Encyclopedia of Law and Economics

Volume II

Civil Law and Economics

Edited by
Boudewijn Bouckaert
and
Gerrit De Geest

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FOREWORD

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The law and economics movement was for a long time regarded as an American movement. This was never completely correct. Its origins, certainly, are international. British economists, Adam Smith and Jeremy Bentham to begin with, and later A.C. Pigou and Ronald Coase (among others), played a founding role, as did Max Weber - himself both a lawyer and an economist. Friedrich Hayek and Bruno Leoni are other examples of scholars from outside the Anglo-American sphere whose thought has had an influence on the movement. And there are others. Today, at any rate, it is plain that the movement is international. There are law and economics associations in Europe and Latin America as well as in North America, law and economics scholarship is being produced in every major country and in many minor ones, and several of the leading journals are published outside the United States. Improvements in transportation and communications, and the rapid diffusion of English as the international language of scholarship, has fostered the internationalisation of law and economics. And there is growing recognition that comparative studies are an indispensable tool for gaining a better understanding of the economic nature and consequences of law. It is, for example, most unlikely that we will ever gain an adequate understanding of the efficiency of the Anglo-American 'adversarial' system of legal procedure without comparing it to the 'inquisitorial' system that prevails in Continental Europe; or understand the role of property rights in economic growth without studying the experience of the Central and European nations that have recently emerged from Communism.

Along with the internationalisation of the field has come an extraordinary growth in breadth of coverage and in specialisation of focus. Few areas of legal scholarship remain untouched by economics. Apart from the obvious examples - areas such as taxation and antitrust and securities regulation and (other) regulated industries and commercial law, all areas where the law is explicitly engaged in regulating economic activity - recent decades have seen a broadening of interest to include tort, contract, family, intellectual property, constitutional, criminal, admiralty, labour, arbitration, and antidiscrimination law, among others. But not only have more and more areas of law been brought under the lens of economics; more and more of the increasingly technical tools of economics - itself a field undergoing rapid growth and

increased specialisation - have been brought to bear on the law, along with the latest in game theory. An immense and difficult body of monographic and journal scholarship is the result.

When a field becomes large, diverse and technical, it cries out for encyclopedic coverage. Thirty years ago one person, in one book, could map most of the terrain of law and economics. That is no longer possible. It has become infeasible for any single individual to keep fully abreast of the field of law and economics. He or she cannot be fully expert in every area of the field. And yet from time to time the scholar will find it necessary to cross the boundary that demarcates his own area of primary interest. For such a person, the opportunity of getting a quick overview of another part of the field by reading an encyclopedia article is welcome and even essential. It is even more welcome to those scholars, consultants, and practitioners who do not consider themselves 'law and economics' people, but whose work intersects the law and economics field. Law and economics has had interesting things to say about virtually every area of law, and this makes it of potential relevance to anyone working in one of those areas, who might be a practising lawyer, an economic consultant, a sociologist, psychologist, historian, or philosopher. For these 'outsiders', facing a research or practical task to which law and economics may be relevant, the opportunity to consult an encyclopedia article as the initial port of entry into the law and economics field is of immense potential value - as it is to students, and to scholars who are beginning to work in law and economics and want a broader view of the field before they decide where to specialise within it.

The *Encyclopedia of Law and Economics* endeavours, I think very successfully, to provide the kind of encyclopedic coverage - comprehensive and sophisticated but lucid, international without being esoteric, uniform without being monochrome, collective but individual - that the field of law and economics requires. It will help to make the field accessible to outsiders and to promote mutual intelligibility among insiders. It provides a meeting place for and an overview of a vast activity of scholarship, and will thus help to unify and advance the field. It is a milestone in an advancing field.

INTRODUCTION

Boudewijn Bouckaert and Gerrit De Geest
General editors

General Aims

The *Encyclopedia of Law and Economics* is an ambitious reference work that attempts to survey the whole law and economics literature in nearly 5,000 pages. Most entries contain two elements: a review of the literature, written by an authority in the field, and a quasi complete bibliography (not just a selection).

Economic analysis of law has expanded dramatically in recent years. In many branches, the literature is now at a 'mature' stage, where scholars agree on basic concepts, theories and even on policy recommendations. Yet, this scholarship does not reach many policymakers, lawyers or judges. Outside the USA, it even does not seem to reach law professors. This is not so much due to the fact that policymakers, judges or law professors are not interested in the economic consequences of legal rules, but rather to the fact that the literature is too inaccessible. There is a clear need for reference works that give a reliable overview of the literature in a way that is understandable also for non-specialists. This is the primary purpose of the *Encyclopedia of Law and Economics*.

Reviews of the Literature

The reviews are relatively lengthy articles (on average nearly 10,000 words) in which the basic questions and items of discussion are explained, the literature is summarized, critical reflections on these publications and on the evolution of the discussion in general are developed, and perhaps suggestions for further research are made.

The authors have been asked not to make their surveys too technical in order to make sure that readers without a mathematical training can still understand them. The result is in-depth and up-to-date syntheses of the literature that are still accessible for non-specialists, like judges, politicians or undergraduate students. All review articles have been anonymously refereed.

Bibliographies

The *Encyclopedia of Law and Economics* is to a great extent also a bibliographical work. In most cases, authors have tried to be quasi-complete.

The bibliographical lists at the end of all entries are not a 'list of cited works'. They list many more references than could be discussed in the text. Beside the bibliography of law and economics studies on the topic itself, many entries contain a second list, entitled 'Other References', which are references cited in the text, but either purely legal, philosophical, sociological, or cited law and economics publications that are not directly related to the very topic (for instance, many authors have cited Coase, 1960).

There is no doubt a need for these such specialized bibliographies. The law and economics literature has exploded in recent years (this Encyclopedia lists over 20,000 law and economics publications). However, to date it has not been so easy for readers to find the relevant publications, because they are spread out over law reviews, economics journals, conference volumes and so on. The fact that economic analysis of law is an interdisciplinary approach means that the specialized bibliographies in economics (like Econlit) or the specialized sources on law (like Lexis or Westlaw) give a very incomplete overview. Moreover, titles of articles or books do not always make clear whether the research was purely legal, purely economic, or truly interdisciplinary.

Quotation Style

As anyone can experience every day, there is no uniformity concerning the quotation style in law and economics, nor in economics or legal science. To make the bibliographies useful for as many scholars and students as possible, it is the policy of the *Encyclopedia of Law and Economics* to provide the maximum of information, but within certain limits. More specifically, the references to articles contain in principle the volume number of the journal and the year of publication, as well as the number of the first and the last pages of an article. Journal titles are written out in full. Titles of works in languages other than English are translated into English.

Structure

The *Encyclopedia of Law and Economics* has a pyramidal structure. The question was what structure had to be chosen. The general division of legal rules into branches differs fundamentally among legal systems. Most continental (European) legal classification systems are based, for instance, on the division between public law and private law. They also unify contract law, tort law and the law on restitution into one branch of law, called 'law of obligations'. American lawyers would have a hard time trying to find their way in such a system. The classification system of Econlit (where K is 'law and economics')

was in our opinion no perfect alternative either, since it is not detailed enough and not much common-law oriented to satisfy continental lawyers.

Therefore we decided to elaborate a new, detailed classification system, inspired by both legal theory and law and economics insights. After a methodological and historical part (0000-0900), the law is divided into substantial norms (1000-6000) and meta-norms.

Substantial norms are divided into property (private property 1000 ff., common property 2000 ff.) and the transfer of property (involuntary transfer between private parties - tort law and restitution - 3000 ff.), voluntary transfer of property between private parties (general contract law, 4000 ff., and the regulation of contracts, 5000 ff.) and involuntary transfers between citizens and the state (taxation, social security, takings, 6000 ff.).

Meta-norms include litigation and evidence law (7000 ff.), criminal law (putting some additional incentives on legal rules defined in other branches of law) and rules on the production of legal rules (9000 ff.).

A correct classification system can improve analyses by suggesting what kind of models are to be applied. Medical malpractice, for instance, is considered by Anglo-American rules as a branch of tort law. It is more correct from an economic viewpoint to consider it as a regulation of contracts between physicians and patients (therefore it is treated in the volume on the regulation of contracts and not in the general part on tort law). Marriage law is according to many legal systems a part of 'family law'. Again, it is better to see it as the regulation of a specific contract. Modern economic scholarship on marriage law tries to apply the models on optimal contract remedies to the problem of unstable marriages.

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CONTENTS

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ORIGINAL ASSIGNMENT OF PRIVATE PROPERTY

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Abstract

Within the context of property rights' systems, developed either by traditional tribal communities or by modern political communities, one will always be confronted with the problem of non-appropriated and abandoned assets. In the legal tradition we use to call the first category *res nullius*, the second *res derelictae*.

The question arises by which rule or procedure res nullius and derelictae should be brought under an ordered property rights' regime and be put, provided transferability of such assets is recommendable, within market circulation.

This entry summarizes the modern economic theories on these issues.
JEL classification: K11
Keywords: First Appropriation, Capture, Occupation, Auction, Title, Initial Acquisition

1. Introduction

Within the context of property rights' systems, developed either by traditional tribal communities or by modern political communities, one will always be confronted with the problem of non-appropriated and abandoned assets. In the legal tradition we use to call the first category *res nullius*, the second *res derelictae*. The origins of the res nullius-res derelictae problem are obvious: (1) either already known assets are not yet appropriated by members of the concerned community or are abandoned again by these numbers; (2) new types of scarce resources, which were not known or not regarded as scarce at the moment of the articulation of the rules of the property rights system, may appear. Examples of (1) are: newly discovered, acquired or conquered land such as the American West, wild animals, water from seas, oceans and streams. Examples of (2) are: inventions and artistic creations, frequencies of the broadcast spectrum, subsurface minerals, orbital spaces.

The question arises by which rule or procedure res nullius and derelictae should be brought under an ordered property rights' regime and be put, provided transferability of such assets is recommendable, within market circulation.

In order to demarcate the subject matter of this chapter as clearly as possible from other topics, it is necessary to point to some differences with the problem of the emergence of a property rights system as such and with the notion of adverse possession.

The problem of emergence of property rights systems regards the economic rationale and the involved cost categories of setting up a property rights rule system and institutions as such. Under the heading of emergence of property rights, the evolutionary proces from an institutionless and ruleless open access-situation towards an ordered system of rights, administrative, policing and adjudicative institutions, is analyzed. In this chapter a problem is discussed which will necessarily always emerge also within established property rights systems. The problem of the emergence of property rights systems implies also the rights' area of political power. For this subject matter we suppose that the constitutional problem of the right political power-balance is solved in an economically rational way, so that the problem may be defined as a choice to be made by an economically rational political or judicial agent between different alternatives concerning the establishment of property rights on res nullius on derelictae. Of course, there are strong similarities between the two subjects. In both cases, for instance, one has to deal with initial open-access situations and one will be faced, as a consequence, with the problem of establishing property rights on stock or rights of capture on flows of stocks.

The problem of initial acquisition should also be distinguished from the problem of *adverse possession*. In the former case, one is dealing with assets which are unowned in terms of the concerned legal systems (for example, land of the American West in terms of the US legal system, not necessarily in terms of native American tribal systems). In the latter case, one is dealing with assets which are, though still owned, not in factual possession of the owner but of another person, that is, the adverse possessor. The problem of adverse possession regards both the relationship of the adverse possessor with third parties and with the real owner (see further in this volume, 1200, Adverse Possesion and Title Systems). In both cases, however, one has to deal with the problem of the definition of possession; in the first case because often first possession constitutes the legal base of initial acquisition, and in the second case in order to determine when one is entitled to claim the protection the possessor enjoys against third parties, and to determine the start of prescription periods.

2. First Appropriation or Auction?

The rule of first appropriation ('first come, first served'; 'finders, keepers') is firmly rooted in Western legal culture and social practice. Also in state of nature situations, such as the allocation of parking places on the street and seats in a restaurant, people regard it as natural that the first occupant should be respected. Probably the possessive advantage explains a lot of this spontaneous attitude.

Legal rules, endorsing first appropriation, are often considered as expressions of a democratic and egalitarian spirit. Everyone has an equal chance at the start, without regard to his class-status, race or religion.

The *American Homestead Act* of 1862 is probably one of the most striking examples of this egalitarian philosophy (Allen, 1991; Lueck, 1995). The act allowed families to claim 160 acres of land, a surface considered as sufficient to feed a large farmer's family. At the payment of ± 10 dollars and the uninterrupted occupation of the claimed land during five years, the claimants obtained a valid title. The Act was applicable to the vast territories, west of the Mississippi-Missouri. About 250,000,000 acres were patented under the Act. Under *Roman law*, first appropriation (occupation) was possible for goods which did not belong to anybody (quae antea nullius erant), such as wild animals, for goods taken from enemies (quae ex hostibus capiuntur), for abandoned goods (res derelictae) (see Gaius 2, 66; see D. 41, 1,1,1-7; D. 41,7,1. Van Oven, 1948). For *treasure trove* (thesaurus) finders keepers applied when the treasure was found in the finders' land. When another found the treasure half of the treasure accrued to the finder, half to the owner (see I, 2, 1, 39. Van Oven 1948; see also art. 716 Belgian and French C.C.).

The *Common law* upholds also a rule of first appropriation concerning unowned things such as wild animals, as is illustrated by the famous case of *Pierson v. Post* (3 Cai. R., 175, N.Y. Supreme Court, 1805 - see further).

First appropriation is also deeply rooted in *liberal legal philosophy*. According to John Locke first appropriation through mixing his own labour with the land constituted the only way of initial acquisition in the state of nature. As a consequence, Western colonists could freely homestead land in America, for Indians still lived under a state of nature (Grunebaum, 1987; Tully, 1994).

While the first appropriation rule is firmly rooted in our legal tradition and social practices, many economic studies criticize this solution as *an inefficient rule* (Anderson and Hill, 1990; Barzel, 1968; Libecap and Wiggins, 1984; Merrill, 1986). Before discussing the economic merits or shortcomings of the first appropriation rule, we have to make an important distinction between the possession of a *resource stock* and the possession of *resource flows* (Lueck, 1995). In the first case the possessor, able to control the stock