



University of Zurich

Faculty of Law
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Law & Economics **Economic Analysis of Law**

Property Rights and Markets

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Markets and Property Rights

1. Fundamental questions of property rights

- Examples
- Four fundamental questions

2. Legal content of property rights

- Protective rules
- Property rules and markets – Private road example

3. Markets and market failure

- Perfectly competitive market
- Market power and monopolists
- Public goods
- External effects

Example 1: Ownership of Sheep

- **In a remote valley of the Swiss National Park a sheep was born in a joint flock of sheep; to whom does the sheep belong?**
 - The owner of the sheep's mother
 - The owner of the sheep's father
 - The shepherd who tends the sheep
 - The municipality that has leased the land from the federal government
 - The federal government due to its ownership of the national park
- **The sheep was killed by a wolf, the owner claims compensation, who has to pay?**
 - The shepherd
 - The municipality because the sheep was killed on its land
 - The organisation which returned the wolf to the wildness

Example 2: The Satellites

- **Datasat Ltd. owns a satellite which transmits business data between Europe and the United States. Sunshine Inc. recently repositioned its weather satellite to better supply weather data to its customers. Since the reposition, 10% of Dadasat's data were lost during the transmission.**
- **Questions:**
 - Consequences?
 - What might happen?
 - Relation to property rights?

Example 3: The Heritage and the Frogs

- **Mr. Smith inherits a property at the lake of Zurich from his father. He would like to develop it into a residential area. He would have to invest millions to drain the swampy landscape. The environmental organization „green frog“ states in a report that some endangered frog species are living in the swamp. The organisation desires to retain the swamp.**
- **Questions**
 - Who does what?
 - Relation to property rights?

Four Fundamental Questions of the Property Law

- 1. How are ownership rights established?**
 - Historically
 - Economically
- 2. What can be privately owned – limits of property?**
 - Intangible goods
 - Living beings, organs, etc.
- 3. What may owners do with their property?**
 - Relation between property rights and third persons' rights
- 4. What are the remedies for the violation of property rights?**
 - Protective rules and consequences

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Legal Content of Property Rights

- **Property is a „bundle of rights“**
 - Rights of use
 - Rights to conclude contracts
 - Right to bargain
 - Right of self-organisation
 - Rights to exclude third persons



Incentive Effects of Protection Rules Make Markets possible and „smier“

■ Property rule

- Encourage productive behaviour
- John Locke: „keeping the fruits of man's own labour“
- Example: Elements of feudalism

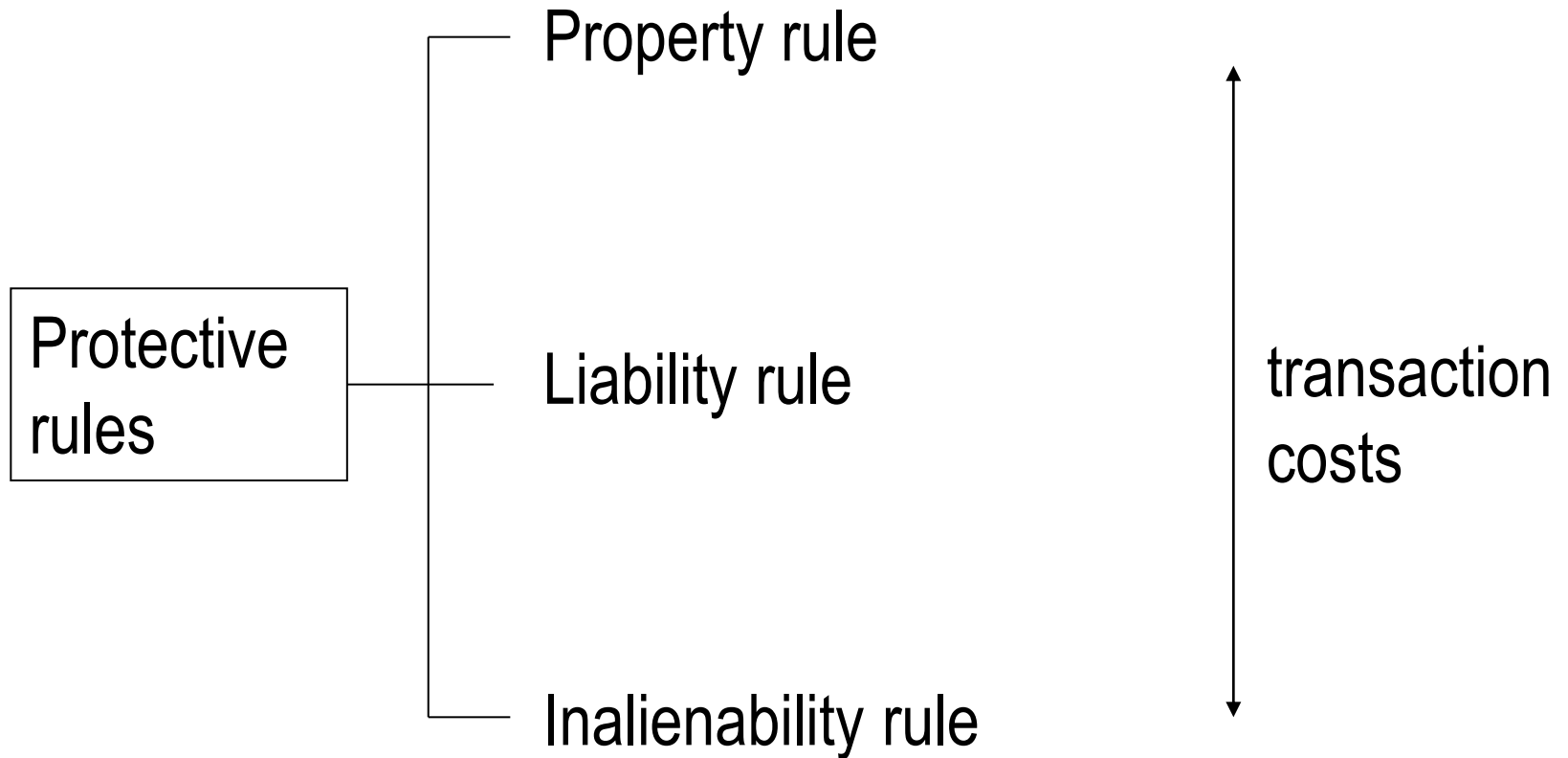
■ Liability rule

- Damaging others becomes more expensive
- „Social Contract“: Economies of scale and protection from theft => the rule of law as public good?

■ Inalienability rule

- Fundamental rights: Exclusion of a market system?
- Examples: Property rights on humans (slavery), harm others

Protection Rules



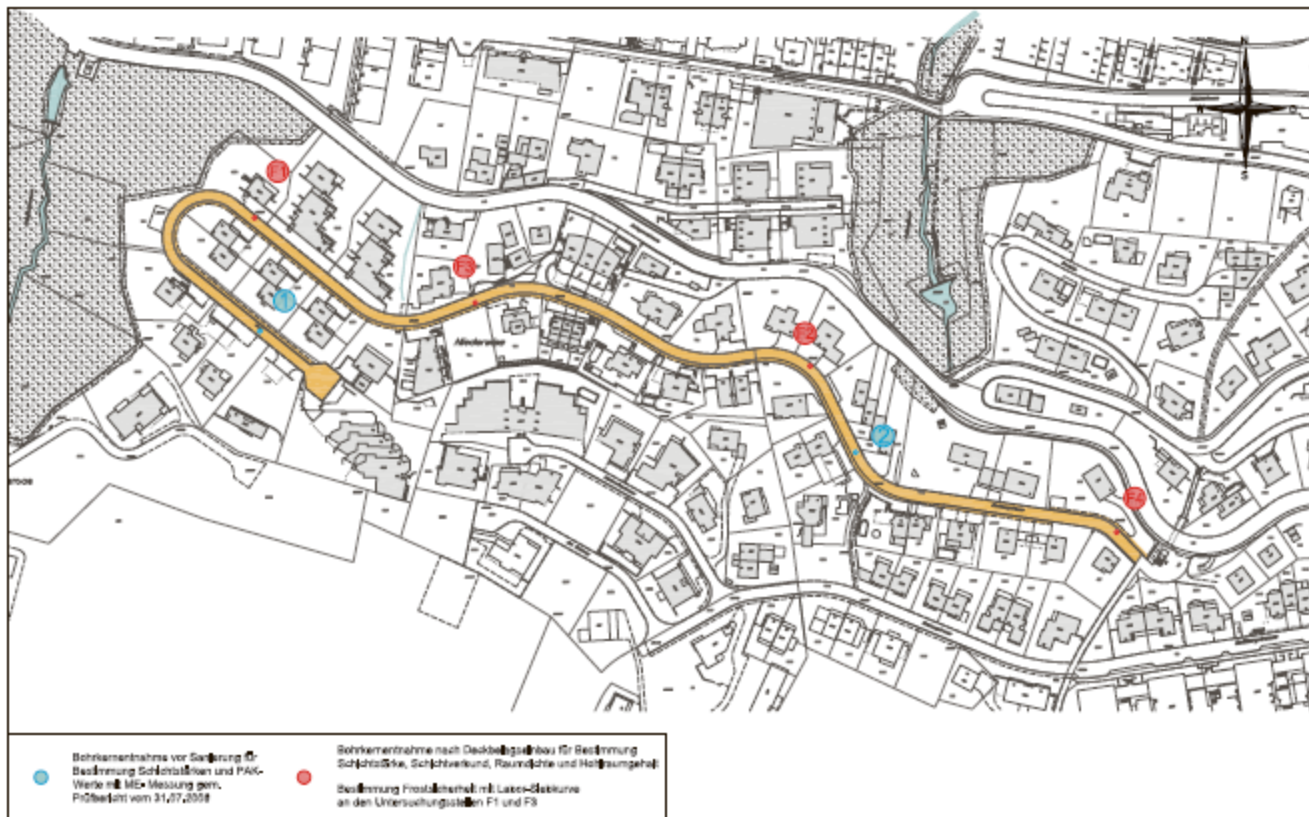
Economics of the property rule: Private roads and their maintenance

- **A road connecting a residential area – private property**
 - Common interest to reach their homes
 - Common benefits for users
- **Cost-benefit analysis**
 - Total benefits
 - Marginal benefits
 - Cost and cost sharing



Private roads – public roads Relevant today?

Sanierung Frohburgstrasse, 8832 Wollerau
Übersichtsplan 1:1'500



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Market and Market Failure

Perfectly Competitive Market

- **Perfectly competitive market**
 - Best possible solution, maximises total welfare
- **Requires:**
 - Clear and protected property rights
 - (Complete) information
 - Many suppliers
 - Homogen, comparable goods
 - No entry barriers to market
 - Equal access to technology
- **Who ensures that these requirements are fulfilled?**

Market and Market Failure

Public Goods

- **Definition: Public good**

- Non-rivalry
- Non-excludability

- **Free rider problem**

- Everyone can travel „for free“ => insufficient incentive to pay

- **Solutions:**

- Subsidize production
- State production

- **Public good**

- The rule of law, constitutionality?
- Stability of the law and legal decisions

Market and Market Failure

Monopolies and Market Power (1/2)

- **Only one supplier**
 - Excessive prices
 - No allocative efficiency, loss in welfare
 - Maximum profit for the monopolist
- **Equal effect: Collusion by suppliers**
 - Producers share the maximum profit
- **Countermeasure:**
 - Antitrust law
 - Governmental control, administered prices

Market and Market Failure

Monopolies and Market Power (2/2)

■ Reasons

- Factual
- Legal

■ Correctives

- Privatisation/deregulation
- Market opening – free trade
- Antitrust law
- Price control law
- Market dynamics – Schumpeter's “creative destruction”

Market and Market Externalities / External Effects

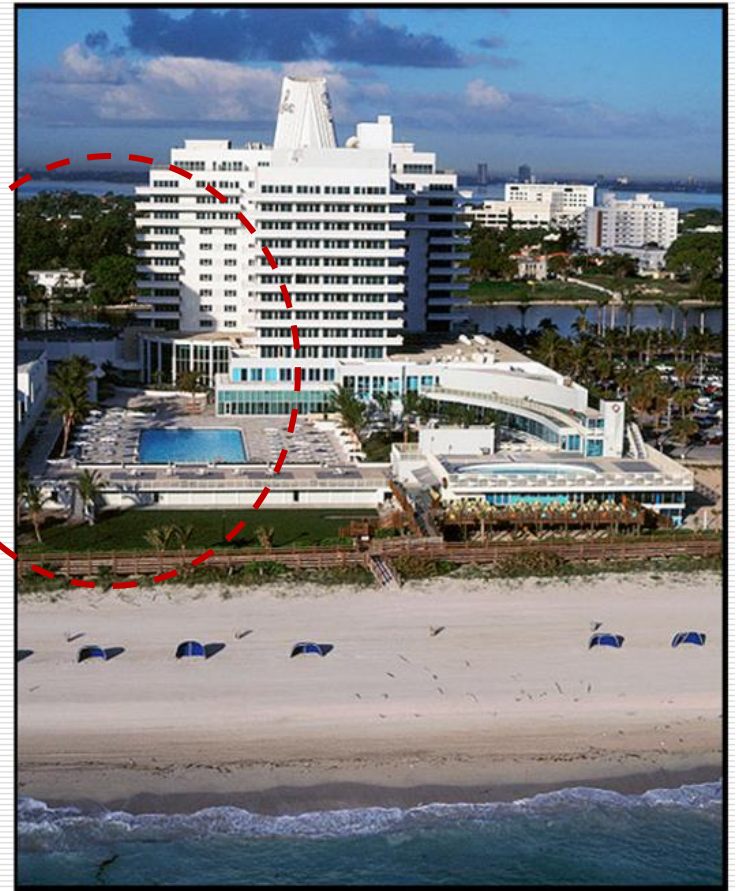
- **Production / consumption of a product/service causes costs for others**
 - Flights cause noise
 - Noise drives the cows mad => no milk
 - Fertiliser pollutes water
 - No fish due to algae in water
- **No allocative efficiency, solutions:**
 - Property rights – liability rights
 - Regulations (marginal values, rules, etc.)
 - Taxes for incurred costs (Pigou)
 - Externalities markets (CO₂ trade)

Coase-Theorem

- **Principle:** If there are no transaction costs, bargaining of property rights on markets will lead to an efficient use, regardless of the initial allocation of property rights.
- **Basic assumptions**
 - Reciprocal nature of harmful action
 - Bargaining as alternative to state intervention
- **Criticism of the Theorem**
 - Existence of transaction costs
 - Uncertain distribution of property rights
 - Dichotomy of distribution/allocation

Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.

(114 So.2d 357; Fla. 1959) 1/3



Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.

(114 So.2d 357; Fla. 1959) 2/4

* * * In this action, plaintiff-appellee sought to enjoin the defendants-appellants from proceeding with the construction of an addition to the Fontainebleau, alleging that the construction would interfere with the light and air on the beach in front of the Eden Roc and cast a shadow of such size as to render the beach wholly unfitted for the use and enjoyment of its guests, to the irreparable injury of the plaintiff; further, that the construction of such addition on the north side of defendants' property, rather than the south side, was actuated by malice and ill will on the part of the defendants' president toward the plaintiff's president; and that the construction was in violation of a building ordinance requiring a 100-foot setback from the ocean. It was also alleged that the construction would interfere with the easements of light and air enjoyed by plaintiff and its predecessors in title for more than twenty years and "impliedly granted by virtue of the acts of the plaintiff's predecessors in title, as well as under the common law and the express recognition of such rights by virtue of Chapter 9837, Laws of Florida 1923. * * * " Some attempt was also made to allege an easement by implication in favor of the plaintiff's property, as the dominant, and against the defendants' property, as the servient, tenement.

* * *

The chancellor * * * entered a temporary injunction restraining the defendants from continuing with the construction of the addition. His reason for so doing was stated by him as follows:

* * * The ruling is not based on alleged presumptive title nor prescriptive right of the plaintiff to light and air nor is it based on any deed restrictions nor recorded plats in the title of the plaintiff nor of the defendant nor of any plat of record. It is not based on any zoning ordinance nor on any provision of the building code of the City of Miami Beach nor on the decision of any court, nisi pruis or appellate. It is based solely on the proposition that no one has a right to use his property to the injury of another and that the intended use by the Fontainebleau will materially damage the Eden Roc. There is evidence indicating that the construction of the proposed annex by the Fontainebleau is malicious or deliberate for the purpose of injuring the Eden Roc, but it is scarcely sufficient, standing alone, to afford a basis for equitable relief.

Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.

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This is indeed a novel application of the maxim *sic utere tuo ut alienum non laedas*. This maxim does not mean that one must never use his own property in such a way as to do any injury to his neighbor. It means only that one must use his property so as not to injure the lawful rights of another. *Cason v. Florida Power Co.*, 74 Fla. 1, 76 So. 535. In *Reaver v. Martin Theatres* (Fla.1951) 52 So.2d 682, 683, under this maxim, it was stated that “it is well settled that a property owner may put his own property to any reasonable and lawful use, so long as he does not thereby deprive the adjoining landowner of any right of enjoyment of his property *which is recognized and protected by law, and so long as his use is not such a one as the law would pronounce a nuisance.*” [Emphasis supplied.]

No American decision has been cited, and independent research has revealed none, in which it has been held that--in the absence of some contractual or statutory obligation--a landowner has a legal right to the free flow of light and air across the adjoining land of his neighbor. Even at common law, the landowner had no legal right, in the absence of an easement or uninterrupted use and enjoyment for a period of 20 years, to unobstructed light and air from the adjoining land. *Blumberg v. Weiss*, (N.J.1941), 17 A.2d 823.

Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.

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* * * There being, then, no legal right to the free flow of light and air from the adjoining land, it is universally held that where a structure serves a useful and beneficial purpose, it does not give rise to a cause of action, either for damages or for an injunction under the maxim *sic utere tuo ut alienum non laedas*, even though it causes injury to another by cutting off the light and air and interfering with the view that would otherwise be available over adjoining land in its natural state, regardless of the fact that the structure may have been erected partly for spite. See the cases collected in the annotation in 133 A.L.R. at pp. 701 et seq.; 1 Am.Jur., Adjoining Landowners, Sec. 54, p. 536. * * *

We see no reason for departing from this universal rule. If, as contended on behalf of plaintiff, public policy demands that a landowner in the Miami Beach area refrain from constructing buildings on his premises that will cast a shadow on the adjoining premises, an amendment of its comprehensive planning and zoning ordinance, applicable to the public as a whole, is the means by which such purpose should be achieved.

* * *

Since it affirmatively appears that the plaintiff has not established a cause of action against the defendants by reason of the structure here in question, the order granting a temporary injunction should be and it is hereby reversed with directions to dismiss the complaint.