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## THE ECONOMY OF PROPERTY FORMS

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# THE ECONOMY OF PROPERTY FORMS

Michael Heller

## **Abstract**

This essay explores a puzzle from the world of property theory, that is from the world of mine and yours, the basic social organizational molecules with which we build our sense of justice. The puzzle is this: why is there so little variety in the forms of property people use across the world? We lack a convincing theory for the “economy of property forms,” where economy is understood in the sense of parsimony. Three partial answers have been suggested. First, the limited number of forms may keep people from wasting property through over-fragmentation. Second, the limit may economize on communication costs for third parties who want to buy or sell property. Third, the limit may be an inexpensive way to help verify ownership. But none of these theories accounts for why obsolete forms persist in many economies, and why value-increasing forms fail to be created. Perhaps a more satisfying answer will require looking to political economy and to cognitive psychology. For now, the economy of property forms remains a provocative question.

THE ECONOMY OF PROPERTY FORMS

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# THE ECONOMY OF PROPERTY FORMS

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## I. INTRODUCTION

I want to pose a puzzle from the world of property theory, that is from the world of mine and yours, the basic social organizational molecules with which we build our sense of justice. The puzzle is this: why is there so little variety in the forms of property people use across the world?

For economists and many lawyers, the problem I am posing is invisible. We typically talk about property in the sense of entitlements, some of which may be ratified through legally cognizable forms, but others exist informally. In this vision, property is not something fixed, but rather understood relationally, as a fluid set of rights, duties, powers, privileges, in other words we all now follow the 20<sup>th</sup> century language of property as a shifting bundle of rights. An infinite number of property forms could be cognizable, and as society becomes more complex, one might expect more forms to emerge. For example, in a draft paper, Harold Demsetz, a leading economist of property rights argues,

[T]he more extensive specialization becomes, the greater is the variety of private property rights that is needed to accommodate differing production and exchange conditions. The development of private property rights... [has] mainly been a response to increased gains from specialization of production.<sup>1</sup>

Indeed we do see more and more *comprehensive* resource governance though private property systems – in the post-socialist world, in securities markets, in cyberspace. However, what we do not see with increased specialization, and perhaps contrary to the basic understanding of property as a bundle of rights, is any greater *variety* in core private property forms.

Bernard Rudden, from Oxford, introduced this problem in an overlooked 1985 paper when he wrote that “the current literature offers no economic explanation of the *numerus clausus* (that is, the limited number of allowable property forms), but seems largely to ignore its

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<sup>1</sup> Harold Demsetz, *The Trend Favoring Private Ownership*, draft manuscript at 16.

existence.”<sup>2</sup> Or as phrased in a draft article by Henry Hansmann and Reinier Kraakman, why does “property law both define a set of well recognized standard forms that property rights can take, and burden the creation of property rights that deviate from those standard forms.”<sup>3</sup> We lack a convincing theory of what I call the “economy of property forms,” where the term economy is understood in the sense of parsimony. First, I will briefly trace the intellectual development of the problem since Rudden.<sup>4</sup>

## II. ANTI-FRAGMENTATION, COMMUNICATION, AND VERIFICATION ANSWERS

*A. Anti-Fragmentation.* It took a preliminary kick at the problem a few years back in work that built on my theory of anticommons property. The idea of anticommons property is straightforward. We have long noted the possibility of a tragedy of the commons, in which people waste a resource through *overuse* when too many may use a resource. Indeed, the image of tragedy forms one of the standard explanations for why we create private property in the first instance, as a mechanism for conservation. The idea of anticommons property focuses us on the mirror tragedy, the possibility that people may waste a resource through *underuse* when too many people can exclude the others. Anticommons tragedy helps explain many real-world phenomena where governments impose hidden costs by creating too many property rights. In my view, the limits on existing property forms, what I called the boundary principle, functions as a crude mechanism the law has evolved to limit the social costs of excessive fragmentation.<sup>5</sup>

*B. Communication.* Tom Merrill and Henry Smith argued in an article last year that my anti-fragmentation argument can not be

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<sup>2</sup> Bernard Rudden, *Economic Theory v. Property Law: The Numerus Clausus Problem*, in OXFORD ESSAYS ON JURISPRUDENCE, 239, 242 (John Eekelaar & John Bell eds., 3d ed. 1987).

<sup>3</sup> Henry Hansmann & Reinier Kraakman, *Property Rights, Contract Rights, and Transferability*, draft manuscript at 3.

<sup>4</sup> E.g. Carol M. Rose, *What Government Can Do for Property (and Vice Versa)*, in THE FUNDAMENTAL INTERRELATIONSHIPS BETWEEN GOVERNMENT AND PROPERTY 209, 214-15 (Nicholas Mercuro & Warren J. Samuels eds., 1999); Richard A. Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S.C. AL. L. R. REV. 1353 (1982).

<sup>5</sup> Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163, 1176-78 (1999).

sufficient, that law need not police fragmentation because buyers and sellers who create new property forms would directly bear the costs of those new forms. They counter with an communication-based argument that focuses attention on costs external to sellers and buyers.<sup>6</sup> They argue there exists a point of optimal standardization, the *numerus clausus*, because marginal frustration and measurement costs increase with each new form, while marginal benefits decrease because a few property forms suffice as building blocks for the complex transactions a moderneconomy requires.

Recently, Hansmann and Kraakman countered Merrill and Smith. The communication approach may help explain why there exist *some* standard-form property rights, and why *clarity* matters, but it does not explain why law *limits* creation of nonstandard forms. Additional types do not reduce the communicative value of standard forms; rather, like new words in a language, they generally increase our ability to speak precisely or govern resources efficiently.

*C. Verification.* Hansmann and Kraakman propose focusing on the institutional mechanisms that shape new forms, what they call property law's verification function. For them, verification is the primary reason for the *numerus clausus*, indeed what most distinguishes property from contract. Buyers need to verify *whether* sellers have the power to sell more than they worry about the *content* of rights. Transferability is the key, and the solution lies in a verification system that establishes rules for determining who among competing claimants will be awarded a right. Verification systems range from simple possession, which allow easy identification of ownership but no divided rights, to branding or labeling, to public registries that may cost to administer and access but that can economically support numerous property forms once they are established. Their theory asks us to look more closely at verification institutions and to think about the third party information dilemma they solve. And there stands the *debate*.

### III. THE STRANGE ECONOMY OF PROPERTY FORMS

*A. The Survivor Game.* None of these theories answers the problem of why we still have both too many and too few forms. Let's start with "too many." If, as Hansmann and Kraakman suggest, having obsolete forms continue in force does not impose additional communication costs, and if some people continue to rely on the form,

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<sup>6</sup> Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1 (2000).

then there is no particular reason to be rid of any, once created. Once you have to check the records to verify whether you are dealing with a life estate or fee simple, the continued existence of some fee complicated imposes no further cost. The *numerus clausus* seems a one-way ratchet. But since feudal times, many quaint forms have disappeared including dower and curtesy, fee tails, incorporeal hereditaments such as advowsons and corodies and so on.<sup>7</sup> By the way, I would vote the fee simple determinable off the island next, and there are a few more survivors to boot out. Over the past 500 years, on net, the *numerus clausus* has shrunk. None of our theories explains attrition in property forms.

*B. Of BLIDs and LADs*. On the other side of the coin, there are many missing forms. Some new forms have emerged, ranging from the private trust to the limited liability corporation in organizational law; the right of publicity, right of integrity, and misappropriation of information in intellectual property. But these forms hardly seem to exhaust the field of useful candidates. On the real property side, Robert Ellickson, a *numerus clausus* entrepreneur writes,

[I]t is worth recalling that during the past half century the passage of enabling acts sparked the rapid spread of two significant micro-territorial institutions, namely, condominium associations and Business Improvement Districts. Those precedents demonstrate that spontaneous order has its limits. It appears that lawyers and legislators – despite their plummeting reputations – at times can play a constructive role in propagating fresh institutional arrangements.<sup>8</sup>

Bob Ellickson noticed a gap in property forms designed to solve a particular intermediate-level collective action problems. *New* residential communities can use homeowners' associations; *existing* commercial areas can create business improvement districts. But *existing* residential city blocks or neighborhoods cannot retrofit themselves to provide local public goods. Absent an off-the-rack property form, like Ellickson's proposed block-level improvement districts (BLIDs), homeowners are walking past piles of \$100 bills.

In a second example, my colleague Rick Hills and I are preparing an article that considers the virtues of LADs, land assembly districts designed to avoid another common, costly intermediate-level

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<sup>7</sup> A.W.B. SIMPSON, *A HISTORY OF THE LAND LAW* 103 (2d ed. 1986); R.E. MEGARRY & H.W.R. WADE, *THE LAW OF REAL PROPERTY* 814-817 (5th ed. 1984).

<sup>8</sup> Robert C. Ellickson, *New Institutions for Old Neighborhoods*, 48 *DUKE L.J.* 75 (1998).

coordination failure. Now, land assemblers face laborious negotiations and holdouts or they seek to commandeer local eminent domain power, as in the Poletown case. A LAD would be a special purpose bargaining unit, like unitization in oil and gas fields, that would create a community counterpart able to negotiate a binding deal with the developer, would allow the relevant micro-community to capture more neighborhood consumer surplus than does the eminent domain alternative, would reduce secondary rent-seeking, and would unlock the potential value from larger plots. LADs address the waste from underuse of resources that I call anticommunity tragedy.<sup>9</sup>

*C. The Liberal Commons Form*. BLIDs and LADs, like condos and limited liability companies before them, would fill a more general gap in the numerus clausus, a lack of property forms that unlock value trapped by otherwise intractable collective action problems when the optimal scale of use changes. The gap spans group property settings where the relevant resource is, as Carol Rose says, “private on the outside, commons on the inside.”<sup>10</sup> She calls this understudied area “limited commons property,” Elinor Ostrom labels it, “common pool resources.”<sup>11</sup> I am advocating we call it a “liberal commons” because each new property form in this arena must solve a recurring set of both liberal and commons dilemmas to be admitted to the numerus clausus.<sup>12</sup> To appeal to, and be accepted as legitimate by, owners of sole private property, a new group property form must protect owners’ liberty and autonomy concerns while offering them the social and economic gains possible in a well-governed commons.

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<sup>9</sup> Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L.R. EV. 621 (1998).

<sup>10</sup> Carol M. Rose, *Left Brain, Right Brain and History in the New Law and Economics of Property*, 79 OR.L.R. EV. 479, 484 (2000).

<sup>11</sup> ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR GOVERNING THE COMMONS (1990).

<sup>12</sup> Hanoch Dagan & Michael A. Heller, *The Liberal Commons*, 110 YALE L.J. 549 (2001).



#### IV. CONCLUDING REMARKS: QUESTIONING THE LANGUAGE OF PROPERTY

The liberal commons form circles me back to a question for this conference. If you agree with the economists that a greater “variety of private property rights is needed to accommodate differing production and exchange conditions,” if you agree with the legal theorists that “lawyers and legislators at times can play a constructive role in propagating fresh institutional arrangements,” if you agree with me the *numerus clausus* has too few group property forms, then what comes next? How can people catalyze new property forms or in some cases destroy old ones?

Perhaps the political economy of the *numerus clausus* matters as much as the economy. New property forms do not spring into existence unbidden because, as Carol and others have written, the same types of collective action problems that stymie efficient resource deployment in the private arena also operate in the political arena. Additionally, psychological (or biological) explanations may help explain the property form gap. People do not lobby for forms that create wealth they have not yet seen, may not be able to capture, and cannot yet imagine. Just as it is difficult for potential immigrants, future residents, to defend their interests in city politics, it is hard for potential property forms to make their virtues known.

All of these approaches bring us to a deeper set of questions at the core of property theory, such as what really is property? How is property different from contract, and what if anything turns on these distinctions? Is our language of property out of date? How useful today is the “bundle of rights” image, the “tragedy of the commons” metaphor, the idea of private property as “sole and despotic dominion” or the standard trilogy of ownership as private, commons, or state. All these analytic tools have been enormously productive over the past few generations, but perhaps now they serve to limit imagination and innovation at the frontiers of property.

“Why do we have so few property forms” is a great question, one I hope and expect will continue to produce exciting, provocative work.