From Externalities to Property Rights

By Martin Hostettler, dipl. Ing. ETH, CH-3084 Wabern[1]

Some time ago, a forestry journal published a special issue on the positive externalities of forests and forest management. The contributions dealt, for example, with the willingness to pay for biodiversity and avalanche protection, or with the regional economic effects of recreational forests. As the guest editors wrote, the purpose was to generate information for the political decision-making process about how the public values the forest. Just two months later, the same journal took up externalities again – but in a completely different way. This time the special issue focused on property rights. How do the two research approaches differ?

Positive externalities are benefits that accrue to someone other than the person acting. Negative externalities are costs borne by someone other than the person acting. An illustration: early in the morning, I smoke a cigar in an open-plan office. The colleague who is already at his desk immediately enjoys the delicate aroma of the Havana (a positive externality), while another colleague, who arrives later, complains about the stench in the office (a negative externality) and, threatening violence, forbids me to do anything of the kind in the future. A third colleague, also present, is unhappy with this response. She has no taste for cigar smoke first thing in the morning either, but instead of a ban she argues for more tolerance.

The example goes some way toward explaining the phenomenon of externalities:

- Externalities originate with someone who acts and affect the people around them.
- We experience and cause externalities constantly and everywhere; in other words, our daily life is peppered with temporary and permanent externalities.
- Many of these externalities, especially the positive ones, we do not perceive consciously, or at least not always.
- Because people have different tastes (preferences), benefit is not a quantity that can be made objective. It is individual and subjective. One and the same action therefore often produces positive externalities for some people and negative externalities for others at the same time.
- If tastes change, externalities automatically change as well. Take our example: 50 years ago, when Ronald Coase (1960) wrote his famous essay on social cost, the situation described was fairly far removed from reality; 25 years ago it was an everyday occurrence; today it is rare.
- Given that expectations constantly adjust to the changing state of the world, property rights, and the prices attached to them, constantly adjust in an on-going process of internalization. In a world in which people can and do change activities to reflect their evolving expectations, externalities exist only when spillover effects are unexpected (Boudreaux & Meiners 2019:24).

For most externalities, a majority of people take the view that their occurrence needs to be neither encouraged nor reduced. Many of the positive ones in particular are supplied privately in sufficient measure, so that few people would vote for promoting them deliberately.

Tobacco taxes and smoking bans show that individual behavior is nevertheless sometimes influenced in order to increase or reduce externalities. The research approaches used in the two issues mentioned above both address precisely these externalities, which appear again and again – one might say permanently – on the political agenda. They do so, however, at different altitudes.

- The *first issue* takes a macro perspective. The existence of the externality is not called into question, and its character remains largely a «black box». The object of research is chiefly the recipient of the externality. The goal is to aggregate the externality and render it objective. The credo holds that quantifying social costs and benefits is both possible and necessary.

1 martin.hostettler@proton.me

- Conversely, the *second issue* traces and dissects the externality under a magnifying glass; the scalpel is called property rights analysis. The externality is examined with meticulous care, and the sender is given the same weight as the recipient. What is of interest is not the forest, forest management, or the regional economy, but the forest owner, the person seeking recreation, and the village resident.

The title chosen by Coase (1960) actually captures it well: in the issue on property rights, the effort is aimed not directly at justifying a remedy, but at investigating the problem. Externalities are synergies and conflicts of use between people. Sometimes what is at stake are tangible goods such as wildlife or water, sometimes shared-use rights such as access to forests or protection against natural hazards, sometimes intangible benefits such as species conservation or quiet. The rights and duties of the individuals involved may be clearly defined or entirely unregulated. The former is a precondition for trading rights and duties, just as buying and selling a Rolls-Royce, a Bentley, or a Fiat Panda presupposes clear ownership. The latter is anarchy: quite exhausting, and an enormous obstacle to sustainable resource management.

Working with property rights is unfamiliar to many. In the economic analysis of property rights, for example, there is no compulsory catalog of legal types, no «*numerus clausus*». Historically, however, by no means an arbitrary number of legal forms emerged, because transaction costs were too high. For lawyers the economic analysis of law, with its own distinctive vocabulary and its almost infinite subdivision of ownership, is therefore often hard to follow. For microeconomic analysis and for a better understanding of the problem, though, the property rights scalpel is invaluable.

References

Boudreaux DJ, Meiners R (2019) Externality: origins and classification. Nat Res J 59: 1–33.
Coase RH (1960) The problem of social cost. J Law Econ 3: 1–44.