Inequality, Property Rights and Welfare

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Abstract

The pursuit of growth is detrimental to the welfare of a developing economy when institutions are weak. This is a claim that has been made by a number of recent studies critically analysing the relationship between inequality and weak property rights, based on the stylised facts. Furthermore it is posited by development economists that the increased inequality which comes with decreased welfare is a key determinant of social conflict. Social conflict, in turn, has the effect of lowering growth.

This study accepts these claims from a theoretical perspective. In particular we seek to identify how inequality and weak property rights impact upon the welfare of an economy/agent during transition from weak to strong property rights, given that this transition enables growth to become welfare enhancing. We model these issues in an extended Ramsey model with a representative agent, who aims to maximize his utility subject to his resource constraint. This extend model differs from traditional treatment in two respects; first, agent's claims over their output are not secure and this is formalized using 'context success functions', and second, agents are heterogenous in their skills to produce output and this is formalized with introduction of agent specific technology level. In the absence of appropriative activity, i.e. with property rights in place, then each agent will enjoy only what they produce. By contrast, with imperfect property rights agents can appropriate one another's output and each agent can only retain a proportion of their own output which is determined by contest success functions.

We show that *under imperfect property rights agents will allocate their resources as follows; a relatively poor rational agent will invest in* ***unproductive offensive*** *activities and a relatively rich agent will invest in productive and* ***unproductive defensive*** *activities.* The rationale behind this finding is that the poor agent may not have anything to defend and the rich agent my have no interest other then defending his own claims.

In equilibrium, we further find that *weak enforcement of property rights accompanied with large variations in technology levels between rich (relatively more productive) and poor (relatively less productive) results in a relatively lower level of average output.* On the other hand the poor agent is better off in the presence of low property rights. However when there is a substantial improvement in property rights (and the dispersion in productivity level increases) the incentive to invest in appropriative activities is lessened. This results in the productive agent being able to achieve a relatively higher utility level.

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