

DISCUSSION PAPERS IN ECONOMICS

Working Paper No. 06-04

Demand for Contract Enforcement and Gains from Trade

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quality of institutions

g

trade

rob

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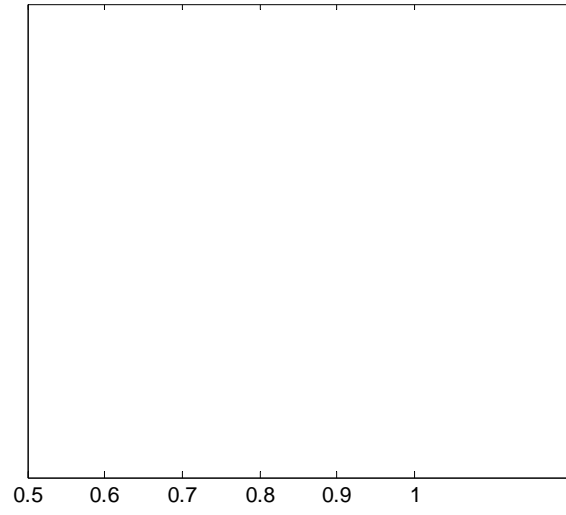
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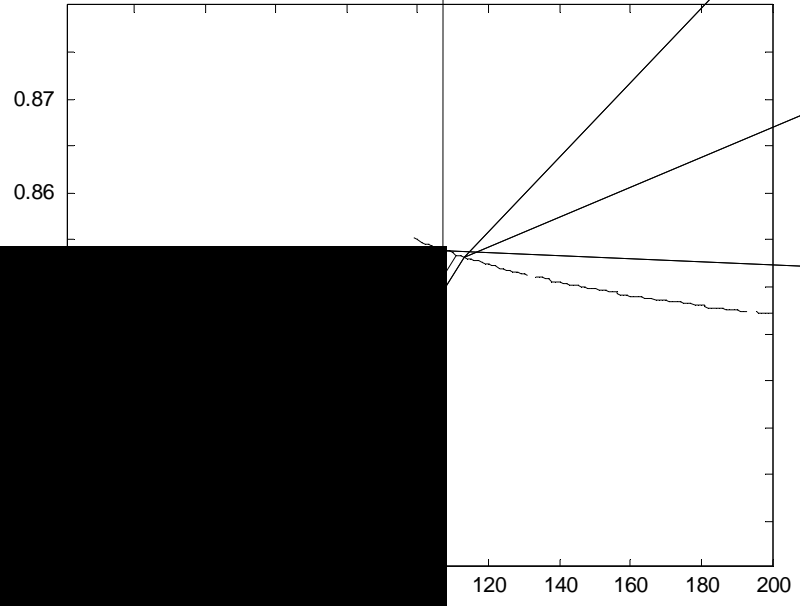
rob

g ≡ —

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$$g \{ \quad \quad \quad \}$$



Suppose punishment is proportional: δ . If an equilibrium with contracting exists, then δ^* is increasing in the gains from trade Δ .



property rights

coerced

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Assume that $\frac{D}{H}$ so that H is well defined. Assume so that the demand for enforcement is positive. Then $*$ is concave in

H

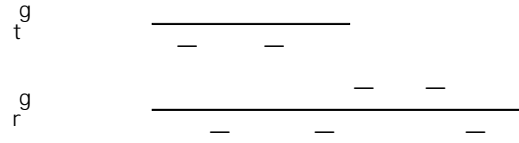
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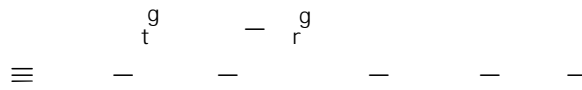
institutions

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contracting



$$g \left\{ \begin{array}{l} t,g \\ r,g \end{array} \right.$$



$g \quad - \quad g$

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$F \quad F \quad F$

Since $H > 0$, the upper root of $p(x)$ is positive, $x = x_H$, which is true whenever $x > x_L$ where x_L is the lower root of the quadratic polynomial

$$p(x) = x^2 - \frac{F}{H}x + \frac{p}{H}$$

It is easy to check that $x_L \in (0, \frac{F}{H})$ provided $p < \frac{F^2}{4H}$ and $\frac{p}{H} > 0$.

Assume that $p < \frac{F^2}{4H}$ and a couple (x_L, x_H) . Then there are three equilibria:

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$$x_L \equiv \frac{\frac{F}{H} - \sqrt{\frac{F^2}{H^2} - \frac{4p}{H}}}{2}$$

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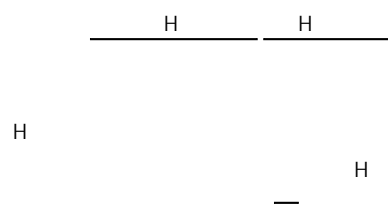
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