

Topics in the Economics of Property Law

Lecture 3



EVROPSKÁ UNIE
Evropské strukturální a investiční fondy
Operační program Výzkum, vývoj a vzdělávání



MINISTERSTVO ŠKOLSTVÍ,
MLÁDEŽE A TĚLOVÝCHOVY



Information Economics

- ▶ property law and economic growth
- ▶ Economics of innovation-*better way to make something or something better to make*
- ▶ Intellectual property law (patent system, copyright system, trademark system, trade secrets)
- ▶ „creative destruction“
- ▶ life cycle of an innovation and its consequences
- ▶ Information and its features:
 - credibility
 - nonappropriability-costly to produce information, cheap to transmit it
 - nonrivalrous
 - nonexcludable



Information Economics

-unregulated private market-less than efficient amount of information

Remedies:

-supply or subsidize art and science

Charitable Contributions

Trade secrets protection (efficiency?)

Intellectual property law

„Problem of commons (underproportization) and anticommons (overproportization)“



Intellectual Property Law

- Ownership of mind's products-the power of exclusion used to extract price from others
- dynamic efficiency X static efficiency
- broadening and lengthening of property rights
- **trade-off between creation and dissemination**

-increasing incentives for creation also increases incentives for dissemination (broadening and lengthening of property rights through charging higher fees), but up to some point, beyond this point the broadening and lengthening of property rights increases monopoly, thereby rewards creation and not dissemination

Example: Uncongested bridge and the toll.

Innovation-diffusion trade-off- worldwide tensions



Intellectual Property Law-Patents

- “to promote the progress of science and useful arts, by securing for limited time to authors and inventors the exclusive right to their respective writings and discoveries”
- No one may use the invention except the owner’s consent, license the use for patent in exchange for the fee (royalty)
- Information in patent application accessible to public (2 drawbacks)

Breadth of patent

- the broad rule encourages fast duplicative research (encompass both inventions)
- the narrow rule encourages slow and complementary research



Intellectual Property Law-Patents



Example: R&D

Research and development- research-pioneering discovery with no immediate commercial value, but with commercial potential, development-series of small improvements and tests to bring it to the market. Broad patents encourage fundamental research, narrow patents encourage development if people who do fundamental research receive the sale value of pioneering invention, but do not receive sale value of commercial application, there will be not enough fundamental research

Breadth of patent and efficiency ?

If transactions costs zero-private bargaining and breadth of patent doesn't matter

If transaction costs high- Normative Coase or Normative Hobbes theorem
-reality-joint research ventures



Intellectual Property Law-Patents

Duration of Patent

- the optimal life of patent? (balance between innovation and dissemination)
- In US the length 20 years
- Two-tier patent system in Germany- „full term“ patents and „petty“ patents for 3 years (annual patent fee increasing over time, only 5 % patents remain till the end of the term, average age 8 years)



Intellectual Property Law- Patents

- The producers of information can obtain profits from speculative investments.
- Some markets produce too much information
- patent protection for some inventions higher than commended by economic efficiency (natural monopolies)
- Too much patent-threatens creativity (pharmaceutical research, Amazon one click, orphan drugs)
- High prices and restricted output of monopoly

Alternative? Through award of prizes



Intellectual Property Law- Copyright

- The breadth of copyright- broad and narrow (forbids only some unauthorized uses)
- The duration-the creator's life plus 70 years
- Tracing costs-creator may want to check if her ideas of novel are original, how to limit these costs? Narrow breadth and limited duration

Example: copyright to English language or to computer language-hinders development

- „Creative Commons“

Future of Copyright?

„celestial jukebox model“

„the model of digital libertarianism“



Intellectual Property Law- Trademark

- Since 13th of century in England, Lanham Act 1946
- Trademark-signal of quality, reduces searching costs for consumers, incentive for high quality product by producers, reputation and credibility of company
- Economic justification-encourage competition and do not impose tracing costs, (Example: bank and unique information), like property rights
- Breadth of trademarks-“generic product cannot be trademark (word camera, the owner could sue anybody)
- Example: Sterling Drug Company in 1921 and aspirin.

Coca-cola and fears that cola/coke will become generic product



Organizations as Property

- Organization-structure of offices and roles created by laws and contracts
- **Unowned organizations**-“governance“, other goals than profit
- **Owned organizations**-move organization from owners who value it less to owners who value it more
- Market for corporations often thin

Unlimited X limited liability

Separation of ownership from control

Hostile takeover



Private and Public Property

- ▶ Private company X public company
- ▶ Coase theorem-private ownership with people in small groups, separable utility function, externalities private-in this case private ownership perfect, (example-oysters)
- ▶ In case of many owners and prohibitive transaction costs, interdependent utility functions, public externalities, public ownership is the solution, (example-pasture land on Iceland in mountains)
- ▶ Tragedy of commons (sea) and anticommons (Moscow)
- ▶ Public ownership three forms:

Open access

Political control

Unanimous consent

Establishing Rights over Fugitive Property

Example: It is difficult to recognize whether the gas comes from under unleased land and which from under leased land. Ms Hammonds owned land which laid above the geological dome from which The Central Kentucky Natural Gas Company drew its supply of gas. Hammons sued the company.

- ▶ Fugitive Property-defining property rights for objects that move around or have indefinite boundaries (natural gas, wild animals)
- ▶ Two principles to solve the problem:

First possession- „First in time, first in right“, easy to apply, danger of overinvestment (want to be the first to enjoy economic rent)

Tied ownership- the owner of surface has the exclusive right to subsurface deposits, avoids preemptive investment, costly with establishing and verifying rights

-efficient rule-compare the incentive to overinvest against the cost of administering and enforcing ownership



When to Privatize Open-Access Resources

➤ Open access resource-the property that is accessible for use by a broad public, the rule of first possession, depletion

Preventing overuse:

„the maximum sustainable yield“

Tied ownership-tied access to common pastures to production on private pastures

Privatization-private owner can exclude

-trade-off between overuse of resource (open access) and costly exclusion of non-owners (private)

Example: Owning the ocean.

The doctrine of free use, the doctrine of reasonable use



Recording and Transferring Title

- ▶ Verifying ownership and remedies when a good is sold without the owner's permission

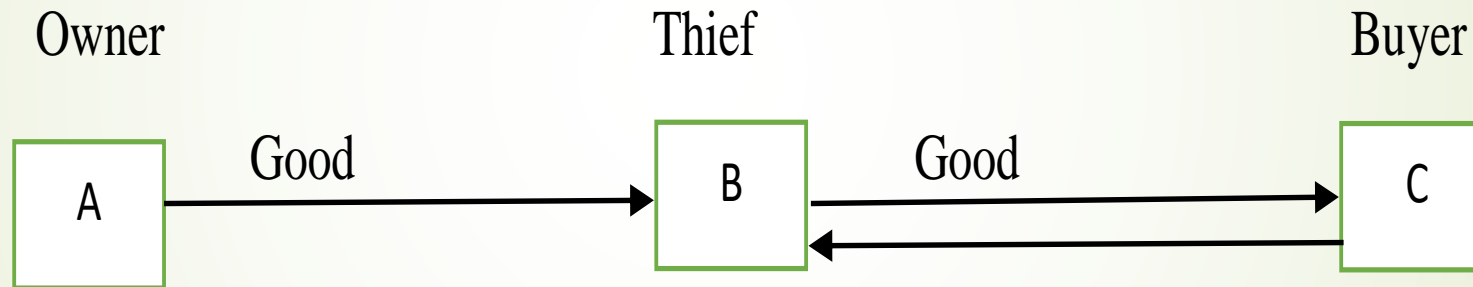
Example: Famous method in Middle Ages „livery of seisin“

In modern times verification through:

- “Public recording of title to land“ accessible to everyone, system for land and valuable items, not for most of the goods (counterproductive-would impede commerce)
- system of official witnesses called notaries

Can a Thief Give a Good Title?

- ▶ If a good is stolen from owner A by thief B and B disappears with the money after selling the good to innocent buyer C, does the good belong to A or C?



- ▶ In Europe-buyer purchases the good in a good faith, more risk on owner
- ▶ In US-thief cannot give you good title, risk on the buyer
- ▶ Liability should fall on the party, which can verify ownership at least cost, (Spanish system)



Breaks in the Chain of Title

- ▶ Uncertain ownership-discounts value of an asset, the law may remove it
- ▶ **Adverse possession**

Potatoes' house extended over property line. Parsley did not discover the trespass, 10 years have passed. Has Potatoes acquired any right to the part of Parsley's property?

If owner sleeps on his rights...

-someone can acquire ownership of another's property, provided it is adverse and the original owner does not protest or take legal action

- ▶ **Estray statutes**

-if lost and owner does not appear to claim within a stipulated time period (1 year), the finder becomes owner



What may owners do with their property- Bequests and inheritances

Example: Owner of house. The law will award property to someone else. The owner may circumvent the law. If it is costly, then he may deplete the property before he dies.

- Circumvention and depletion costs
- in case if it becomes impossible to use the property for a higher valued use (tough restrictions on transfer)-example- family house will be exclusively used as a residence
- Solution-the rule against perpetuities (generation skipping rule)



Rights to use someone else's Property

- Can someone use another's property lawfully without owner's permission?
- Case of Ploof v. Putnam
- Putnam owner of the small island in lake Champlain. Ploof was sailing on the lake with family, when violent storm arrived suddenly. Ploof moored his sloop to a pier on that island, hoping that later they may sail in safety. Putnam's employee untied the ship (was worried that the sloop might damage property) and pushed it away. The ship driven by the storm and wrecked. Ploof sued Putnam. Putnam-the owner has the right to exclude trespassers. The court concluded that **in an emergency, one person can use another's property without permission. However the user must compensate the owner for the costs of use**, (hiker lost in mountains-uninhabited shelter, consumes food, but must provide compensation).



Inalienability and Unbundling Property Rights

- **Inalienable**-refers to something of yours that you cannot lose by specified means, (body organs, sex, sale of children, human rights)

Prohibition of transfers inefficient because it prevents people from getting what they want

Example: Inalienable bodily organs

- **Unbundling property rights**-the owner has rights a,b,c, and wants to unbundle it and sell right c to one person

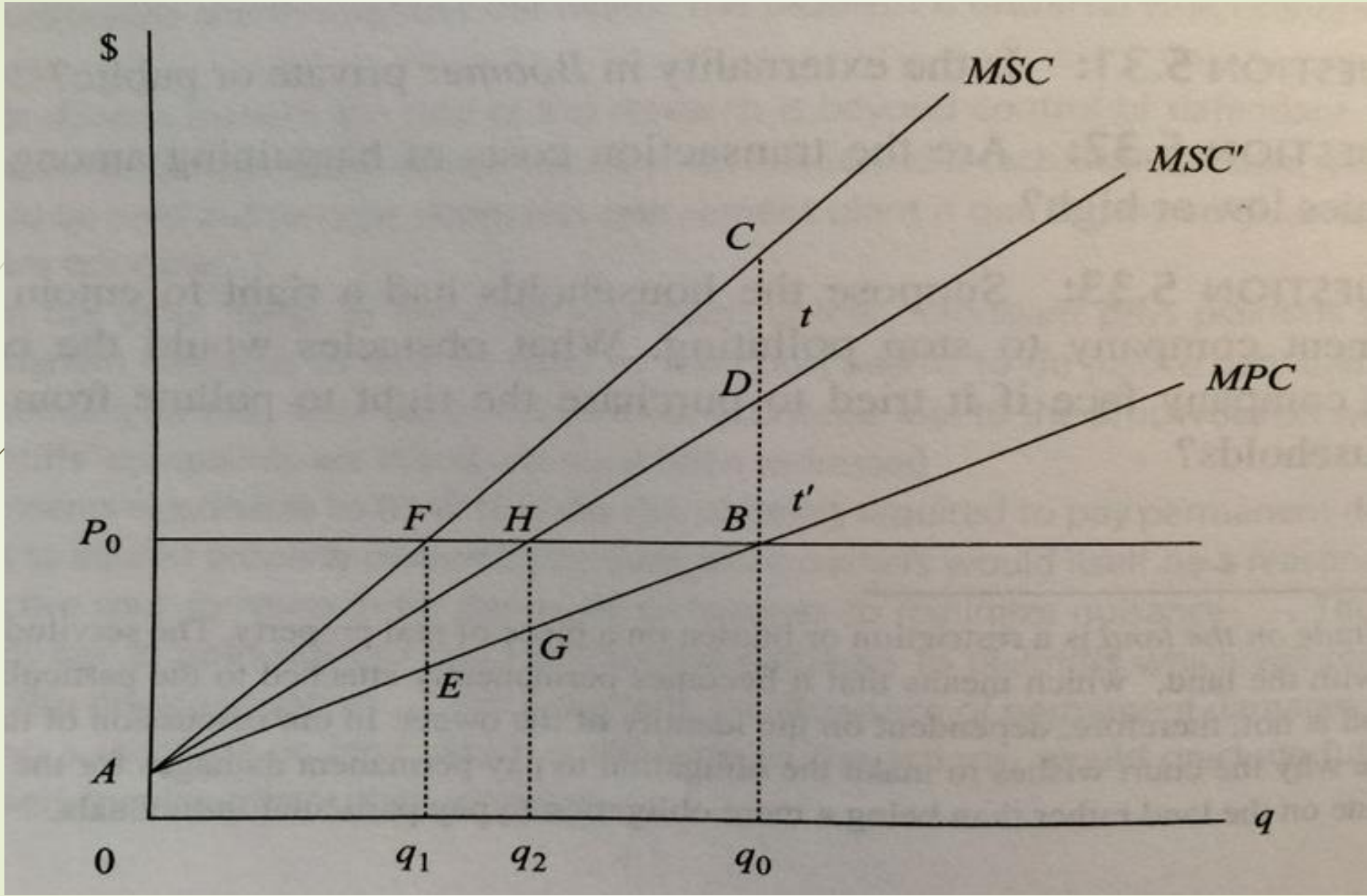
Example of family pocket watch

-can I unbundle rights in case of real estate-no I can only restrict the use by the future owners for a limited time (then rule against perpetuities applied)



Externalities and Remedies

- Externality
- Internalizing externality
- Private externality
- Public externality
- Public bads
- Nuisance
- Private nuisance-injunctive relief
- Public nuisance-damages
- Efficiency of temporary X permanent damages

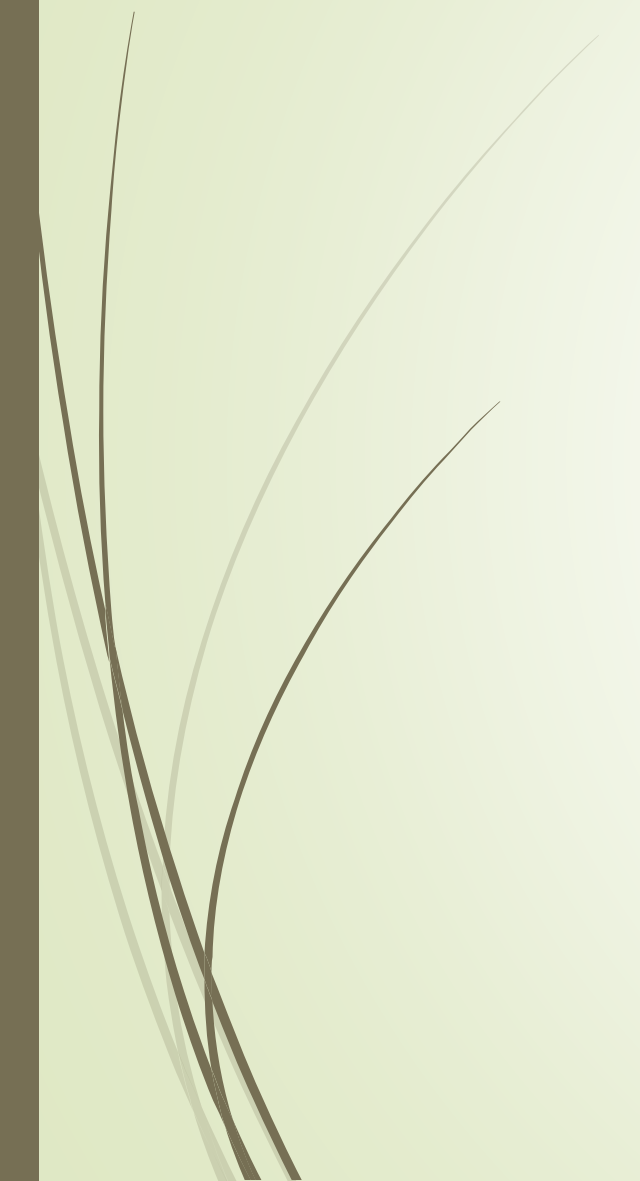



Takings

- ▶ Compensation
- ▶ Public use-state takes one person's property and sells it to someone else
- ▶ Hold-outs-government must purchase large tracts of land from many owners
- ▶ Insurance
- ▶ Regulations

Example: Xavier-government official- "land-use planning laws" to the south from blue line. The government wants to forbid industrial uses, but commercial uses allowed. Yvonne has a retail outlet, but she want to expand and utilize the rest of building for the factory. If she wants to invest into factory, then government decision will affect her and she will lose money. If the change is *regulation*-no compensation, if *taking*-then compensation. If Yvonne is confident that downzoning is taking and that she will receive compensation, she bears no risk from governmental action. She will invest as if there were no risk of loss. If she is confident that she will not receive compensation (regulation), then she bears the risk of loss, will not invest.

"paradox of compensation"-if the state compensates property owners for governmental takings, property owners have an incentive toward excessive improvements, whereas if the state does not compensate, the government has an incentive to overregulate private property



Národohospodářská fakulta VŠE v Praze



This work is licensed under the Creative Commons Attribution-ShareAlike 4.0 International License. To view a copy of this license, visit <http://creativecommons.org/licenses/by-sa/4.0/> or send a letter to Creative Commons, PO Box 1866, Mountain View, CA 94042, USA.