

# LAW AND ECONOMICS





NEW

SZÉCHENYI PLAN

# LAW AND ECONOMICS

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# LAW AND ECONOMICS

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# LAW AND ECONOMICS

## Week 2

### Definition and titles of property

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# Structure of the week

- I. Property law – legal definition of property (in rem)
- II. Rights within the property: bundle of rights
  - Rights of the property owner?
- III. Numerus clausus
  - What rights are in rem, protected by property rule?
- IV. Roles of registration
- V. Expropriation, eminent domain, confiscation

# I. Property law – in rem

- In rem in Hungarian law = property law in economics
- In rem = absolute rights (vs. contractual rights = relative rights)
  - Absolute right: obligation towards everybody.
  - Relative right: obligation only towards those who accept (e.g. in contract).
- Legal (historical) origin: connection between object and person (in rem...)
- Now: connection among people
  - *Bundle of rights*

# I. Property law – in rem

- Objects of property law („assets”):
  - Objects
    - Not only in a physical sense (e.g. animals also)
  - Claim – against others (e.g. because of a contract or damages)
    - Can be *assigned*: allow, assign a claim to someone else (e.g. factoring)
  - Rights, entitlements (transferable)
    - Copyright
  - Whole position in contract (assignment + delegation)
    - E.g. share in a company
- Practically, all goods in economics.
  - Goods = scarcity



# II. Property rights

- Classical triads of property
  - Use (right to yield)
  - Possession
  - Command (transfer)
- Incomplete list – only examples in law, too.

# II. Property rights

- Rights are not always in the same hand.  
Example:
  - Possession – deposit
  - Use – lease, rent
  - Utilization – usufruct
  - Command – transfer constraints
- In economics, all owners of the rights are „owners” – in law: only the property-owner

# II. Property rights

- Can all rights be delegated?
  - British law: Property = bundle of rights
    - If all rights are in other hands – no property remains. No property-owner only owners of rights
  - Continental law: property is more than the sum of rights
    - E.g. after expiration of rights who receives them back?
    - Who is entitled in case of new rights (new liability)?

# II. Property rights

- Transferability as the basic element of property rights
  - Transfer constraints (e.g. the body is not the property of man):
    - why?
    - externality (third party – voluntary or coerced transaction? )
    - bounded rationality

# III. Numerus clausus

- *Numerus clausus: those rights that are protected as property rights (property rule)*
- *Property vs. contract*
  - Absolute vs. relative
    - Obligation – against everybody else or only the promisor?
  - Property: „runs with the asset” – obligation against who receives the asset
    - LESS important: obligation against everybody
    - ONLY against the new owner of the asset (contractual right is not an obligation without acceptance)
  - Property is transferable
    - Contractual rights are not – only after agreement with the other contractual party
    - Exception: assignment

# III. Numerus clausus

- *Why numerus clausus – why are not all rights property rights?*
  - verification (Hansmann–Kraakmann): for third party (e.g. buyer)
  - Hansmann–Kraakman: assets = rights in numerus clausus

# IV. Registration

- *Differences in private and social costs and benefits*

## **Social benefits:**

- Safety of sale (no need to check the owner)
- Incentive to verify or label the property.
- Against theft
  - In case of utilization: risk of being caught
  - In case of sale: reduced price.
- Credit market: mortgage
- Tax administration, regulation

# IV. Registration

## **Social costs:**

- Administration (vs. Registration fees?)
- Compliance cost – cost (time, etc.) of registration
- Verification, labeling – e.g. why territorial sharing is OK, when time-sharing is not registered?

## **Private vs. social:** Private incentive is...

- ...weak: tax administration/regulation,
- ...too strong: against theft



# IV. Registration

- *What kind of assets?*
  - High value
  - High surplus from transaction
  - Theft: more frequent, higher loss
  - Mortgage: important issue
  - Administration cost: large economics of scale
  - Durability: utility over time

# V. Expropriation

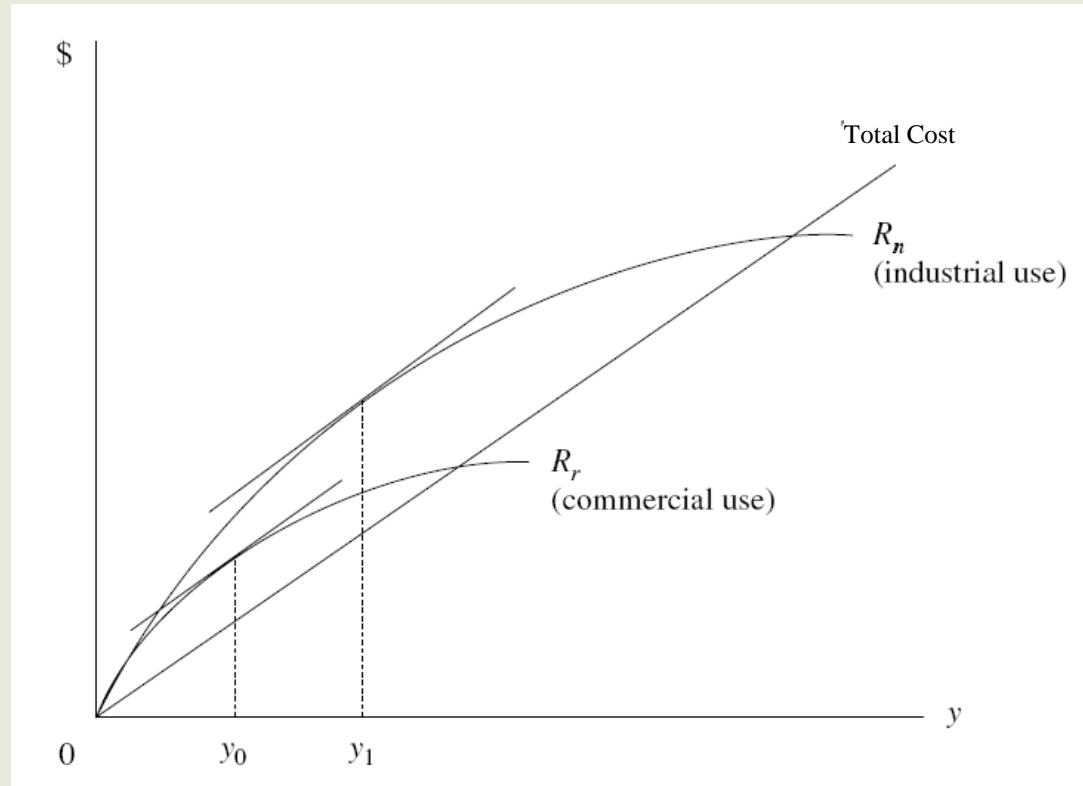
- Legal issue: real vs. value guarantee
  - Right to the asset or to the value of the asset?
  - Real guarantee: to the given asset – no expropriation
  - Value guarantee: to the value – expropriation with compensation (mandatory sale).
- Why expropriation, *why not sale?*
  - Value guarantee (argue for expropriation) :*
    - Transaction, bargaining cost – bargaining about the price
    - Hold-up problem
      - If last parcel increases its price, the other parcels' value is reduced.
  - Real guarantee (argument for sale):*
    - Administration cost (determining compensation – threat of undervaluation).
    - Supraoptimal expropriation, because of low compensation.

# V. Expropriation

## Why value guarantee: need for compensation?

*Expropriation: suppose asset goes to higher value use*

- *With compensation:*
  - *high and certain return from the investment:  $y_1$*
- *Without compensation:*
  - *risk of confiscation must be borne:  $y_0$*
- *Social optimum: somewhere in between*
  - *should consider the risk of an opportunity of higher value use*
- BUT with compensation:  
certain return  
=>Industrial use



# V. Expropriation

- Paradox of compensation
- Two incentives:
  - Expropriation only if it increases value!
  - Investment only if it increases value even with the risk of confiscation (probability of higher value use)
- No perfect (first best) solution
  - Paradox of compensation will appear later
  - e.g. tort law

	<b>Government's incentives</b>	<b>Investor's incentives</b>
<b>With compensation</b>	<b>Optimal expropriation</b>	<b>Supraoptimal investment</b>
<b>No compensation</b>	<b>Supraoptimal expropriation</b>	<b>Optimal investment</b>

# Practice

# Revision

- *Property, owner in economics?*
- *Reasons for creating property rights: dynamic and static reasons?*
- *What is an asset? Numerus clausus?*
- *Why are not all rights property rights?*

# Problem

- US Constitution: Taking of property is permitted only if it stays in public use.
- Debate: is public use the same as state property?
  - Conservative view: yes.
  - Question: what are the advantages and disadvantages if courts follow this rule?

# Solution

- Alternative? Bargain.
- Supraoptimal expropriation – if undervaluation.
- Uncertain that expropriation only if higher value use (vs. the case of bargaining)
- Transaction (bargaining) costs
- Potential hold-up problem
- Public choice answers: no lobby to coerce the property transfer.



# Problem

An apartment is auctioned off because of the unpaid loans of its previous owner. The apartment is sold as inhabited real estate. The buyer is aware of the inhabitation. However, the occupants are unwilling to sign a rental contract with the new owner or pay the bills. While they are away, the new owner unlocks the apartment and removes their furniture and other belongings. The removed occupants sue for damages, arguing that their rights to occupancy were restricted and their belongings were damaged while removed.

What would be an efficient judgment? What aspects of the case should be considered? Should the occupants' right to occupancy be protected?

# Solution

- Basic question: should numerus clausus include lease?
- Buyer knows: tenant in the property
  - risk in the price
- Clear definition of rights (Coase theorem).

Vs.

- Incentives for paying?

# Discussion

- Is property always the optimal solution?
- NO: costs of property rights
  - protection
  - monopoly (if I need the given asset – no close substitution – the owner has monopoly power)
- Reasons for property!
  - Dynamic:
    - Incentive for investment – the return goes to the investor (owner)
  - Static
    - Solution for common pool problems.
    - Player with incentive to invest and constrain overuse.

# Discussion

**What is a right (e.g. personal right, constitutional right, human right)?**

- Connection between personal or human right and property?
  - Not transferable property
  - Why forbid transfer?

# Discussion

Wesley–Newcomb–Hohfeld (1879–1918):  
Elements of right

<p><b>POWER</b> To waive, annul or transfer</p>	<p><b>IMMUNITY</b> Against others altering</p>	<p><b><i>Second order:</i></b> <i>Rights over the first-order rights</i></p>
<p><b>PRIVILEGE</b> To (or not) use</p>	<p><b>CLAIM</b> Against others infringe</p>	<p><b><i>First-order</i></b></p>

From Stanford Encyclopedia of Philosophy