

# Manufacturing Property Rights

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## Surveying dogs



## An exercise in “Reverse Engineering” of Property Institutions

- “The Choice of Titling System” (*JLE*, 05), with N. Garoupa
- “Property Enforcement as Organized Consent” (*JLEO* '03)
- “Role of Title Insurance in Different Systems” (*GPRI* '01)
- “Economics of Notaries” (*EJLE*, '96)
- “How to Simplify Business formalization” (IADB 05)
- “Are Lawyers Needed in Conveyancing” (UPF *WP*)
- “Judicial Rulemaking” (*Handbook NIE*, 05), with V. Andonova
- “Judges Cognition & Market Order” (UPF *WP*), with V. Andonova
- “Judicial Rulings & Market Outcomes” (UPF *WP*), w. M. Casari

## Gap in knowledge

- Huge demand of knowledge
  - ♦ Property → collateral → credit → investment → growth
  - ♦ Easy formalization → more firms → growth
- Little supply: “blueprints lost” (!?)
  - ♦ Law & Law & Econ: local, fragmented, but useful
    - Calabresi & Melamed'72, Baird & Jackson'84, Rose'88, Heller'99, Merrill & Smith'00, Hansmann & Kraakman'02
  - ♦ Empirical studies often treat institutions as black boxes
  - ♦ Or as cancer tumors, when measuring only costs (DB)

## The path to growth

- Growth requires not only “investment” but specialized and well allocated investment
- Therefore requires that people hold rights on things:
  - ♦ Secure: enforcement
  - ♦ Multiple: many people for each thing
  - ♦ Transferable: low transaction costs

## Law: Two types of rights on things

- *Contractual* rights (personal)
  - ♦ Valid against specific persons
  - ♦ Do not run with the asset
- *Real* rights
  - i.e., *in rem*—“property rights” in USA law
  - ♦ Valid against all persons
  - ♦ “Run” with the asset

(A distinction mostly ignored—see, e.g.,... Arruñada'96)

## The tradeoff of real rights

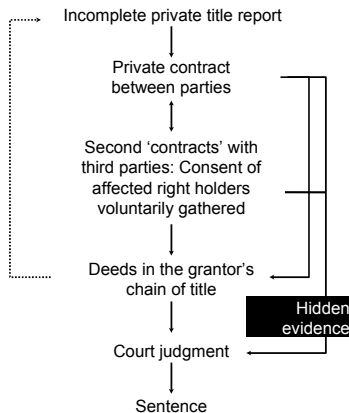
- Enforcement advantage: *consent* of rightholder required for a right to be damaged
  - Example: Mortgage → no default risk
- Higher transaction costs when real rights (e.g. mortgage) may survive transactions (e.g., sale) →
  - If hidden mortgage enforced, uninformed parties are reluctant to buy, or to lend even with mortgage

## Solution: Public intervention to reduce transaction costs

- Publicity required for a mortgage to be enforced *in rem* → 2<sup>nd</sup> lender or buyer knows & requires 1<sup>st</sup> mortgage removed.
- Consequence: 2-step contracting
  - 1<sup>st</sup> b/w parties (borrower and 2nd lender or buyer)
  - 2<sup>nd</sup> b/w parties and third parties (the 1st lender)
- Implementation: Switch adjudication or priority rule
  - Privacy: first in contract first in right
  - Publicity: first in publicizing, first in right

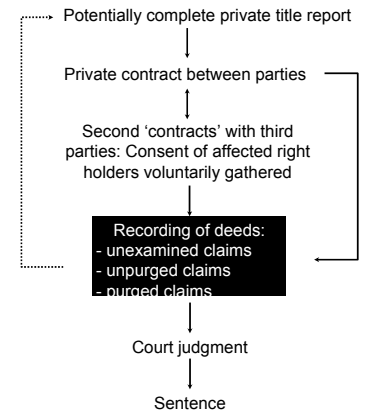
### Privacy

(England before registration implemented 1897-200x)



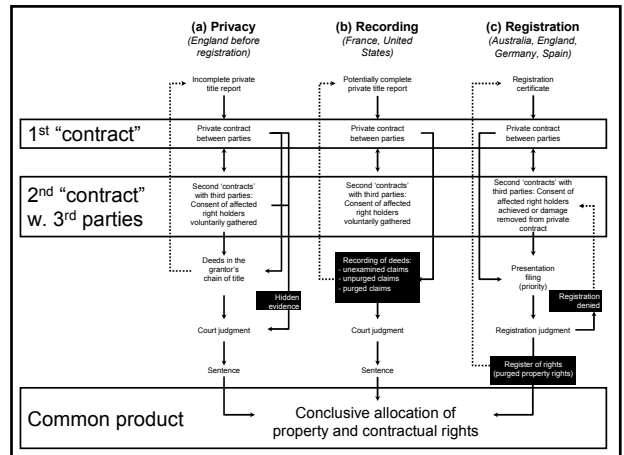
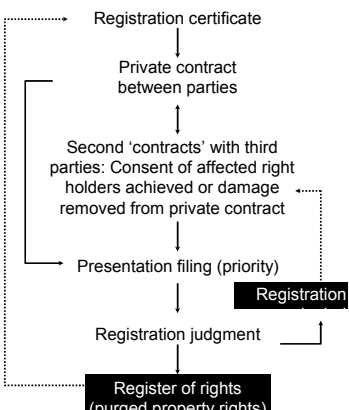
### Recording

(France, USA)



### Registration

(Germany, Australia, Spain, UK)



### Comparison (1): Purging of conflicting rights

- Voluntary & incomplete in privacy & recording
- Mandatory & complete under registration
- Artisan versus industrial production of property rights

### Comparison (2): Functional equivalencies

- Old civil law notaries = Title "Insurance" Cos.
- Registration = Recording + Courts
- Same effects after public intervention, but this intervention is:
  - ◆ ex post (judicial) & occasional in privacy & recording
  - ◆ ex ante & general in registration → innocent acquirers protected *in rem*

### Comparison (3): Common organizational principles

- Competition in the first, private, contract b/c it has only or mostly effects b/w parties
- Territorial monopolies in the second, public, "contract" b/c it has effects on third parties
  - ◆ Recording → priority
  - ◆ Registration → rights

### Three policy questions

- How to regulate private contracting?
- How to organize publicity?
- How to ensure that judges do enforce rights?

## 1. Private contracting

### Diminishing demand

- Evolution of titling systems
  - ◆ Privacy: search, guarantees, depositories, authentication
  - ◆ Recording: search, guarantees, depositories, authent.
  - ◆ Registration: search, guarantees, depositories authentication (until info tech)
- Changes in parties and transactions
  - ◆ Parties: large, reputed → info asymmetry irrelevant
  - ◆ Transactions: standard, mandated → no contract design

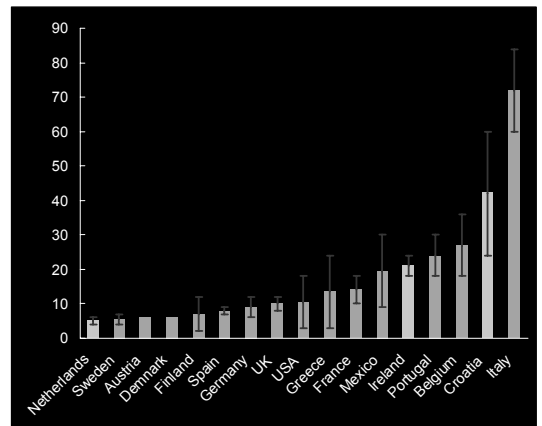
## Tentative policy implications

- Doubts on timid policies, freeing:
  - ♦ prices (as in The Netherlands) → Bigger rents
  - ♦ or even entry (Portugal) → Rent dissipation
- More drastic restructuring viable:
  - ♦ Making intervention by notaries voluntary, as in Italy (for cars!) and Portugal (companies, land?); or by lawyers (16 USA states where only DYI allowed)
- Serious doubts of reform proposals (NZ, Eng) to allow conveyancers to register

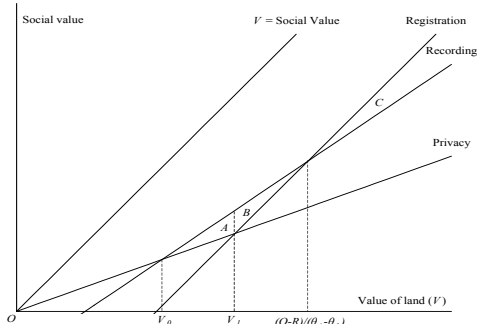
## 2. Publicity

## Recording or registration?

- Recording supposedly less costly
  - ♦ Voluntary purging—but duplication
  - ♦ Private incentives—but heavily regulated monopolies
- Registration supposedly more effective
  - ♦ Greater security—but:
    - hard to reach & maintain, falling back to recording
    - incomplete—e.g., “overriding interests”
    - too effective causes “generalized gatekeeping”



## “Choice of titling system” (Arruñada & Garoupa, JLE, 2005)



## Choice based on adaptation

- Demand for standardized, zero-defects, Toyota-like property rights
  - ♦ Parties: anonymous
  - ♦ High land turnover
  - ♦ High land value
- Supply: IT → costs down + new possibilities
  - ♦ e.g., electronic signature or “notarization”

## Conclusions for institutional analysis

- Knowing the “technology” of the institution essential for creating, repairing, driving or even measuring it
- Reverse engineering
  - ◆ Existing institutions in developed countries are the best source of information for creating institutions in developing countries
- Comparative analysis
  - ◆ Fruitful when driven by theory & facts instead of stereotypes such as “legal systems”
- Interdisciplinary
  - ◆ Law describes the machines—its process and products
  - ◆ Economics of organization—effectiveness
  - ◆ Cognition: failures in rationality—enforcement

Thanks