PUBLIC PROPERTY AND PROPERTY RIGHTS THEORY

Abstract

The state has a dominant position in property rights. It sets the rules which all persons must follow when exercising those rights. Such institutions critically affect decision – making regarding resource use and hence, affect economic behavior and performance. By allocating decision making authority, they also determine who are the economic actors in a system and define the distribution of wealth in a society. Because certain property rights arrangements can reduce transaction costs in exchange and production and encourage investment, in order to promote overall economic growth, they have public goods aspects. Moreover, it is sometimes possible to create or change rights in land so that public property can be developed privately or commercially. This paper attempts to examine how can property rights on public land be available in an economically efficient way and if the state should limit itself in the exercise of property rights. Finally, it examines the problems encountered in negotiation and the political and economic considerations that influence property rights arrangements on public property, since the political bargaining underlying property rights contracts is essential in order to understand the outcomes.

A. INTRODUCTION

The economists have discovered a more systematic approach to balancing the multiple issues of public goods and, therefore of public property. The system is named for Charles Tiebout (1956), who first identified the possibility of migration and local government as a means of dealing with the provision of a particular type of public goods (Fischel, W., 2003:347).

Before Tiebout economists suggested that the problem of providing these goods was no different from that of providing national defense. The free rider problem engendered by non – exclusiveness of goods required that the only mechanism of dealing with public property was political. While economists from Erik Lindahl (1919), onward have discussed how voting shares might be reconciled with tax shares, the default answer for public property was that elected officials should only deal with it. They would set expenditures and raise tax monies to fund it at the levels that private citizens would have found optimal themselves. State paternalism seemed the best solution to public good provision and so, to the management of public property, because no one saw an opportunity to establish property rights for the provision of such goods.

Because the free rider problem seemed to be no different at the local level than at the state or national level, mainstream public finance theory before Tiebout had no reason to explain the existence of local government, or even prefer it to more centralized governments. Larger units of government actually seem preferable under such conditions. Tiebout (1956) argued, however, that the existence of many local governments within a metropolitan area, might provide an alternative solution to the free – rider problem. As Tiebout envisioned the process, municipal managers would offer a menu of public services and potential residents would choose their residence from among competing communities. By doing so, residents would reveal their demand for local public goods. Municipal managers might act like firms, but even if they were not governed by the profit motive, Darwinian selection (as suggested by Armen Alchian 1950) could winnow out those who did not give potential immigrants what they wanted.
Since this model was also incomplete (it did not explain for instance, how local public goods were financed), got little attention, until Wallace Oates (1969) pointed out that most local governments financed their public services with property taxes and these taxes and the activities they financed provided a guide of the fiscal benefits of each community to potential residents.

Oate’s empirical research found that differences in property taxes and public services were reflected in home values: Home buyers purchase a community along with a home. Communities with better schools and lower taxes have higher home values (Dee 2000). This relationship indicates that potential residents do indeed value public goods when selecting a place to live.

This paper is intending to answer some important questions referring to the Greek management of public property. Could the model of establishing property rights be applied to the management of the public property in Greece? Does the Greek legal framework enable a more efficient regime on property rights? If the answer is positive, how can property rights on public land be available in an economically efficient way and in what way the state should limit itself in the exercise of property rights? Finally, in this paper, it is investigated the differences between property ownership and economic ownership and the importance of the latter at the establishment of rights on assets.

B. PROPERTY RIGHTS THEORY

Property rights are the socially acceptable use to which the holder of them can put the scarce resources to which these rights refer. It is the bundle of legal rights which describe what a person may or may not do with the recourses he owns: the extent to which he may possess, use, transform, bequeath, transfer or exclude others from his property.

Private property rights have two other attributes in addition to determining the use of a resource (Alchian A.). One is the exclusive right to the services of the resource. Thus, for example, the owner of an apartment with complete property rights to the apartment has the right to determine whether to rent it out and, if so, which tenant to rent to; to live in it himself; or to use it in any other peaceful way. That is the right to determine the use. If the owner rents out the apartment, he also has the right to all the rental income from the property. That is the right to the services of the resources (the rent).

Finally, a private property right includes the right to delegate, rent, or sell any portion of the rights by exchange or gift at whatever price the owner determines (provided someone is willing to pay that price). If I am not allowed to buy some rights from you and you therefore are not allowed to sell rights to me, private property rights are reduced. Thus, the three basic elements of private property are (1) exclusivity of rights to choose the use of a resource, (2) exclusivity of rights to the services of a resource, and (3) rights to exchange the resource at mutually agreeable terms.

According to the property rights theory, the primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities. Every cost and benefit associated with social interdependencies is a potential externality. One condition is necessary to make costs and benefits externalities (Desmetz). The cost of a
transaction in the rights between the parties (internalization) must exceed the gains from internalization. In general, transacting cost can be large relative to gains because of the difficulties in trading or they can be large because of legal reasons. In a lawful society the prohibition of voluntary negotiations makes the cost of transacting infinite. Some costs and benefits are not taken into account by users of resources whenever externalities exist, but allowing transactions increases the degree to which internalization takes place.

The role of property rights in the internalization of externalities can be made clear within the context of the above examples. A law which establishes the right of a person to his freedom would necessitate a payment on the part of a firm or of the taxpayer sufficient to cover the cost of using that person’s labor if his services are to be obtained. The costs of labor thus become internalized in the firm’s or taxpayer’s decisions. Alternatively, a law which gives the firm or the taxpayer clear title to slave labor would necessitate that the slaveowners take into account the sums that slaves are willing to pay for their freedom. These costs thus become internalized in decisions although wealth is distributed differently in the two cases. All that is needed for internalization in either case is ownership which includes the right of sale. It is the prohibition of a property right adjustment, the prohibition of the establishment of an ownership title that can thenceforth be exchanged, that precludes the internalization of external costs and benefits.

C. THE ECONOMIC OWNERSHIP

1. The definition of the economic ownership

The economic ownership school approaches property from a perspective of the actual appropriation and searches for titles, lawful and unlawful alike, that bring it about. This enables it to reach some pertinent inferences on the deviations of economic from legal ownership.

Economic owners are those into whose hands income flows in the sense that they decide on the utilization of that income are economic owners of thing – good (Bajt, A, 1993:86). While the right of ownership assigns the right to use things – goods, economic ownership expresses actual use as reflected in the distribution and appropriation of income. In this sense, economic ownership is a question of fact. It is economic ownership with which legal ownership is concerned.

The things that people are legally entrusted with may, but need not generate income. If they generate income, owners may not appropriate it or may not appropriate it in its totality. Holders of the right of ownership (legal owners) may not be economic owners in that case. On the other hand the income that people are appropriating may but need not be based on ownership; economic ownership may also be based on public law rights, on adverse operation of any civil law, ownership rights included, and also on no legal rights at all, on illegal appropriation.

2. Distinction between ownership in the legal and ownership in the economic sense:
1. While in the legal sense any object of the external world, whether or not useful, can be owned in the economic sense only economic things – goods are objects of ownership.

2. Since goods are owned to secure the services – income flows they provide, which promotes them to factors, the true object of ownership in the economic sense are factors.

3. The physical form of both the income flow and factor is irrelevant from the economic ownership point of view.

4. The value of any factor derives from the value of the generated income flow. Since income flows extend into the future, the value of any factor equals the present value of the respective future income flow.

In order to make the appropriation of the integral flow possible, the property rights doctrine insists on a rigorous specification of rights, their exclusiveness and clear delimitation and protection and enforcement by the state. Above all, it insists on unrestrained rights, not attenuated either by a ban on some uses or by a diversion of the income stream away from the factor owner.

The reason appears to be obvious. On the efficiency assumption, there exists a perfect positive correlation between the volume of property rights assigned to a factor owner and the volume of the income flow he appropriates. If any of them is lowered – attenuated, the other adapts downwards. If property rights are attenuated, income flows diminish correspondingly. If income flows are diverted form owners to other recipients, use of property rights and factor inputs shrinks.

According to the property rights school, there exist two possible solutions to the problem of externalities. The first is to handle them by taxing (feeing, fining) and subsidizing or other governmental action. This is Pigou’s approach, followed by many economists. As it is regarded as suboptimizing allocation of resources, negotiation between agents whose rights collide is proposed as a superior method. This is the approach of the property rights school.

Assuming transaction costs to be zero, a market perfectly competitive and all factors of an economy privately owned, renegotiation of rights leads to an optimum allocation of resources and maximum growth. According to the so – called Coase theorem, this will be invariant to the original assignment of property rights. Via renegotiation, any original assignment of property rights brings about the same allocation.

Due to the renegotiation, rights are contractually attenuated, realigned. In fact, new rights are created and income flows are correspondingly rearranged. This perfectly fits the contractarian type generation of rights and also accounts for the force of etiquette, social custom and ostracism (Alchian 1965: 129) and social norms and people’s taste for good society (ideology) (Eggertsson 1990: 454) in the emergence of property rights.

Unfortunately, transaction costs are usually not zero but positive, frequently very high; renegotiation is influenced by unequal bargaining power; and many factors are not assigned to private persons at all (public property, social property in socialist countries). In such conditions renegotiation of rights does not necessarily lead to optimum allocation. This is the case for public law intervention forbidding or restraining some uses and stimulating some other. In this case, property rights are attenuated not contractually
but by public law. Along the lines of the property rights reasoning, such interventions if not fully off the track, optimize allocation.

Public law attenuation of property rights is not prompted merely by impediments to the optimum allocation of resources via renegotiation. Old rights are attenuated and new ones are created by autonomous public intervention as well. This is exogenous attenuation. The modern massive public law statutory liability and environmental regulation illustrate this. Of course it could be argued that allocation is suboptimized in this way. Yet, once the public law generation of rights in solving the externalities problem has been recognized to optimize allocation, the argument against autonomous public law attenuation and creation of new property rights leading to realignment of economic ownership becomes unconvincing. In fact, in cases of nonoptimum renegotiation, initiative frequently originates from public bodies rather than private agents. The property rights school criterion of the total effect (Coase 1960: 44) makes public intervention an unavoidable complement to the structuring of property rights in general.

This allows us to systemize three points that weaken the negativist property rights school stand on the public law rights:

1. The public law shares in the creation, protection and enforcement of property rights. The contractual market derivation of property rights, as opposed to the public law rights, can be accepted as a first approximation and a typical genesis only. Economics teaches us that even within these confines derivation is truly contractual only if the distribution of bargaining power is not skewed. Besides, because of positive transactions costs and many factors not assigned to private persons, negotiations of rights gives way to public law interventions. Furthermore, while property rights are protected and their observance enforced by civil law instruments and violation prosecuted as criminal act, progressively more liability has been established by public law statutory regulation, so that in the view of some, tort law should be regarded as a stopgap pending future statutory. Finally, the property rights systems as such are protected constitutionally and their observance enforced publicly and by public law instruments and state coercive machinery.

2. The public law contribution to the property rights optimalization of allocation. In many cases both unlawful appropriation and public law rights submaximize income streams. However, it need not always be the case. We have already met situations in which public law interventions into private property rights improve rather than impair efficiency. Quite generally, in modern welfare states large parts of income are subject to redistribution on the basis of public law interventions, such as property and income taxation, especially progressive, high social contributions, collective bargaining, price and rent controls, inflationary money creation, forced savings capital formation and so on. While discussions on the relative efficiency merits of these interventions are not yet concluded, and while many of them probably and some certainly stretch too far, it is beyond doubt that with all of them eliminated and with appropriation based on civil law property rights exclusively, efficiency would be hurt considerably.

3. The ideological underpinning of such treatment. Any theory that worships a specific property rights and / or economic ownership structure as the most efficient irrespective of the relevant circumstances is ideologically biased. In as far as the property rights school insists on exclusively civil law based appropriation, it owes this to its
specific liberal ideology. The same applies to any enforced economic ownership structure.

D. THE BASIC PRINCIPLES AND DIRECTIONS ACCORDING TO THE GREEK CONSTITUTION DETERMINING CHOICES AT THE MANAGEMENT OF PUBLIC PROPERTY:

The most basic elements in defining an economic establishment are the range of exercising and developing of private economic initiative. Pinpointing the ease and extent to which the State can intervene in financial activities is the basis for defining the economic establishment and classifying it according to traditional models. The economic provisions in the Constitution, therefore, reveal the guidelines that the legislators must not trespass.

When considering the institutional framework set by the Greek Constitution, the choices available for administering public property and determining property rights on it cannot be used to carry out radical liberal policies. Indeed, economic activity is planned and coordinated by the political administration, as defined by the provisions of chapters 1, 2 and 3 of Articles 106 of the Constitution. As a result, the ideological background of the Greek Constitution is more in line with the theoreticians of social contract, than with the neo-conservatives. Public interest, according to the Greek Constitution, is the general will which supersedes the needs of any private economic initiative.

Moreover, the constitutional restrictions according to which private fiscal initiative are not allowed to engage in activities which would damage national economy do not alleviate the related obligations the State is obliged to respect the field of private economic activities. It only sets certain specific and extreme boundaries on the freedom of such activities, especially in sectors that have aspects of monopoly and serve vital needs of society. Similarly, completely banning the regulatory powers of the legislator in the field of private financial activity is not constitutionally accepted when it leaves the general interest and the national economy unprotected and endangers the fruits of economic freedom with possible irrational choices of private financial initiatives. Thus, the Constitution precludes certain extreme options concerning the overall status quo of the economy, disallowing the total nationalization of the economy and the admission of private property rights on them (Tsironas A.;38).

It should be stated at this point that such constitutional obligations function on two levels: on the one hand, they directly bind administrative bodies, as all the State’s activities including its contractual activities are subject to the Constitution; on the other hand, constitutional obligations restrict legislative authority as they require regulation of the contractor’s selection procedure in such a way so as to safeguard the principle of equality. This contrast is a direct result of the difference in the constitutional quality between contracts in the public and private sectors. With respect to the latter, legislators are negatively bound by human rights; therefore, they can only intervene externally, setting the limits of private autonomy. The opposite holds true of contracts in the public sector, where contractual liberty is absent and the efficiency of contractual relations requires that choices be made in accordance to constitutional provisions (Kaidatzis A., 2006: 65).
This also influences the options available in managing public property; the State may be forced to yield part of its authority. Nevertheless, according to the relevant case law by the Council of State (CoS), the public sector cannot admit property rights on activities that according to the Greek Constitution fall under the direct and exclusive jurisdiction of the State. Typical examples include national defense, law enforcement and the execution of justice or the penalties imposed by authorized courts. The Constitution offers more details as to what these activities are. There are three criteria that can help us define the activities that, according to the Constitution, fall under the direct and exclusive jurisdiction of the State: firstly, exercising public authority; secondly, public authority exercised as part of the social state; and thirdly, all those activities referred to in the CoS relevant case law.

All the above, in conjunction with the scope and content of the constitutional protection granted to private economic initiative, lead to the conclusion that the current Constitution does not enforce an exclusively free market economy. The restrictions imposed on business activity by legislation and regulation, as well as the direct intervention in the function of private enterprises, are considered constitutional State intervention. Naturally, these factors are in no way sufficient to define the Greek economic system as a purely public economy. However, they are sufficient to shake the belief that the Greek constitutional order, that tolerates State penetration in private economic initiative to such a degree, provides for a pure free market economy and is ready to admit property rights on public property. Hence, a more consistent view would be to say that the Greek economic system presents several elements characteristic of a mixed economy – a statement supported by the prevailing view as well as case law.

It is, therefore, obvious that the Constitution grants individual legislators a relevant freedom of action, in other words, a wide discriminatory power to tackle economic problems and shape broader economic policies. Given that the constitutional guarantees of individual rights and the social state are not infringed upon, it follows that the Greek Constitution can be characterized as open with respect to economic policy and the economic regime in general (Manitaki A., 1994: 1204).

However, even if the Constitution does not include special provisions that enforce a particular economic regime, it cannot be considered economically and politically neutral. Besides, the critical element that defines the character of an economic regime is no longer the balance of relations between production and ownership, as defined by constitutional economic provisions, but the constitutional balance between individual liberties and the corresponding State powers. The constitutionally protected economic regime attempts to strike a compromise between two extremes: on the one hand, there is the legal field pertaining to enjoying economic freedom and expressing private economic initiative, and on the other hand there is the field of State intervention, within which the State attempts to coordinate the economy and safeguard public interest. The State’s most important means of imposing power is economic penetration and participation in business activities (Tsironas A., : 43).

Taking into account the particular balance between economic rights and their restrictions, one could claim that the Greek Constitution allows for the enjoyment of economic freedom in a mixed liberal economy and can therefore allow property rights on public property. It also makes provisions for exercising private economic initiative in a liberal interventionist economic regime. However, any political position that drastically
departs from the current economic regime, regardless of whether it leans towards extreme liberalism or towards an entirely State-run economy, is incompatible with the Constitution. It follows that the management of public property must be practiced within the framework of neither a purely liberal nor a purely interventionist economic policy.

E. CONCLUSION

Property rights are essential social institutions for combating the potential wealth losses associated with open access. That is, when there is no clear definition of ownership over valuable assets, then parties will wastefully compete for them and underinvest in them (Liedcap, G., 2003: 165). In the most extreme case, the value of the asset will be fully dissipated through competition for control and through lost opportunities for investment and exchange (Anderson and Hill 1983). More commonly, such extreme cases will be avoided, but the potential wealth from effectively exploiting the resource will not be reached, and some unsatisfactory, underperforming state will prevail. To remedy this situation, individuals have incentives to negotiate privately or through government to develop more complete property rules. The desire to mitigate the losses of open access and to secure the associated gains is not always sufficient to bring beneficial institutional change. Even when some agreement on property rights is possible, its form may deviate sharply from what would seem to be the most desirable arrangement.

The details of the bargaining or contracting process explain why. The parties are motivated by rational self-interest in distribution – their share of the aggregate social returns from agreement. If the anticipated shares make the parties better off relative to the status quo, then agreement is likely. If not, the parties are motivated to continue under the current regime, even if there are aggregate social losses from so doing. The larger the total benefits of devising new or modifying old property rights, the more probable is agreement.

The more homogenous the parties, the more likely they will be able to construct and agree upon an assignment of property rights (shares). Where the parties differ in important dimensions, such as production cost or access to information about the value of the asset, then agreement on property sharing rules will be more difficult. If the numbers are large, the transactions costs of reaching agreement will be increased. These points help explain the persistence of seemingly ineffective property rights arrangements across societies and across time. The parties may agree that something must be done, but they cannot agree on how to proceed most effectively.

Given the importance of property rights institutions for efficient resource use, more attention must be paid to their development, and where they are effective, they must be protected. There is always tension between the productive benefits of secure property rights and the distributional results of a property allocation. Distributional concerns drive the negotiations for developing and modifying property rights. Understanding these concerns and how they impact contracting for property rights are necessary in explaining why a society has the kinds of property rights that it does and the obstacles that are faced in attempts to modify them. High levels of economic welfare cannot be taken for granted. As property rights are abridged in response to distributional concerns, the range of economic opportunities available to the owner is narrowed. The resulting shift in
expected returns can lead to different and less valuable resource use with profound economic welfare consequences for the entire society.

It must be noted that the political and social context are essential for whether or not and in which direction institution change. The change should fit to the institution; any change in the rules governing the use of property rights has to fit in the existing formal uses and informal packages.