

CONTRACT INCOMPLETENESS, CONTRACTUAL ENFORCEMENT AND BUREAUCRACIES¹

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Abstract This paper explains a frequent coexistence of deficient property rights and heavy bureaucracies. We suggest that in environments with insecure ownership bureaucracies substitute for enforceable contracts. We study irreversible investment in an asset, and model the property allocation as a game between a ruler and investors. Since the *ex ante* ownership allocation is not enforceable, an *ex post* share increase is optimal for the ruler. His share adjustment is costly; the heavier the bureaucratic machine the higher his cost. Bureaucracy improves investment incentives by reducing the wedge between the ruler's *ex ante* and *ex post* equilibrium shares.

Keywords: Endogenous Property Allocation, Imperfect Commitment, Commitment Mechanism, Contractual Enforcement, Costly Contracts, Bureaucratic Machine, Game Theory and Bargaining Theory

JEL classification: C70, D23, D73, L33, L50

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