

Chapter 8 #1) What are the steps that one might take in undertaking a cost-benefit analysis?

To conduct this, the following has to be asked:

- 1) *Who can influence the outcome? How can they influence it and at what cost?*
- 2) *What would happen if the relevant parties are merged into one?*
- 3) *If there were zero transaction costs in exchange, who would end up with the entitlements? This part compares costs and benefits and decides on the efficient solution.*
- 4) *How will individuals respond in the future to the law? Does the law create incentives for efficient outcomes? What would the individuals do to prevent damages? At what costs?*

Chapter 8 #2) Should there be a two-hour parking limit on residential streets near a college campus (to prevent students from parking there all day)? Hint: Who would buy out whom if one side owned the right to charge for parking spaces?

When owners of property decided to purchase their property, they usually benefit more from street parking since parking availability closest to their house would be very helpful. It can be argued, then, that the benefit they accrue is higher than the benefits that students obtain from being allowed to park on those spots. Therefore, no matter who has the allocation first, if transaction costs are low, the property owners will end up with the right to the parking spots (or, at least, can park in those longer than two hours with their permits).

Note that if the property owners did not have the right, they may have needed to always scout around for parking and / or pay students not to park in those spots, which can be very costly and time-consuming. Therefore, to bypass this problem, it is more efficient to limit the ability of students to park in those spots.

Chapter 8 # 3) A person sets up a rest home for people with nonviolent psychological problems in a residential area. The neighbors complain. Should the hospital be allowed to stay? Ignore the issue of who was there first.

We should apply cost-benefit analysis here. Given that we can first consider either the hospital or the neighbors move, we can see that it is more likely to be more expensive for the neighbors to move than for the hospital to move somewhere else. Depending on the hassle that the institution is going to be for the neighborhood, it looks like the residents would buy the right to a peaceful neighborhood. It's harder for them to relocate than for the institution.

Where does this rule lead us? Institutions that could purportedly harass the peacefulness of a residential neighborhood, would tend to choose locations that are not close to densely populated areas.

Is the outcome efficient? I would tend to say yes as long as these establishments are not too far from the residential areas. They need to be supported logistically (with the necessary provisions and personnel) and also accessible to relatives and friends of the hospitalized persons.

How do the markets act in similar circumstances? We observe that prisons, mental institutions, military camps are usually far from residential areas. If they are close, we usually observe problems.

Chapter 8 # 4) In *Cornucopia gold Mines v. Locken* 150 F.2d. 75 (1945), a trespasser was killed when she inadvertently touched a fallen high-voltage line hidden in the shrubbery. The high-voltage line was connected to the gold mine, which was in use intermittently. The gold mine owned the power plant that produced the electricity for the mine and a nearby town. The location of the accident was about a half mile off the road. Should Cornucopia be liable to the estate for the woman's death?

- *There is a damage.*
- *Parties that could influence the result: (a) the woman, (b) the mine.*
- *What could they have done:*
 - a) *The woman could not have trespassed (illegal action),*
 - b) *The mine could have made sure there are no high voltage power lines running around in its property.*
- *Compare costs and benefits:*
 - a) *No trespassing by the woman entails no cost.*
 - b) *Good maintenance of equipment by the mine entails some cost.*
 - c) *It is undoubted that the woman was at fault because she acted in an illegal way.*
 - d) *But if I act in an illegal way, should I die? If I park my car illegally and then a drunk driver crashes into it, should I bear the whole cost? No, if I act illegally, this doesn't allow others to act illegally against me.*
 - e) *So, the mine should perform its duties properly and maintain its facilities in a good state. Otherwise it is liable for any damage that might result out of its negligence.*

f) *Since both sides are at fault, the damage should be divided between the parties according to their respective share in the damage.*

Chapter 9 #1) Explain why freedom to smoke and freedom not to smoke are symmetric concepts.

When an individual has freedom to smoke, that person can smoke if he/she wishes to. On the other hand, freedom not to smoke also conveys that smoking is permissible and that the person is allowed to choose not to exercise the right to smoke.

Chapter 9 #2) When are transaction costs high regarding the right to smoke (not smoke). Why? When are transaction costs low (internalized)?

If the nonsmokers had the right to no smoke (but it was legal to sell off the right), then each nonsmoker would try to be a monopoly holdout and capture all of the consumer surplus from the smokers. Thus, we have a situation of high transaction costs. In turn, this implies that if smokers (nonsmokers) are entitled to smoke (smoke free air), the right will not be exchanged even if nonsmokers (smokers) value the entitlement more.

Even when transaction costs are low (for example, there is only one nonsmoker and one smoker together for a long period of time) and smoking is legal, we are unlikely to see the nonsmoker actually paying off the smoker not to smoke. However, we may observe requests that the person not smoke.

Chapter 9 #3) Explain how technology might alter the efficient allocation of the rights (to smokers or nonsmokers).

If there is a huge improvement in technology such that nonsmokers do not need to inhale smoke that smokers produce, then it is more efficient for smokers to have the right.

Chapter 9 #4) Show how profit-maximizing firms implicitly give the right to smoke or not to that side which values it the most.

The owner of the bar maximizes profits. The bar owner chooses the music to be played (country or western), the décor and the ambiance. Ambiance includes whether smoke is allowed or not allowed.

If smoking is allowed, some non-smokers will not come or not stay as long; If no smoking is allowed, some smokers will not come or not stay as long (of course the same issue arises with the kind of music chosen). Another way to view this is in pure price terms, can the owner charge more for having a smoke free bar or a smoke allowed bar. Either way one side is implicitly buying out the right from the other. The bar owner chooses the ambiance to maximize profits.

The fact that few if any bars were non-smoking before the ban suggests that the ban is inefficient. That the cost of non-smokers of second hand smoke was less than the benefit to the smokers.

Before regulation, if there were sufficient demand by non-smokers, one could choose to go to a smoking or non-smoking bar. Now the first alternative is not allowed and as argued above the lack of the second type was due to lack of sufficient demand by non-smokers. So the ban is inefficient.

Chapter 10 #1) On what basis should we choose rules of thumb? Explain.

Rules of thumb are often used as substitutes for ordinary economic markets when the price system involves high transaction costs, and as initial allocators of rights to facilitate the exchange of rights when transaction costs are low. Presumably those rules that survive are the efficient ones.

Chapter 10 #2) Suggest some alternative methods of allocating rights to proceed first in a four-way intersection. Suggest when each is the most efficient method of allocation.

- a) Price system – costly since you need to collect information about how much people value going first (collection of information is costly). This can reach Pareto optimality because the one individual can buy off the other so that both are made better off.*
- b) Economists doing cost-benefit study – hiring economists is costly*
- c) Majority rule – work most of the time but how do you determine the majority? The number of drivers? This might take more time and effort to apply.*
- d) Rank – the rule that higher ranked cars go first may not work well since people will just get an incentive to purchase higher ranked cars*
- e) Skill – really difficult to determine relative skill*
- f) First come, first serve – cheap to observe. Also, on average, this method is correct and easy to use.*

g) *Random – chaotic and has better alternatives such as right goes first*

Chapter 10 #3) What determines how we allocate the rights to play and the rights to have an advantageous position within a game?

Skill will be an allocator of the right to play when skill is relatively easy to determine and skill has a greater payoff to the participants. It is less likely to be used as an allocator of rights at the beginning of a game than during the game where skill is more readily determined. This is because in many instances, allocating the right at the beginning of the game through a demonstration of skill can be very costly (think of potential injuries, the time it takes, and the effort it demands). Furthermore, if skill is used, a special skill task (whose sole purpose is to determine allocation of rights) is more likely to be used at the beginning of play than during the game. Finally, skill is more likely to be used at the beginning of a game for those games in which skill is readily determined (at the beginning) than for those games where skill is costly to ascertain.

Note that a special skill device is also more likely to be used in determining the allocation of rights when the allocation involves an important property right rather than an unimportant communal right (like golf courses where everyone always gets their turn).

Another important note is explaining the differential treatment of skill. The answer depends upon the fact that many rules are derived demands, the interests of spectators determining the allocation of rights (do not want it to be boring).

Chapter 10 #4) Why do knights with lances ride on the right and pedestrians walk on the right?

The answer depends to a large extent on the fact that most people are right-handed. If you are a knight, you have your sword or lance in your right hand and want your weapon to be within striking distance of your enemy who is coming from the opposite direction. When you have a lance, you hold your weapon in your right hand and move it to knock off the opposing knight from his horse. Therefore, you ride your horse on the right side of the barrier.

On the other hand, pedestrians generally carry things in their right arms. People are less likely to knock into each other if their free arm is in the center of pedestrian traffic. In this way, even if they do knock into each other, the packages are less likely to be knocked down. Therefore, pedestrians tend to walk on the right to avoid contact in contrast to knights with lances who proceed on the right to increase the pressure of the contact.

Chapter 11 #1) Define precisely: entitlement, property right, excludability, transferability, liability rule, communal rights.

Entitlements are sets of rights. This can be the right to use the property, exclude others from using it, and ability to sell it. In a nutshell, an entitlement is the freedom to use resources in a certain way and the freedom to prevent others from using those same resources in certain ways.

A property right is an attribute of an economic good. All transfers of rights are voluntary, but not all rights are transferable.

Excludability is the right to prevent others from using a certain property. This applies to private property.

Transferability is the ability to transfer property rights. This is limited as some rights are inalienable (like voting or marriage).

Liability rule allows involuntary transfers of entitlements, but the person is compensated by an objectively determined criterion. When transaction costs of a property rights system are too high, a liability rule system is preferable.

Communal rights are the rights to use but not to exclude.

Chapter 11 #2) Briefly explain why do excludability and transferability encourage economic efficiency? What is the economic explanation for outlawing theft?

This is because when the property owner is able to exclude others from using the property, and at the same time, is freely able to transfer or sell the rights to someone else, then the owner has an incentive to maximize the returns to that property, thereby producing the maximum care needed for the property. In this way, overuse is prevented as the owner also considers the future value of the economic good.

Theft encourages the thief to use resources not for production but solely for a transfer or wealth. Moreover, the owner of the property also has to exert more effort, time, and other resources in order to protect the property. Therefore, theft is inefficient.

Chapter 11 #4) When is property right preferred over a communal right? Provide an example. When is a communal right preferred over a property right? Provide an example.

Property rights are preferred over a communal right when overgrazing, hypercongestion, or overuse occurs. An example would be with overfishing (tragedy of the commons).

Communal rights are preferred to property right when transaction costs associated with the exchange of property rights are relatively high compared with any possible misallocation of rights because there is no right of exclusion and there is an expected low cost of misallocation of resources. Drawing limited amounts of water from a river imposes little or no costs on other users. Therefore, when water is plentiful, it makes little sense to charge for its use.

Chapter 11 #5) Why are communal rights to fishing inefficient when there are large-scale harvesting methods?

This is because there is overfishing and inefficient allocation of resources devoted to getting the fish first (the first one gets the fish). This ends up with the inefficient depletion of these resources.

Chapter 11 #6) Why don't people "over-fish" if there are property rights to fishing.

The owner of fishing will not overfish because it reduces the value of the capital more than the present extra return from fishing. The owner at all times maximizes the present discounted value of the fish (as long as the property rights are secure).

Chapter 11 #7) In Maine, lobsters are grown in privately owned lobster pots in the ocean. What are the costs and benefits of this method of harvesting lobsters?

The property rights system means that you do not have to throw the lobster back and that you can harvest it when it is the optimal size (so you could wait longer even if it a legal size if the increase in the value is greater than the interest rate). However, you have to keep the cage (like a fence), which is costly, and the property right has to be enforced (publicly or privately) so that no one steals the lobsters from the cages. These involve economic costs. These costs are not encountered in the communal rights system unless there is a robbery (someone holds you up, which of course could also take place in the property rights system). So in a nutshell the communal rights system involves less enforcement cost but with suboptimal harvesting time as you do not have your name on the fish if you put it back in the ocean.

Chapter 11 #9) Ellickson (1993) has argued that domesticating barking dogs was an important innovation that helped to make private property feasible. Others have argued that the invention of barbed wire encouraged the privatization of public lands. Explain.

The domestication of barking dogs made the monitoring of private property cheaper. Therefore, more people were attracted to own property. The invention of barbed wire made it more simple and effective to settle the division of property as well as cheaper to exclude others from using that same property. It is also more effective in preventing others from trespassing.

Chapter 11 #10) In the United States, you can donate or sell blood and sperm and you can donate a kidney, but you cannot sell any organ. Under the National Organ Transplant Act of 1984, it is even illegal to offer to pay for hospital or funeral expenses in order to encourage the donation of an organ. Furthermore, you cannot buy an organ that has already been harvested. What would happen to the supply of organs if it were legal to sell them? Would poor people tend to be the suppliers? Is this necessarily bad?

There will be more organs sold in the market and those who are selling will tend to be the less wealthy individuals. This is bad because not only is it promoting negative detriments to health of these people, it also incentivizes are inefficient use of body parts (may be healthier and more productive with them than without those parts).

Chapter 11 #11) What is privity of contract? Provide an example.

Privity of contract: a contract cannot confer rights or impose obligations arising under it on any person or agent except the parties to it. An example is with the conditions set as a couch is being sold.