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Book Review of
"Property Rights: Cooperation, Conflict, and Law" (Anderson and McChesney, 2003)*

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This book is a collection of 13 essays on the economics of property rights. The essays have been grouped in six parts, each of which begins with a short introduction by the editors. In the first part, Edwin West surveys the historical background of the concept of property rights. Yoram Barzel discusses the literature on property rights within business firms. In the second part, Thráinn Eggertsson explains the well-known economic consequences of open access, known as "tragedy of the commons". Louis De Alessi summarizes empirical studies on overexploitation of resources. In the third part, Terry Anderson and Peter Hill explain the evolution of private property in America's nineteenth-century West. Gary Libecap illustrates private contracting for property rights with case studies on the Brazilian Amazon and North American oil fields. David Haddock discusses how force and threat can be used by private parties to define and protect property rights.
In part IV, Dean Lueck examines several applications of legal first possession rules to establish property rights. Fred McChesney points out that the government can define and enforce property rights to prevent the tragedy of the commons, but it can also use its coercive power to create new inefficiencies. In part V, Bruce Yandle compares Pigouvian taxation and Coasean bargaining as alternative means to solve the externality problem caused by pollution. Harold Demsetz argues that externalities between two firms could be eliminated if they integrated into a single firm. Finally, in part VI Richard Epstein discusses several cases regarding the government taking of private property for public use. William Fischel addresses the issue of regulatory takings in the context of zoning.

The book is a very interesting and accessible introduction to selected topics that have been addressed in the literature on property rights. Hardly any knowledge of economic theory is required to

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understand the text. There is no formal analysis, even though some simple formulae could have significantly streamlined and clarified the discussion in several instances. For example, the explanation of the overfishing problem on pp. 61-68 (including two tables with numerical examples) is quite cumbersome and could be made precise in a few lines using first-order conditions. When the authors speak of a "model" (e.g., see chapter 9), they usually mean a figure showing a marginal cost and a marginal benefit curve. Of course, this falls short of what economists usually call a model. To be sure, the insight that marginal benefits and marginal costs can be decisive is an important achievement of economics, and for legal scholars this might still be a new way to frame problems. However, in the last decades substantial progress has been made in economic theory. In particular, powerful game-theoretic tools have been developed in information economics and the theory of economic incentives, which are relevant to the property rights issues but unfortunately are hardly used in the present book. Moral hazard (hidden action, hidden information), adverse selection, the hold-up problem, and incomplete contracting are obviously among the main economic characteristics of most topics addressed in the book. Unfortunately, there is no systematic treatment of the topics in the light of such well-known categories.

The words "free riding" and "prisoners' dilemma" occur for the first time on p. 147, even though the underlying ideas have been explained before. Indeed, the same ideas and the same examples are repeated in several chapters over and over again (which might be due to the fact that the chapters have been written by different authors). For instance, the "fast-fish loose-fish" rule and the "iron-holds-the-whale" rule that were used to resolve disputes in nineteenth-century Atlantic whaling are described in chapter 4 and again in chapter 5 and again in chapter 8. Most of the book is mainly descriptive. It is true that many of the examples and anecdotes are interesting. E.g., in chapter 4 we learn about beavers, elephants, shrimps, oysters, alligators, halibut, and arctic explorations. The stories about the American West, ranchers, cattlemen's associations, and gold mining in chapters 5, 7, and 9 are not quite as entertaining as a John Wayne movie, but still a joy to read. Yet, while these descriptions are interesting, the analysis is usually not very deep. One problem with a purely verbal analysis is that the assumptions that underlie the claimed conclusions are not made crystal clear. To be sure, many conjectures sound quite reasonable, even when they are only derived by hand-waiving. Nevertheless, economists who are not satisfied with statements that seem to be in accordance with common sense might prefer to see more precise arguments that could be transformed into formal economic models.

A major shortcoming of the book is the fact that much of the modern literature on property rights has simply been neglected. When speaking about the "property rights approach" or "the theory of the firm", today many economists refer to the seminal contributions of Grossman and Hart (1986) and Hart and Moore (1990), as summarized by Hart (1995). The latter two references are not even mentioned in the book. Grossman and Hart's (1986) model is only mentioned in a short footnote in chapter 2, where the author says that he discusses their model "in other articles" (no references are provided). To be sure, there are many ways in which the Grossman-Hart-Moore framework can be

criticized. However, I think it is inappropriate to simply ignore their approach altogether. If this book is supposed to be a primer on the economics of property rights (it says so on the back cover), then it should at least prepare the reader for the models that he or she will find on this topic in today's mainstream journals.

In one of the most interesting and lively chapters of the book, Pigouvian command-and-control solutions of the externality problem are contrasted with Coasean bargaining (chapter 10). As is well known, Pigou pointed out the possibility to internalize external effects with the help of governmental interventions. Yet, it is emphasized here that Pigou also doubted that any public authority would whole-heartedly seek that ideal, due to ignorance and corruption by private interest. On the other hand, as is well known, Coase emphasized that external effects could be internalized when the involved parties bargain with each other, provided that transaction costs are negligible. Yet, Coase has also made clear that in the presence of high transaction costs, it is possible that government actions may produce better results than negotiations between individuals in the market. In practice, fear of common law suits and investor punishment, eco-labeling of consumer products, or even the fact that factory managers "generally live in the vicinity of the factory" might help to reduce pollution, as is argued in chapter 10. However, I think that there may be quite some wishful thinking involved here.

When the numbers of polluters and potential victims are large (think of automobile drivers), I cannot see any practical alternative to taxation. Indeed, Rob (1989) and Mailath and Postlewaite (1990) have shown that bargaining between many agents over the provision of public goods cannot be successful in the presence of asymmetric information. A benevolent dictator could clearly achieve more. Of course, a real-world government is not benevolent. Yet, if the possibility of welfare-improving intervention is simply rejected, then this seems to be based on ideology, not on economic analysis. In any case, the recognition that "people, not nature, hold rights that must be protected" (p. 264) points to one problem that is usually overlooked in the Pigou/Coase debate. Pollution often affects future generations. People who are not yet borne cannot participate in Coasean bargaining and they cannot buy certificates. Of course, it is unclear whether politicians who are mainly interested in the coming elections have any incentives to consider long-run effects. In this context, it is interesting to recall how legislation created what is now the Yellowstone National Park (see chapter 5, and the discussion of the role that has been played by lobbying efforts of the Northern Pacific Railroad).

The second chapter on externalities (chapter 11) may also lead to controversial discussions. As an illustration, consider two parties, A and B, who choose activity levels $x \geq 0$ and $y \geq 0$, respectively. Let the payoffs of the two parties be given by the concave functions $A(x,y)$ and $B(x,y)$, where $A_x > 0$, $A_y < 0$, $B_x < 0$, $B_y > 0$; i.e., the parties' activities have negative external effects. The Coase Theorem says that in the absence of transaction costs, it does not matter whether A can insist on $y=0$ (regime I) or whether B can insist on $x=0$ (regime II). The parties will always agree on the first-best levels of x and y that maximize $A(x,y)+B(x,y)$. If the bargaining costs are prohibitively high, then in property rights regime I, $y=0$ and x maximizes $A(x,0)$, while in regime II, $x=0$ and y maximizes $B(0,y)$. Whether regime I or

regime II leads to a larger total surplus then depends on the functional forms. In chapter 11 it is now argued that integration of A and B in one firm would eliminate the externalities, implying that x and y would be chosen in order to maximize A(x,y)+B(x,y).

This example nicely illustrates several problems. The term "integration" is used here in the sense of the industrial organization tradition. As has been pointed out by Tirole (1988, p. 170), the term integration for the benchmark solution is misleading. On the one hand, the benchmark solution might be achieved by contracting between independently owned firms. On the other hand, it is not obvious why incentive problems should disappear when the ownership structure is changed. If party A and party B are needed to choose x and y (assume that they have unique human capital), all that is changed by integration might be what would happen if bargaining between the two parties failed – this is precisely the point of view adopted by Grossman and Hart (1986). Moreover, the example illustrates that we must be precise about the information structure. If x and y are verifiable, the first-best solution can clearly be achieved. Yet, x and y may be hidden actions or they might be observable (by the parties) but unverifiable (by the court). In the latter case, the analysis will depend upon whether or not renegotiation can be ruled out. Alternatively, the parties A and B might have pre-contractual private information (it is not obvious how this could be changed by integration). For example, the payoffs may be $A(x,y,\theta_A)$ and $B(x,y,\theta_B)$, where only A knows the realization of the random variable θ_A and only B knows the realization of θ_B. In the latter case, the findings of Myerson and Satterthwaite (1983) imply that it might be impossible to achieve the first-best solution by voluntary bargaining. The government could implement the first-best solution, because it has coercive power and can violate the parties' participation constraints. Of course, whether or not the government will do so depends on its objective function.

To conclude, this book (which has a beautiful front cover) contains a number of interesting anecdotes and case studies related to the economic theory of property rights. Several topics are omitted. Leasing, franchising, licensing, employee-owned firms, cooperatives, nonprofit firms, and many other issues are not mentioned in the book. Privatization is briefly mentioned, but the relevant literature is not discussed at all. Consistent with the critical view of the state, it is argued that the government might not privatize enough (p. 246), even though some observers may think that blackouts in North America and train accidents in Europe could have been avoided if there had been less privatization. The economic methodology used throughout the book is elementary, so that legal scholars without prior knowledge in economics will encounter no obstacles. Economists who are interested in the recent literature and formal models might be less satisfied. When theoretical concepts are mentioned, this is often done in an imprecise way (e.g. "tit-for-tat or other games", p. 188), the underlying assumptions are not mentioned (e.g. why are contracts only bilateral on p. 232), or standard results are ignored (e.g., in contrast to what is said on p. 340, it is well-known that in profit-maximizing auctions the seller should discriminate against stronger bidders; see Myerson, 1981). However, I can recommend

the book to economists who are looking for interesting stories, thought-provoking arguments, and valuable summaries of the history of economic thought with regard to property rights.

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