

Beyond the Coasian Irrelevance: Motivation and Overview

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Motivation: Resource Allocation as a Public Policy Issue

- Allocating public resources
 - Rights to use government resources (e.g., licenses to explore natural resources, radio spectrum)
 - Public school, public housing, public health care
 - Exemptions from duties (e.g., military draft, jury duty ...)
 - Immigration Visas
 - Industrialization policies in some countries
 - Industrial licensing policies (Korea, India)

Motivation: Resource Allocation

- Reallocating and regulating private resources
 - Taking (or Eminent domain)
 - Price controls: Rent control, Housing (e.g., Singapore, Korea)
 - Restriction on trade: Inalienable properties (e.g., human rights, sex, nuclear weapons....)
 - Regulation of contracts: Unconscionability, penalty doctrine...
 - In a broad sense, this is what legislatures and judiciaries are doing everyday....

Questions and Issues

- How do we assign public resources?
 - Market methods
 - What auction formats?
 - Non-Market methods
 - First-come-first-serve, lottery, tests, need based, merit based?
- Should (possibly competitive) markets warrant regulation? What forms?
- When is taking of private properties justifiable, if ever? What should we require as conditions?
- Should we restrict abilities to trade, resell, or they way individuals contract?
- How do we enforce the rights (e.g. property rule v. liability rule)?

Coase Theorem

- Initial assignment of property rights does not matter --- i.e., the end outcome is *utilitarian* efficient --- *as long as*
 - the right is transferable,
 - transfers incur no transaction costs
 - *utility is transferable* (i.e., quasi-linear + no wealth constraints)

Beyond the Coasian Irrelevance

- Coase theorem spells out the important necessary conditions for efficient allocation:
 - Well defined property rights
 - Transfer rights
- The “irrelevance prediction” neither most useful nor the intended part of the theorem, to the extent that transaction costs are rarely negligible.
- Instead, Coase theorem is perhaps most eloquent in telling us *why initial assignment of property right matters*, and useful in providing us the language and framework for analyzing *how it matters*.
- Indeed, much of modern theory of organization can be seen as “fleshing out” the transaction costs that make initial assignment relevant.

General Wisdom from the Modern Theory

- Market-oriented assignment (e.g., auctions) is desirable.
- Transfer rights should not be limited.
- Competitive market should never be regulated (or price-controlled).
- Takings justified (only) when there is serious hold-out problem on the owners.
- Liability rule better than property rule with large transaction costs.

Motivation for the Lectures

- These results are neither trivial nor true always.
- The results depend on the precise nature of transaction costs.
- *The purpose of the lectures is to investigate clearly the different sources of transactions costs that make initial assignment of properties relevant and study what the investigation leads us in terms of answering the questions more precisely.*
- But before, go back to the questions a little more.....

Further Motivations: Case Studies

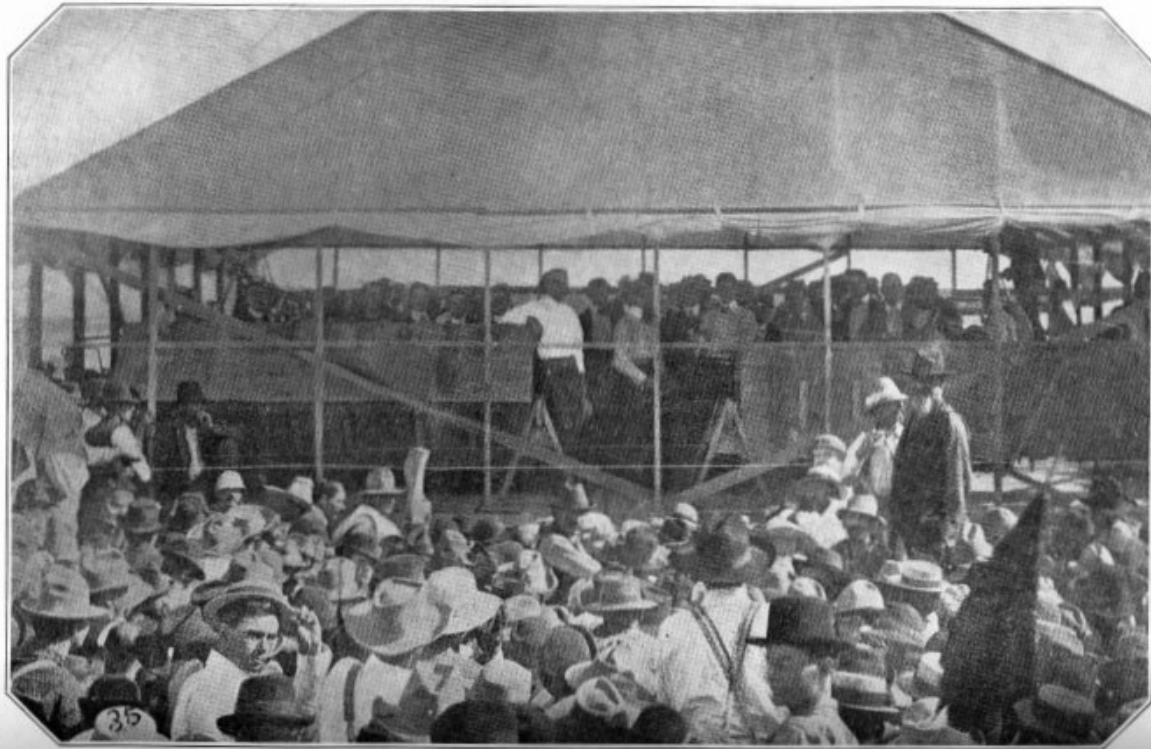
- Case 1: Oklahoma Land Assignment:
- Case 2: FCC Assignment of Spectrum Licenses
- Case 3: Korean Housing Markets
- Case 4: Military Recruitment
- Case 5: Takings

1889 Oklahoma Land Rush



- On the appointed day, thousands of settlers lined up along the border, most on horseback, many on foot. Various rail companies had special trains stationed at the border, packed impossibly full of settlers. At noon, US Army stations blew bugles or fired cannons to start the race, and the settlers stampeded into the territory.
- **Problems:**
 - **Conflicting claims:** Some participants staked their claims only to discover another claimant on the same 160-acre claim but on the other side of a hill.
 - **Sooners:** Many (as much as 90 %) entered the lands illegally prior to the official openings, led to the more stringent registration process.
 - **Violence**

1901 Oklahoma Land Lottery



READY TO BEGIN THE DRAWING AT EL RENO, 10 A. M. JULY, 1901

- “The new rules drawn up by the Secretary of the Interior ... directed that all persons ... register; the names so registered should be written on cards and enclosed in envelopes; envelopes were to be thoroughly shuffled then drawn out and numbered.”
- “Sooners” eliminated.
- **Problems (?):**
 - The integrity often questioned;
 - Speculation: Massive participants (165,000), many of whom resold...
- *Last surplus land was auctioned off in 1906.*

Case 2: FCC Radio Spectrum Assignment

- Comparative hearings:
 - FCC decided which firms should get licenses by holding hearings.
 - But by the early 1980s so many firms were applying for licenses that the system ground to a halt.
- Lottery: In 1982, the FCC started awarding licenses by lottery.
 - Speculation: 400,000 applicants; RACDG partnerships
 - Long process of resale: It took telecommunications companies years to shuffle and reshuffle the licenses into the right hands.
- Auctions (1994): Suggested by Coase (1958). Generally considered to be a success, although there remains issues regarding efficient aggregation and collusion...

Case 3: Korean Housing Market

- Price control (1972-2000): Price ceilings for multiunit new housing at below market price; first time home buyers are rationed by an elaborate system of lottery.
- An importance source of expanding home ownership for the middle class, given the underdeveloped mortgage market.
- Problems: **Speculation** (and random enrichment) and **inelastic housing supply**.
- Deregulation followed, with mixed reactions.

Case 4: Military Recruitment

- **Civil wars:** Voluntary + Selective Conscription with wrinkles
 - Bounty: a fee granted for enlistment.
 - Substitution: paying a non-draftee to take ones' place.
Exemption resalable!
 - Commutation: paying the government \$300 to be excused.
 - Controversies, riots....
- **Vietnam Wars (1969-73):** Selective Conscription
 - Lottery (based on birthdays)
 - Deferment allocated based college admission and health conditions. (*Assignment of exemption is merit based.*)
- **Voluntary recruitment:** It is as if the exemption is assigned by a competitive market, paid by foregoing the salaries.

Case 5: Takings

- Eminent domain: Lawful taking of a title by a government without an individual consent. In the US, taking requires (1) just compensation and (2) “public use”.
- Takings often rationalized by the hold-out problem:
 - Often public project requires large tracts of “contiguous” land (e.g., airfield, military base).
 - Bargaining is not efficient with numerous individuals, for they have incentives to holdout, which may subvert a socially valuable public project.
 - Successful example (Interstate Highway System): Eminent domain was used to purchase the 42,000+ miles of rights of way needed for construction.

- But when takings are justifiable remains unclear, especially with regard to the public use requirement:
 - Originally, public projects such as highways, railroads, canals, school and hospitals...
 - *Berman v. Parker (1954)*: Expanded the notion to include economic redevelopment of a blighted area.
 - *Poletown v. City of Detroit (1981)*: Michigan Supreme court ruled for Detroit which condemned its neighborhood to allow for GM to build its assembly plant. Economic benefit (Employment and tax revenue) recognized as a valid ground for use of eminent domain.
 - *County of Wayne v. Hatchcock (2004)*: the Michigan Supreme Court, acknowledging its mistake in the Poletown ruling, overturned it. (Economic development alone is not enough.)
 - *Kelo v. City of New London (2005)*: US Supreme court ruled, in a 5-4 margin, in favor of the city that condemned 115 residents of Fort Trumbull to build a marina, shopping mall, Pfizer facility, parking lot, etc. Economic revitalization of a distressed area recognized as a valid ground for use of ED. Caused a lot of backlashes; enforcement remains uncertain. Triggered several states to pass laws limiting the power of ED.

Prevalence of Non-market Assignment

- Housing: Korea, Singapore, U.S.
- Health care
- Government assets (e.g. airport landing rights, import quotas, privatization....)
- School Choice, enrollment in class
- Immigration Visas
- Exemptions from jury duties

And Restrictions on Transfer Rights

You cannot sell or resell

- Human organs, Sex (all except at zero price), Nuclear Weapons, Votes, Human Rights
- Health care
- Many Government Licenses
- School Choice
- Immigration Visas
- Exemptions from jury duty

Plan for the Remaining Lectures

- We will review recent research that studies various sources of transaction costs that make initial assignment of rights relevant and how they can help us answer the questions.
 - Wealth constraints
 - Asymmetric information
 - Hold-up and incomplete contracts
 - Contract externalities