

Western University

Law and Economics

Lecture 5



Extension: Polinsky's example

Output of Factory	Marginal Profits of Factory	Marginal Damages of Resident	Total Profits of Factory	Total Damages of Resident	Total Profits less Total Damages	Marginal "Gains from Trade"
0	--	--	\$0	\$0	\$0	--
1	\$17,000	\$ 7,000	\$17,000	\$ 7,000	\$10,000	\$10,000
2	13,000	7,000	30,000	14,000	16,000	6,000
3	9,000	7,000	39,000	21,000	18,000	2,000
4	5,000	7,000	44,000	28,000	16,000	-2,000
5	1,000	7,000	45,000	35,000	10,000	-6,000
6	-3,000	7,000	42,000	42,000	0	-10,000
7	-7,000	7,000	35,000	49,000	-14,000	-14,000



Case

- [BOOMER V. ATLANTIC CEMENT CO., INC.](#)

309 N.Y.S.2d 312 257 N.E.2d 87

(Court of Appeals of New York, 1970)



Public vs. Private Goods

- Public goods cannot be provided efficiently by a free market because of
 - 1) non-excludability and
 - free rider problem
 - 2) non-rivalry in consumption.



Two rules of ownership

- 1. First Possession (finders-keepers): The first one to possess the property is entitled to use it.
- 2. Tied ownership: Ownership of a given resource determines the ownership of another resource.



Application – subsurface resource

- 1. First Possession:
 - "that oil and gas are not the property of anyone until reduces to actual possession by extraction" or
- 2. Tied ownership:
 - "that the owner of the surface has the exclusive right to sub-surface deposits"



He found \$182,000 -- in her bathroom. Who gets the cash?

- Bob Kitts: home-improvement contractor
- Amanda Reece: owner of an 83-year-old Cleveland home Kitts was rehabilitating
- As he was ripping plaster from bathroom-wall studs, Kitts found bundles of bills totaling \$182,000.
- They traced the home's Depression-era ownership to a businessman named Peter Dunne. Dunne apparently died unmarried and childless.



Theft

- "A person is guilty of theft, if he dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it".
- Why should it be a crime?
- Inefficiencies?



Can a Thief give Title?

- After leaving class, you purchase a diamond ring for \$1,000 from someone in the hall. It turns out that the ring was stolen. The real owner turns up.
- **The American Rule**
 - You never got title. The thief never had property rights and thus illegally transferred the ring to you. You must give it back.
- **The European Rule**
 - If you bought in good faith, it is yours. The original owner cannot recover.



Which Rule is Best?

- If C_o , the cost to the owner of protecting his property, is less than C_p , the cost to the purchaser of verifying the validity of the seller's title, then the European Rule is better.



Eminent Domain (Takings)

- "...nor shall private property be taken for public use, without just compensation."
– 5th Amendment, US Constitution
- Governments usually have the power to take private property for public use provided that they give the owner "just compensation." This power is called "eminent domain" or "expropriation".



An example

- A city wants to build a fire station on Sam's property.
 - It sees benefits (use value) of \$70,000.
 - While the market value of the property is \$50,000, Sam would want \$80,000 to compensate him for his use value.
- Taking at a fair market value vs. paying Sam's true value



Two possible sites for a fire station

Owner	Fair Market Value	Use Value to the Owner	Use Value as a fire Station
Sam Jones	\$50,000	\$80,000	\$70,000
Mildred Brown	\$55,000	\$60,000	\$68,000



The Case for Eminent Domain

- Indispensable property
 - There is only one property that would do the job. A mountain pass where a fort must be built to protect against invasion.
- When multiple properties must be purchased.
 - Transactions cost and hold-out problem



Holdout problem

- Suppose a local-government agency (the public developer) wants to purchase a large number of small properties for a project, such as a highway, a park or a commercial establishment that would have high value to the local government.
 - If the developer offers to buy the properties at prices favorable to the owners, most might sell.
 - But a few of the owners could threaten to block the project by refusing to sell at a reasonable price.
 - In return for selling their properties, such owners, called holdouts, could demand a substantial share of the value that the project would create.



Regulation vs. Taking

- A regulation is a legal restriction promulgated by government administrative agencies through rulemaking supported by a threat of sanction or a fine.
- Common examples of regulation include attempts to control market entries, prices, wages, pollution effects, employment for certain people in certain industries, standards of production for certain goods and services.



Facts: Xavier is a government official whose wall contains map with a thick blue line across it. Currently, the land-use planning laws allow the area to the south of the blue line to be used for any commercial, industrial, or residential purpose. The government proposes to change the law and forbid industrial uses, although commercial uses would still be allowed.

Yvonne owns a building that is located on the blue line. She currently uses the building as a retail outlet, but she contemplates expanding and improving the building for use as a factory.



- Yvonne must decide how much to invest in improving her building. If she abandons the idea of using her building as a factory, she will make a smaller investment in improving it for use as retail space, and the government's land-use regulation decision will not affect her. But if she proceeds with the idea of using her building as a factory, she will make a large investment, and the government's decision *will* affect her.
- Should the government carry out its proposed change, she will lose money on the large investment, and a court will then have to decide whether she is entitled to compensation for the loss. The decision will turn upon whether the court declares the change in the governmental land-use plan to be a regulation, in which case no compensation is due, or a taking, in which case compensation is due.


