



# Law and Economics

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# Property Rules, Liability Rules and Inalienability: One View of the Cathedral

- Guido Calabresi & Douglas Melamed
- Integrated Approach
- For legal relationship, covered under property law, torts and crime

# Entitlement & Its Protection

- Issues faced by legal system

Step 1 Problem of Entitlement – whom to entitle

- In conflicting interests which person or group to favour

- If entitlement is not certain result may be “**Might is Right**”

Step 2 Manner in which entitlements are protected

- Property Rule, Liability Rule or Inalienability

# Property Rule

- Entitlement is treated as property
- To buy entitlement – by voluntary transaction
- Value agreed by the seller
- To sell it and decide value is Seller's decision i.e. Veto right
- No state intervention

# Liability Rule

- If someone destroy / damage entitlement, he will have to pay objectively decided value
- Value of entitlement is decided by some organ of State – value at which Holder would have sold it.
- State intervention is required to determine value
- Applicable when voluntary transaction or ex-ante bargain is not possible

# Inalienability

- Initial entitlement is determined
- Forbid Sale – Transfer is not permitted even if seller and buyer are willing

# Mixed Application of Different Rules

- Land protected by Property Rule
- Exercise of Eminent Domain under Liability Rule
- “Drunken Owner” - Inalienability

# Reasons for Deciding Entitlement

- To whom the entitlement should be provided

## Reasons

1. Economic efficiency
2. Distributional preference
3. Other justice considerations



# Economic efficiency

- Not only administrative efficiency
- Allocative efficiency also
  - Further change would not improve the condition of those who gained by it and could compensate who lost from it
  - Risky activities – likely to lead to lowest sum of accident cost and cost of avoiding accident

# Transaction Cost Aspects

- Zero Transaction Costs
  - No difference between Property Rule or Liability Rule
- Or
  - Which Side had entitlement

- High Transaction Cost
  - Cost of Market
  - Cost of Court

Property Rule preferred if Market Costs are lower than Costs of Court

Liability Rule preferred if Market Costs are higher than Costs of Court

# Four Combinations

- Entitlement
  - Right to polluter to pollute
  - Right to pollutee to clean air
- Means of Protection
  - Property Rule
  - Liability Rule