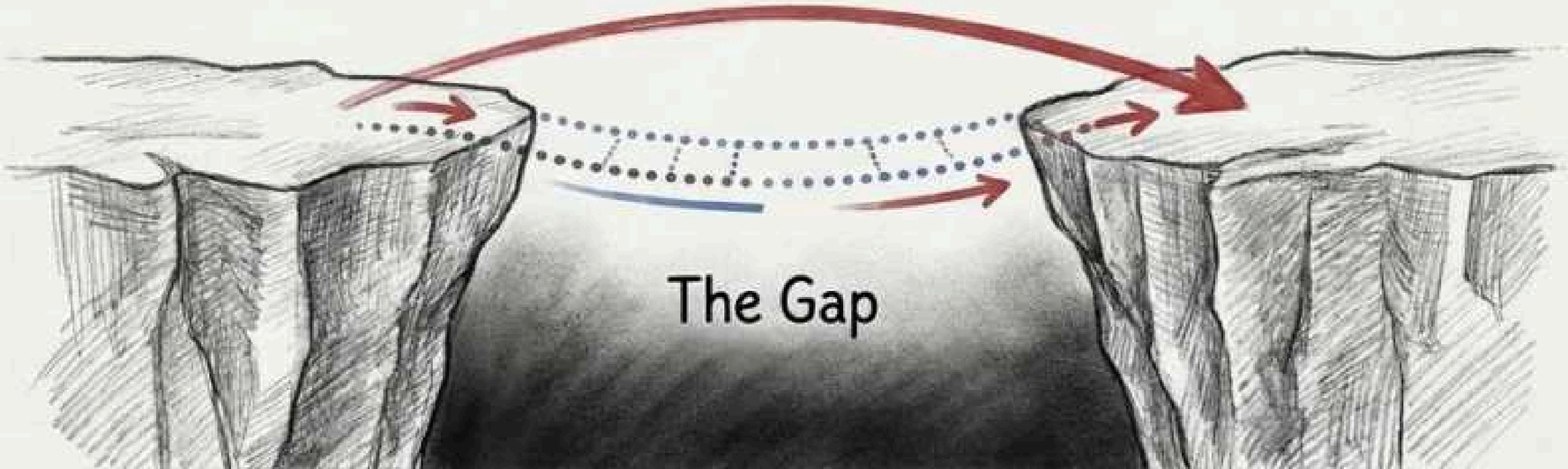
# The People Who Act



Starts business + Bears risk + Organizes resources in new ways

Alertness (Israel Kirzner)

Arbitrage: acting on a price difference



# Arbitrage in Action

Price in Marlow = $1.00/kg

↑ Marlow Price goes up

Price in Millbrook = $1.20/kg

↓ Millbrook Price goes down

Cost of transport = $0.10/kg

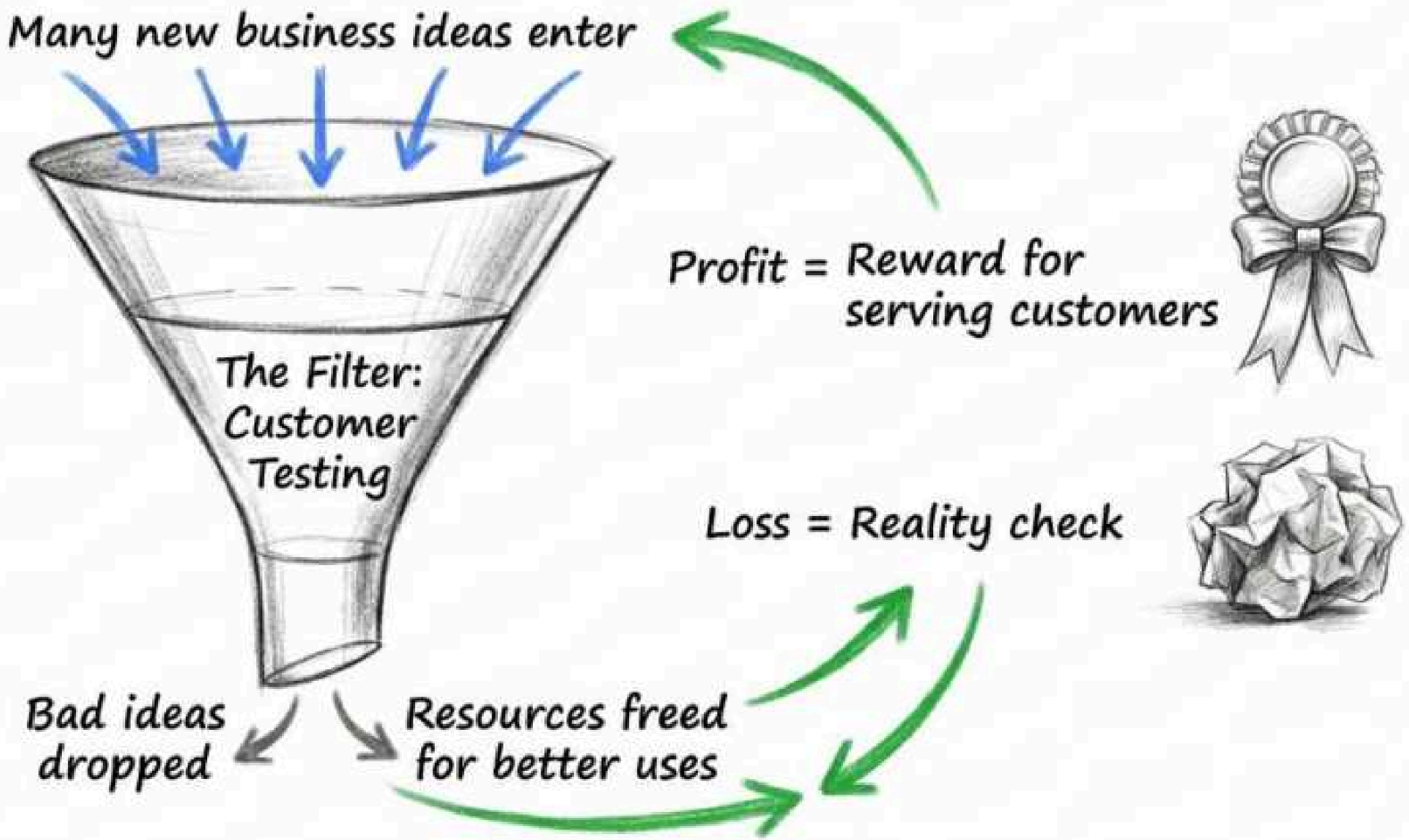
Profit Equation:
Profit = ($1.20 - $1.00 - $0.10) x 500kg

Profit = $0.10 x 500 = $50 Profit

⟷ The Gap Narrows



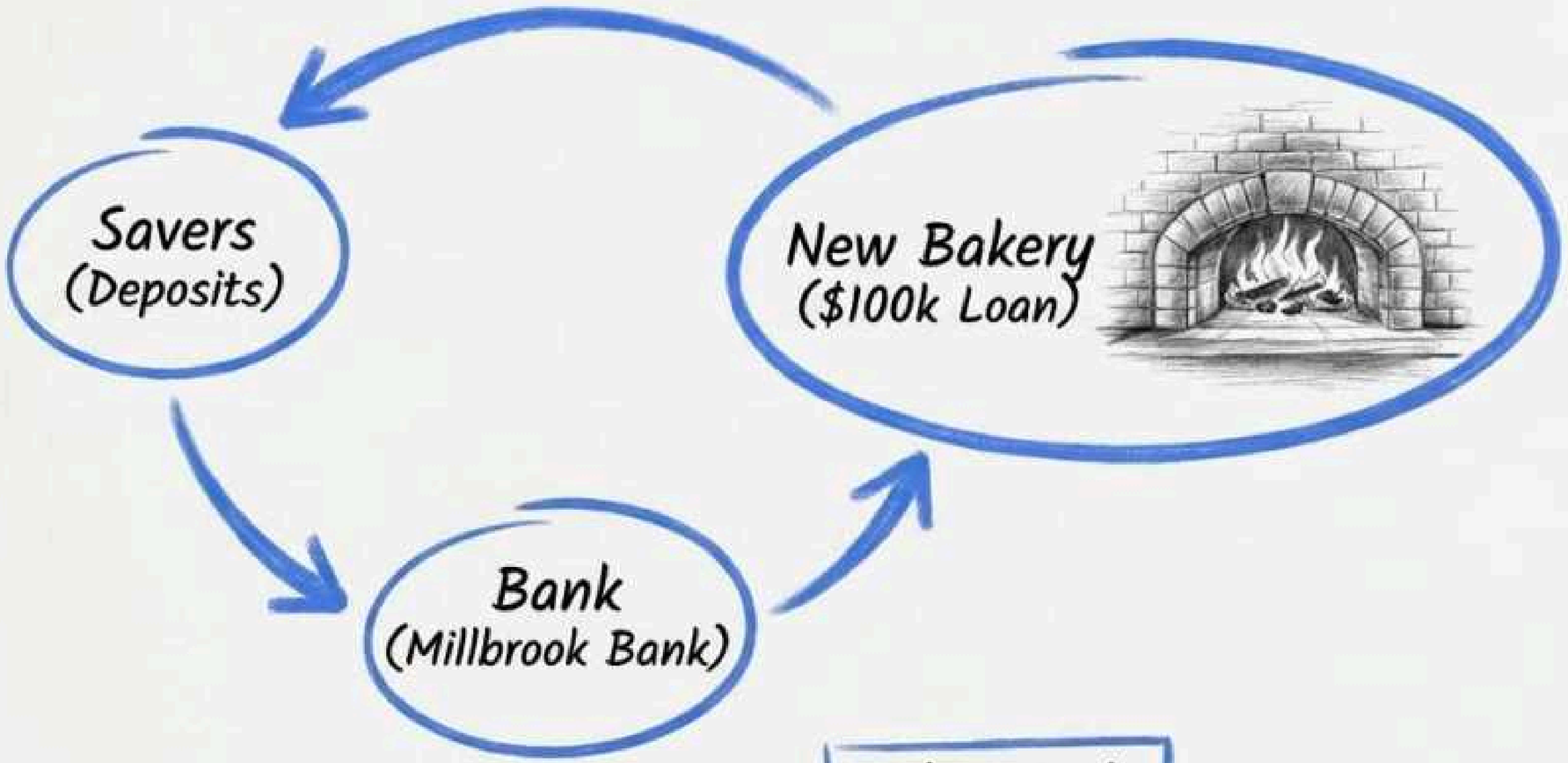
# The Reality of Risk




A large share of new businesses close within a few years—this is how markets learn.

# Financing the Entrepreneur

Financing the Entrepreneur




**Success Path:**

Saver gains → Bank gains → Owner gains

**Failure Path:**

→ Loss falls on Owner and Lender

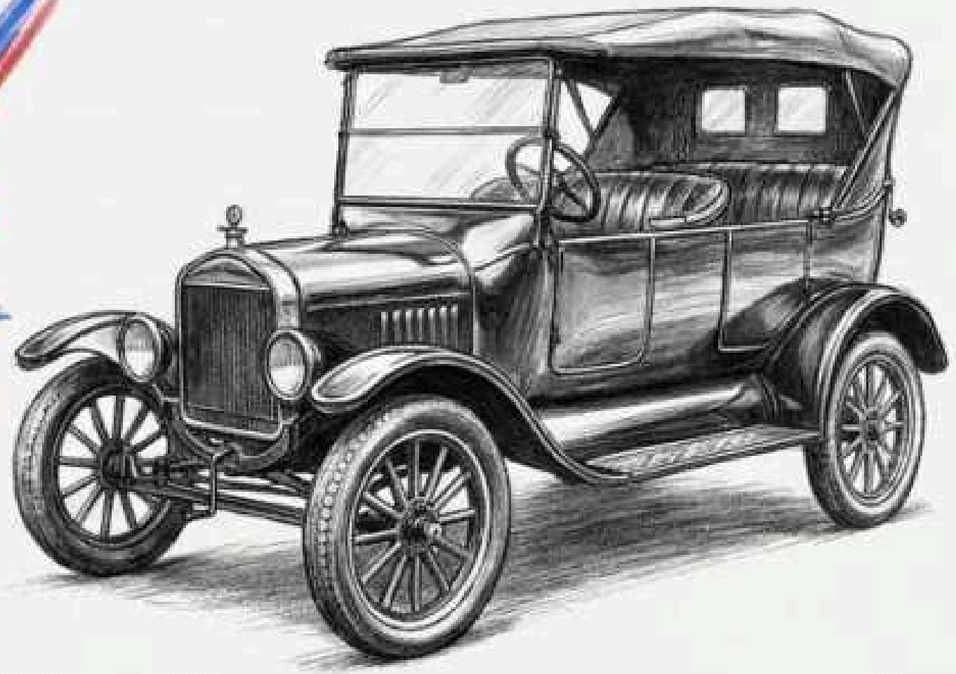
# Creative Destruction

Joseph Schumpeter (1942, *Capitalism, Socialism and Democracy*)

## The Old



## The New



*True competition is between old and new products.*
*Costs fall on obsolete skills/towns; Gains are lower prices and new goods.*

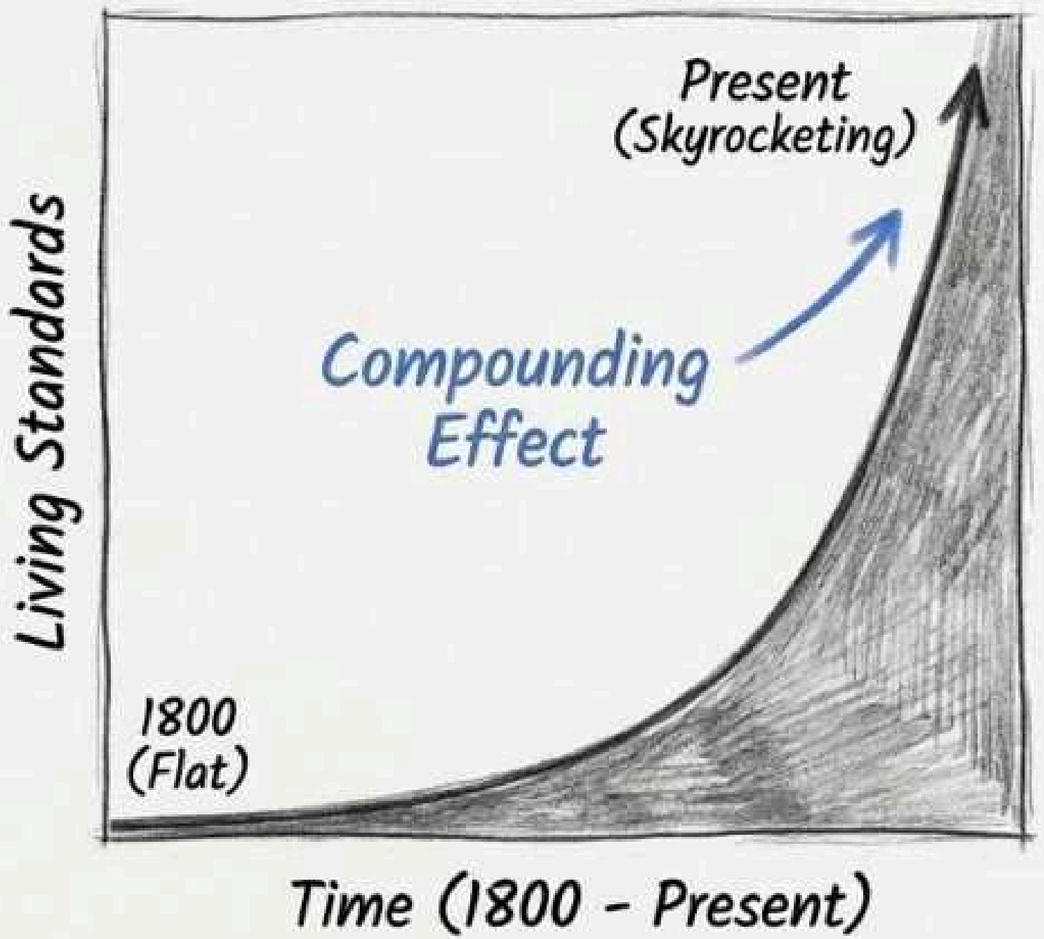
# Living Standards & The Rule of 70

$$t = \frac{70}{r}$$

(t = years to double, r = growth rate)

Scenario A: r = 2% → t = 35 years

Scenario B: r = 1% → t = 70 years



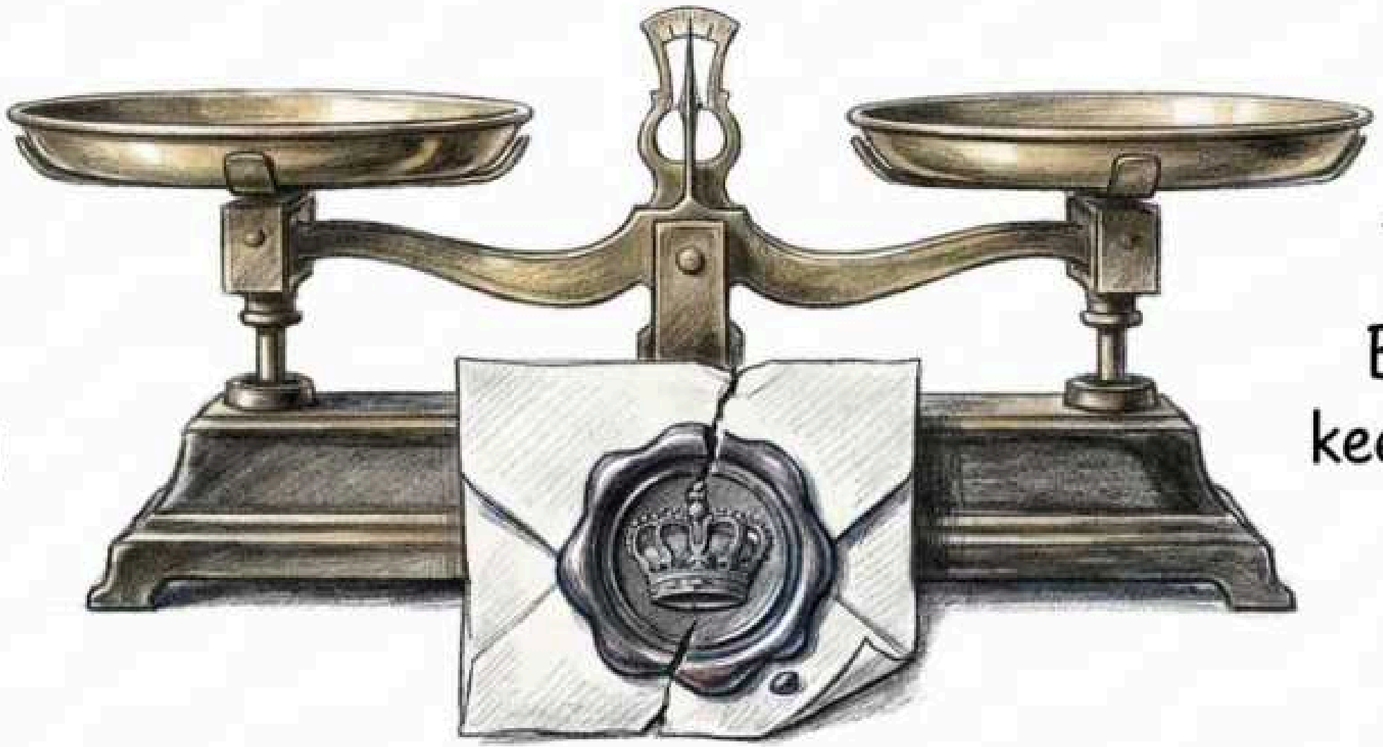

Massive divergence in living standards since 1800 driven by rewarded innovation.

# Rewarding Invention

Premise: New ideas are easy to copy → Inventors need a temporary monopoly

Too Weak

Inventing doesn't pay



Too Strong

Blocks rivals, keeps prices high

The right balance is an empirical question and varies across industries

# The Debates on Ownership



## Milton Friedman (1970)

Social responsibility of a firm is to increase profits within the rules. → $

## Stakeholder View

Firms owe duties to workers, communities, and the environment.

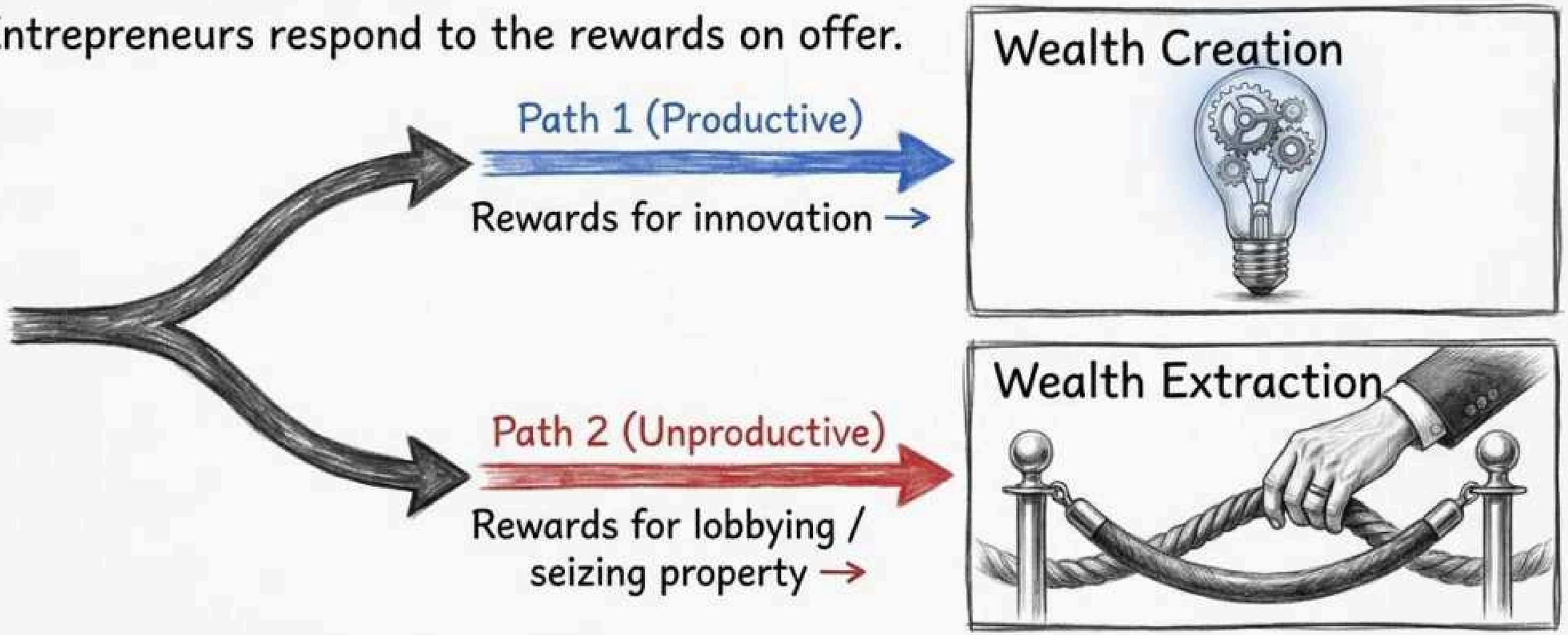


**Limited Liability** lets people invest savings without risking total ruin. ✓

## Productive vs. Unproductive Action

William Baumol (1990)

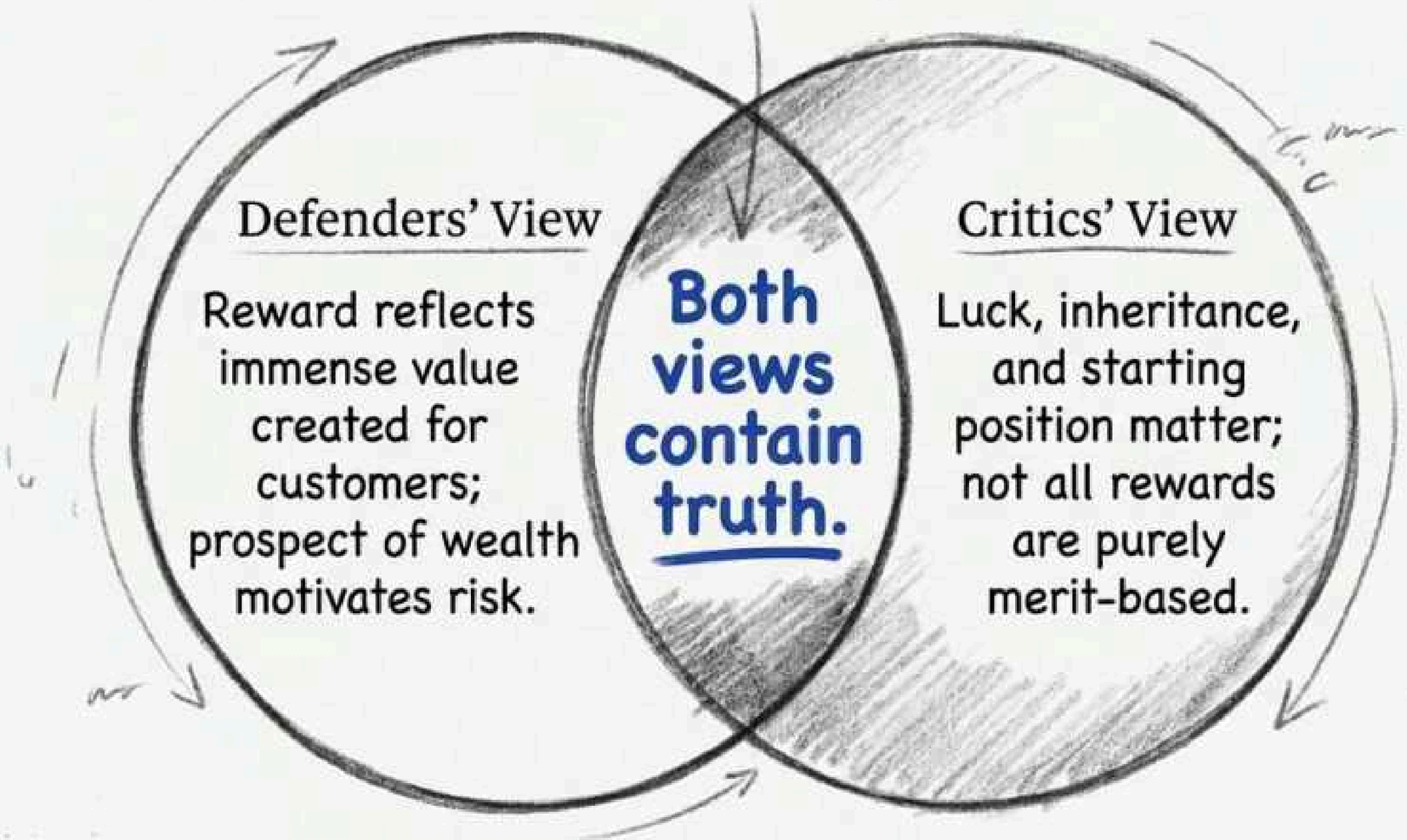
Entrepreneurs respond to the rewards on offer.




Institutions and rules decide which type flourishes.

# Assessing Large Rewards

Do massive rewards equal merit?



# Practical Limits on Property

## Property Rights are Not Absolute




- ☑ Property Rights are Not Absolute
- ☑ Zoning limits construction
- ☑ Externalities (smoke) are restricted
- ☑ Eminent domain requires compensation

Lines must be clear, predictable, and fairly applied.

# Question for this Lecture

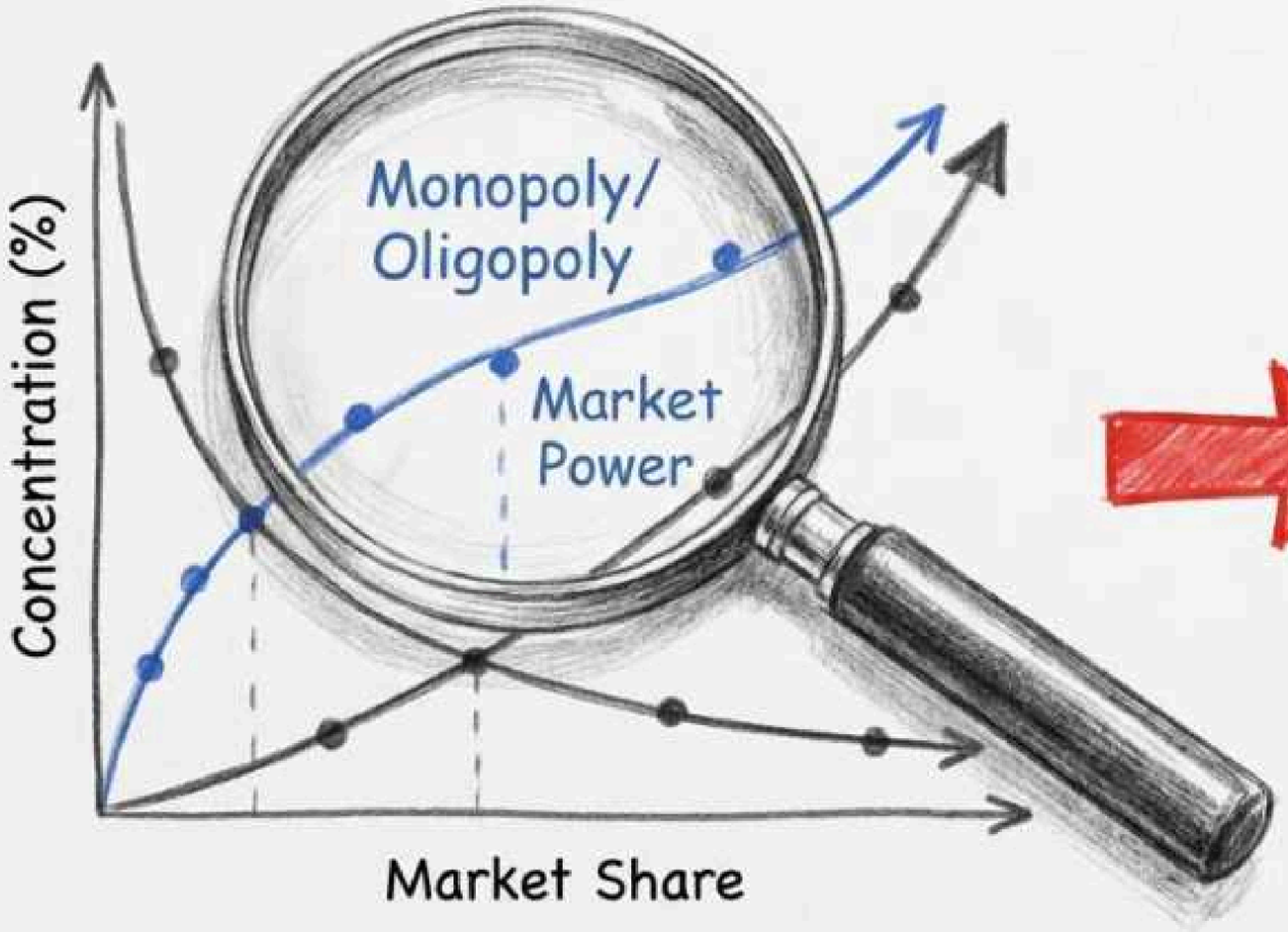
Think of a local resource used by many but owned by no one (park, river, road).



How is it kept in good order?
Would private ownership do better?
Would quotas work?
Are community rules enough?

# The Economist's Whiteboard

¶ 3.22




## Coming Up in Lecture 4

Competition, Trade, and
Market Concentration
(Monopoly/Oligopoly)