PROPERTY RIGHTS, THE COASE THEOREM AND INFORMALITY

Martín Krause
Professor of Economics, University of Buenos Aires

Austrian economists have had a bivalent view of the foundational contributions of Ronald Coase to modern law and economics, particularly on what was later called the “Coase Theorem” (Coase, 1960), and a much more critical view on the following “efficiency” view of law.

A benign interpretation would stress his critique of general equilibrium theorizing, the need to consider the institutional framework when transactions costs are sufficiently high to prevent bilateral negotiations and his rejection of Pigou’s policy proposals of subsidies and taxes to solve problems of positive and negative externalities (Boettke, 1997). In this view, Coase is a pioneer and a main contributor to the now flourishing concern on the role of institutions and, with that, joining a long Austrian involvement on the subject, already present in Menger’s work. This view also stresses the importance of voluntary solutions to problems of negative externalities, not considered in Pigou’s view.

A second interpretation, which may not exclude the first, rejects a view on the “reciprocal nature of harm” and, most of all, his proposal that under the presence of transaction costs “what has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered as a result of stopping the action which produces the harm” (Coase, p. 27), with the corresponding advice to judges, probably coming from some Coase’s followers than from Coase himself, to apportion rights following a cost and benefit analysis in a way to maximize the

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positive aggregate result. The subjective nature of value and the impossibility of interpersonal comparisons of utility would turn such an attempt fruitless if not dangerous.

A long debate on normative considerations ensued essentially fielding two positions: on one side those supporting a Lockean natural rights view based on the property over one’s own body as a determinant of rights and considerations of justice (Block, 1977, 1995) and an efficiency view supporting Coase’s, even with a Hayekian evolutionary perspective (Demsetz, 1979). According to this last view, “survival is what will identify what is efficient and what is not” (Demsetz, 1979, p. 115). Many Austrian would agree with that although they would not go as far as granting the power to identify efficiency to a judge and would argue that efficiency is a dependent variable to property rights, not the other way around.

Also, on the first issue, most economists just assumed that the mere presence of transaction costs discarded voluntary solutions and concentrated on public policies or institutional reforms.

This chapter is not aimed at solving this debate between efficiency and natural rights and focuses on positive analysis. It will just try to bring into consideration a case study on property rights and the solution to problems of externalities within an environment where the formal system of administration of justice and the solution of disputes is not present, as in the informal neighborhoods or shanty towns found in most poor and not developed countries. The whole discussion over the Coase Theorem assumed a problem with the clear definition of property rights but also the existence of a formal judicial system and judges to which a certain normative advice was addressed: either to judge according to efficiency or justice criteria.

The “positive” question, though, is: What do judges actually do? In the case of formal, governmental judicial systems the answer is not easy since, as a part of the political system, we
must bring in Public Choice considerations (Stearns & Zywicki, 2009). What about informal settings? Is there any informal solution of disputes and in that case, who gives it? And whoever does it, what kind of criteria do we find in place? Does the solution of negative externalities problems follow efficiency, value maximizing, or justice criteria?

Also, do bilateral or multilateral negotiations take place to reduce the effects of negative externalities or are transactions costs a fixed and high enough constraint that prevents them?

Our conclusion will be that both are found in informal slums: voluntary solutions to problems of externalities are widespread even in the absence of formal rules, transaction costs are unobservable for third parties but in many cases must have been low enough to allow them, subjective benefits must be higher than subjective costs, and informal solutions of disputes among neighbors follow a “rights” approach and do not intentionally look for efficiency, although this one may be an unintended or secondary result of allocating rights. Informal mediation services are also present, insinuating the value of their services are more than their cost.

Although focused on informal slums in poor and developing countries the conclusions extend also to informal neighborhoods and activities in developed countries as well (Venkatesh, 2006).

**Slums and squatters**

There are no reliable statistics on the amount of people living in housing without a formal property title but whatever is, it is not small. Neuwirth (2006) estimates it at one billion, one of every six humans on the planet (p. 9), and on the rise. According to this author two hundred thousand people leave the rural regions and move to the cities every day, seventy three million a year. By 2030 there would be two billion, one in four people. UN-Habitat estimates the number at
928 million by 2003, 32% of the world’s urban population and 43% of the population in not
developed countries. The report projects the population in slums will increase by 37 million a year
to reach 1.5 billion by 2020. Latin America, which has 9% of the world’s population, accounts for
14% of the people living in slums. Estimates include 39.5% of those dwelling in Rio de Janeiro, 50%
in El Salvador, 39% in Caracas (Smolka & De Cesare, 2010). Cravino (2006) quotes different sources
showing informal housing of 63% in Lima, 73% in Managua, between 50 and 65% in México DF,
59% in Bogotá, 22% in Sao Paulo and 50% in Quito.

Life in informal towns was the realm of sociological studies until the work of Hernando de
Soto and partners at the Instituto Libertad y Desarrollo in Lima, Perú, brought a completely
informality in general and in housing in particular as a failure of governments, not markets, and as
a reaction of the poor with entrepreneurial spirit to make a living and get housing. The ironic
reference to the guerrilla group “The Shining Path” showed poor Peruvians did not want a socialist
revolution, they just wanted property rights and freedom of contracts in trade and production.
They estimated by 1982 42.6% of the housing in Lima was informal and by 1984 the average price
of an informal house was u$s 22,038, meaning that the total value of informal housing in Lima was
8,319 million dollars, equivalent to 69% of the foreign debt of Perú at that time. Also, government
spending in housing for the poor amounted to 173.6 million dollars, or 2.1% of the informal
investment. Finally, De Soto stressed the importance of informal rules of conduct and reported on
the takings, the assignment of parcels and informal titles of property.

This view completely challenged the prevailing paradigm based on exploitation theory and
purporting a different, and altruistic, logic among the poor. De Soto showed them as individuals
pursuing their interests as anybody else, left out of the markets through a heavy layer of regulations, to which they reacted by going around them.

Takings took place in two ways: gradual or violent. The first took place in already existing slums or the surroundings of farms or mining camps where they were tolerated by their employers. The other mainly took place in government property and were led by a group of people from a same neighborhood or family or native group, which built a number high enough to take the land minimizing the risk of immediate expulsion. They would parcel the lots and adjudicate them, hire engineers or engineering students to draw a plan considering future areas for schools and parks and lawyers to submit formal requests for adjudication just to show they had started a formal process when facing the threat of eviction.

Informal negotiations among the squatters amounted to an unwritten “takings contract” basically setting the limits of the settlement and the responsibilities of the informal organization charged with enforcing it. These are not the only informal organizations though: Clubs, parent’s associations, informal schools (Tooley, 1999) and churches are also present, among others. A similar pattern is found in most slums in Latin America

**Voluntary solutions**

In the presence of transaction costs, negotiations over the effects of negative externalities are costly and voluntary solutions may fail. This has led many economists to disregard this kind of solutions as well as view them as a third party observer evaluating how high those costs are.

Nevertheless, for Austrian economists costs are subjective as well and inimical to the acting individual. Valuation becomes evident only as “revealed preference” in action. Therefore,
there is not much that an independent observer can say except that if the transaction was made it must be assumed that the parts thought “it would lead to an increase in the value of production” and if not, that the subjective costs were higher than the subjective benefits.

In a field research experiment in a shanty town in the suburbs of Buenos Aires where there is no formal definition of property rights in housing we found voluntary solutions widespread, (Hidding Ohlson & Krause, 2010).

San Isidro is located some 20 miles north of the place where Buenos Aires was founded in 1580, a border zone between the areas occupied, or rather transited, by the Guaraní and Querandí tribes. Juan de Garay, the founder, distributed parcels in the northern coast of the River Plate among his men, somewhere beyond San Isidro. Only two centuries later a small town to be called San Isidro, Madrid’s patron saint, started to grow and completed its development thanks to the migration of people produced by the economic boom of Argentina in the second half of the XIX Century.

The large estates were parceled and originated the urban downtown, on the one hand, and a residential neighborhood of large parcels and houses called Lomas de San Isidro. La Cava is an informal settlement, created mainly over government land, right besides the upscale Lomas. In 1946 the state water company, Obras Sanitarias, requested the federal government for this plot of land in order to use the red soil to filter water and manufacture bricks, generating a sink or “cava”, giving its name to the estate. The digging soon reached groundwater and the project was set aside. The sink was partially refilled and started to be settled by squatters to the 50 acres of its present area. Different censuses estimate between 1700 to 2100 houses and between 8 to 11 thousand people, though it housed a larger number in the past.
In La Cava only 16% of those polled say they have property title on their houses. Others even asked what that was. Among the rest, 17% said they have an informal document, usually consisting of an informal sale/purchase invoice. Altogether, 84% say they do not have formal documentation. On average, they lived 15 years at the same house, which shows low rotation. Those who say they have a property title also have lived at the same house 15 years on average. When asked how did they got the house, 37% bought it, while 26% built it. In many cases they grew as annexes of a family house; 6% say they got their house from the government.

We asked La Cava dwellers how did they solve problems with neighbors when there was any conflict related to continued coexistence such as negative externalities. As an example, what happens if a neighbor plays high volume music or emits smoke or nasty odors? What if there are problems with the dividing walls or unclear borders between one property and the next, or someone builds a second floor blocking sunlight or damaging the other? Houses are quite precarious, small and contiguous, and these are real possibilities.

Confirming conclusions from a subjective cost interpretation of the Coase Theorem, 76% said they solve these problems talking with the other side. They prefer not having intermediaries, nor from the same neighborhood or outside and they avoid violence at any cost. Only in extreme cases they resort to it. They know they cannot go to justice and that starting violence is a dangerous game. Besides, in a place where people live very close to each other, having a good relation with neighbors is an important asset. Those unresolved have to do with the nature of the neighbor, they must evaluate his/her reaction and sometimes it is better to bear the cost of the externality than the one of attempting a solution.

In some cases informal organizations administer justice, basically on property and crime issues. In this second case, De Soto (1987, p. 30) reports on the procedure as allowing the
presence of both the victim and the defendant, witnesses and a jury, contrasting with the formal Peruvian judicial system where there is no jury. Penalties include beating, undressing, burying or expulsion which comes with the loss of property. If there is resistance or the expulsion fails a new dweller is allowed to occupy the empty space in the criminal’s lot reducing the informal property right. For homicides the criminal is turned in to the formal police or may get “lynched”, particularly for children’s rape.

Regarding property issues, the Peruvian judicial system never got involved much in the solution of disputes and they were even turned to administrative authorities, who were also overburdened and eventually accepted decisions of informal organizations. “Peace judges” are usually called to mediate but they solve the disputes following not formal law but extra-legal norms.

Leaders of informal organizations act as first instance judges and the Assemblies as a second instance dealing with issues of property delimitation and sale or rent contracts.

It is important to note that informal organizations administering justice on property issues face a competitive environment: its leaders are removed if they do not succeed in fulfilling the expectations of squatters either with regard to relations with formal authorities, the provision of public goods or the administration of justice. De Soto also reports they have no remorse whatsoever in changing leadership without taking ideology or political alignment into consideration (p. 28); a view shared by Cravino (2009, p. 163) on shanty towns in Buenos Aires, who finds “delegates” take decisions and even impose measures of control in cases of “daily life such as how they build, if they are noisy or have conflicts with other neighbors”. Such a competitive environment would reduce agency problems and align the decisions of judges closer to the values of squatters.
Zarazaga (2010a) has researched on the role of what is called “punteros” in Argentina, political bosses in poor and informal neighborhoods who prosper finding and assuring votes to certain political leaders in exchange for many different services. The “puntero” is a long time resident who is able to get social plans, food, or building materials in exchange for votes at the time of election. Mayors in these districts build hierarchical networks with these “punteros” in order to keep political control and get reelected. Most of the mayors in the suburbs of Buenos Aires, where Zarazaga’s research is focused, have been reelected several times. But while the vote is the reward for the politician, the “puntero” may get a fraction of the salary of dwellers or even sex favors. What is important to our consideration is that it is an exchange based on convenience and devoid of any real political content. The role of “puntero” is based on a reputation to deliver the goods, he/she knows each dweller and what his/her specific needs are and will keep that position as long as he/she can continue delivering and is available at any time of the day. Otherwise they will be remorselessly abandoned and removed.

As part of his research Zarazaga (2010b) interviewed 120 “punteros” in different Buenos Aires slums 92% of which had an average of 24 years of political and social activities there, 94% knew the composition and specific needs of each family to which she would deliver goods and services, 92% knew also the political preferences of the group. Reputation comes from “problem solving”, including the solution of disputes.

In Maquis Park, Chicago, Ill., Venkatesh (2006, p. 4) reports similar services: “Big Cat (leader of the local gang) not only helped Marlene to police younger gang members; he also gave money to her block club for kids’ parties, and members of his gang patrolled the neighborhood late at night because police presence was a rarity”. And regarding the role of churches: “Pastor Wilkins belongs to this small group of six to ten preachers (the number changes over time) who
are the first point of contact for breaches of contract and social disputes between shady dealers – street gangs, prostitutes and burglars among them. These pastors and ministers will retrieve stolen property, mend a broken relationship between pimp and prostitute, and prevent a street gang battle from escalating into a war. One minister estimated that, between 1989 and 1995, he earned approximately $10,000 a year for such services” (p. 258).

**Justice**

De Soto assigns the informal settlement management organizations a “value maximizing” goal: “According to ILD research, the main goal of informal organizations arising from a ‘takings contract’ consists in protecting and increasing the value of property accessed. In this regard, they perform a number of functions such as negotiations with authorities, protecting public order, attempting the provision of public services, registration of property in the settlement and administration of justice” (1987, p. 27).

Does this mean they follow a Coasean efficiency principle? The reference, though, relates to negotiations with formal authorities, not among dwellers. They are forced to negotiate with authorities because informal rights are also weak and vulnerable and dwellers will value any step to consolidate them. Negotiations include different problems ranging from the recognition of the possession to the provision of basic services and infrastructure. De Soto or Zarazaga, though, do not get into what criteria do these organizations or social leaders follow in these cases. We will try to deduct them from other sources.

Squatters show a “Lockean” view on the origin of property rights, possession through occupation. Cravino (2006) reports the following ways to get an informal house:
1. Occupation of a parcel and self-construction of a house; this is “original possession” and mixing labor with it.

2. Accessing to a portion of a relative’s parcel, building a house beside or on top of it. In this case the original possession was the relative’s who “donates” part of the possession.

3. “Allegamiento”: when a house is shared by a relative or friend, particularly for a short period of time to allow the newcomer to find a place.

4. Houses lent by relatives, neighbors or friends. Cravino (2009, p. 106) reports an ambiguity between “taking care” and “keeping” a house. Even if lent, with time those in the custody of the house will consider they acquired a right over it, particularly if they made improvements or maintenance work.

5. Occupation of a deserted house (the former owner was an immigrant and returned to his/her original place of residence). Usually this requires the approval of a community organization, a delegate or a church.

6. In only few cases, they get housing from the local government.

Chávez Molina (2010) finds the same principle with the allocation of stands at the informal trade fair of Francisco Solano. A southern suburb from Buenos Aires it is the place of one of the largest trade fairs in the city, opening on Wednesdays and Saturdays with over 1,600 stands offering food items, textiles, shoes and any kind of fake products. Although the fair as such has been approved and is regulated by the local government, this one has only authorized 600 stands and there is no control on the products sold at it. In fact, there are like two fairs within the same area: one more formal and the “tail” as they call it, completely informal.

The existence of these informal markets is visible in any not developed country and even in some developed ones. What is relevant to our subject here is that there is no formal regulation on
the place to be occupied by each trader. All those interviewed by Chávez Molina (2010, p. 153) said the place has to be “earned”, through the constant participation at the fair and the ensuing relations with other traders. Anyone can set up shop at the fair, starting at the “tail” which is at the end fair or in lateral streets, and only through constant participation and personal relations with established traders will be able to move to better locations when places are made available. If someone does not show up for a month, no one will question some other trader taking the place, although they may consider situations such as sickness leave.

A side note of interest for Austrian economists derives from this importance of first possession and relates to the need of a formal property title. Most Austrian economist would emphasize the importance of well defined property rights, but does this require a “formal” title or the “perception of the stability of possession”. In fact, that is what the formal title gives and the advantages of a well functioning registration and titling system has been recognized by Austrians and stressed in De Soto’s following book (2002), in this last case pointing to the need of a title to access banking mortgage credit. Empirical studies have also shown the impact to titling in investment (Galiani & Shcargrodsky, 2005) and also on the quality, size and structure of houses, on children’s outcomes and the formation of beliefs towards property and markets.

Other authors question whether a formal title is needed to secure possession and protect investments, or could other processes achieve a similar result. For example, van Gelder (2010) comments:

“Factors such as the official recognition of a settlement, introduction of infrastructure and services, and other factors that could strengthen de facto security of tenure were considered more fundamental than holding a legal document for a plot (e.g., Gilbert, 2002). With respect to accessing credit, titled owners did not take out a bank loan more
frequently than residents who lacked title. In El Tala only three people with a property title had taken out a mortgage loan in the previous five years versus two people in the untitled part of that settlement. More people—eight in the titled and five in the untitled areas—had taken out loans at lending institutions that charge high interest rates but do not require property as collateral. In other words, the owners did not pledge their dwellings as collateral to obtain the loans.” (p. 15).

Ostuni & van Gelder (2008, p. 205), appeal to a “subjective construction” or perception of security that could certainly come from a property title but also from the goodwill of government officials, a laissez-faire government policy regarding settlements or the supply of basic services. Baltruisis (2009, p. 71) reports that prices in informal “favelas” in Guarulhos, close to Sao Paulo had an average price of R$ 3,700 in Sao Rafael while those at Cabucú, a recently occupied slum only R$ 600.

Despite the form it will take, the perception of security is determinant and adjudicative decisions by mediators or informal judges would therefore tend to stress it. This speaks against a cost/benefit analysis on such decisions since making the allocation of property rights depending on a judge’s evaluation of a net result would bring instability back, a point raised by Block (1995), though also mentioned by Coaseviii.

Rental contracts seem to abide by a strict property right principle: if the tenant cannot pay she must leave the room or house immediately. There is not much flexibility and renegotiation is not usual. Few tenants resist eviction (Cravino, 2006, p. 206).

*Dispute settlement*
Up to this point, values and visions of slum dwellers seem to be concerned more with “rights” than “efficiency” as determinant of dispute settlement. Another source to check on this will come from an unexpected reference for Austrian economists: a Marxian view. Boaventura Sousa Santos (1977) conducted extended research on alternative legal system in the slums of Rio de Janeiro. In order to study an environment of “legal pluralism”, Santos presents a model Brazilian slum he names as Pasargada, the name of the ancient Persian capital.

Pasagarda is one of the largest and oldest squatter settlements in Rio de Janeiro. Began around 1932, it had a population of 18,000 by 1950 and 50,000 by the end of the 70s. It is divided into two parts: one on the hill and the other down the valley where a polluted river runs and the most precarious dwellings are located. Most of the houses are on the hill. The streets, as in many other shanty towns are narrow and muddy with sewage running through them. The houses are mainly made of brick and mortar with electricity and running water, and those who haven’t get it from public taps or neighbors.

There are several factories in the surrounding areas where many dwellers work, others are entrepreneurs, public officials, municipal workers and odd-jobbers. There is an intense social life channeled through recreational clubs, soccer teams, churches, the electricity commission and a resident’s organization. It is clearly one of the informal organizations De Soto describes for Peruvian informal towns. The association has an elected board and a president, and members pay a monthly fee.

The association, particularly its president and treasurer, the two paid full time officers ratify contracts taken to them, particularly on the sale of houses, requesting a proof of ownership and even writing the text in accordance to agreed terms. The contract is read and signed by the two parties and two witnesses, stamped with the association’s stamp with copies for both parties.
and a third is kept on file. The contracts ratified by the resident’s association are quite the same as in the formal word, but since the land formally belongs to the state, when a house is sold and bought is called “benfeitoria” or improvements over the land. An example considered by Sousa Santos (1977, p. 51), reads as follows:

“I, EL [full identification], declare that I sold to Mr. OM [full identification] a benfeitoria of my property located at [location]. He paid [amount] as down payment and the balance of the Price will be paid in eight promissory notes beginning [date]. In case Mr. OM defaults in making the payment for three months, this document will be declared invalid. This agreement is free and legal and the property is free of charge and encumbrances. The land does not enter in the transaction because it belongs to the State. This contract will be signed by the parties and by two witnesses in two copies, one of which will be kept by the Association for any contingencies that may arise.

Date:

Signature:

Witnesses:"

Others include the sale of a room within a house and the right of first refusal in case the new owners wants to sell; the sale of a house with the obligation to the buyer of building a wall, the donation of a house; the sale of a house by an illiterate and his son acting as witness but confirming the acceptance of a legitimate heir; the requirement of the legal spouse’s consent. Formal procedures are very important, the president requests proof of ownership and in case it was lost the testimony of witnesses.

With regard to the principles applied to dispute settlement they make no explicit reference to efficiency concerns. Let’s consider another of the Sousa Santos cases (1977, p. 61):
“Mr. GM comes to the RA with Mr. MT and explains his problem to the presidente.

MR. GM: You know I own that *benfeitoria* on [location]. I want to sell it to Mr. MT but the problem is that I cannot obtain the consent of my wife. She left home nine months ago and never came back.

PRESIDENTE: Where is she now?

MR. GM: I don't know. Actually I don't think that her consent is very important in this case because, after all, the whole house was built by my efforts. Besides, there is no document of purchase of construction materials signed by her.

PRESIDENTE (silence, then): Well, I know you are an honest person and your wife has behaved very badly. (Silence.) How long has she been away?

MR. GM: Nine months

PRESIDENTE: That is really not very long. (Silence.) I think that your oldest son should agree to the sale of the *benfeitoria* and sign the document as a third witness.

MR. GM AND MR. BT: We agree.

MR. GM TO MR. BT: We could draft the document right now ....

The document is then drafted in the following way:

I, Mr. GM [full identification], being separated from my wife, who disappeared without notice, and living as a good father with my six children, declare that I sold a *benfeitoria* of my property located on [location] to Mr. BT [full identification]. He will pay immediately [amount] and the balance will be paid on a basis of [amount] per month. We declare that since there are no documents in my wife's name or in mine, I sell this *benfeitoria* without charges or encumbrances. Indeed it was built through my own efforts. I sign this
declaration in the presence of two witnesses and in two copies, one of which will be kept in the Residents' Association in case any contingency arises.

Date:

Signatures:

Signatures of three witnesses:

(one of whom is Mr. GM's oldest son)"

It could be argued that there is an efficiency justification in allowing the sale to take place since the asset would then go to the most valued use, but although that is the consequence, it is no part of the argumentation on the decision. Acting in "good faith" is the main principle for the following decision:

“Mr. SB sold his shack to Mr. JQ for Cr$1,000.53. The purchaser paid half of the price immediately and promised to pay the rest in installments. On the date agreed upon he paid the first installment (Cr$50). The second installment of Cr$200 was also paid on time. However, instead of giving the money to the seller himself, Mr. JQ gave it to the seller's wife. She kept the money for herself and spent it at her pleasure. Besides, she was unfaithful to her husband and had gone to bed with the purchaser's brother. Having learned this, Mr. SB, the seller, killed his wife and demanded repossession of the shack. The purchaser complained that he had duly paid the installments and intended to pay the balance. He had given the second installment to the woman in the belief that she would take it to her husband.

The seller's sister was called to the Association to represent her brother who could not come since he was being sought by the police. The presidente said that it would not be fair to revoke the sale since the purchaser had acted in good faith throughout. On the other
hand, the seller should not be injured by the purchaser's failure to tender the money directly to him; therefore the installment in question should not be credited to the balance of the price.

The *presidente* finally decided, and the parties agreed, that the purchaser would pay the balance in six installments, three of Cr$100 and three of Cr$50."

There is no mention here on the different valuations of both parties regarding the shack nor to the allocation towards the most valued use, but a “classical” approach of defining and allocating rights.

*Negligence and “coming to the nuisance”*

Similar considerations apply negligence law, where an “efficiency” view is derived from the Coase theorem in the search for a more precise definition of it, embodied in what has been called the Hand formula, an evaluation of the actor’s burden against the degree of loss multiplied by the probability of harm (Rizzo, 1980). For the same arguments on the subjectivity of value and the impossibility of economic calculation for a planner/judge, Austrians have adhered to a traditional strict liability doctrine which obviates the need for a centralized cost-benefit analysis. The efficiency approach not only demands an evaluation of the defendant and plaintiff’s negligence but also, in the case where both were negligent, an evaluation of the “least cost avoider”, that party that could have avoided the damage at least cost.

At this stage it may be obvious to point out that in the slums cases of accidents are evaluated according to what actually happened, not on a speculation of “what might have happened in two alternate worlds and then compare the outcomes” (Rizzo, 1980, p. 292). Strict liability provides a stable environment for the causal agent that incentives a certain level of
analysis on precautionary care, which might be “efficient” as a result of the accumulated wisdom regarding similar cases. Causal agents are usually liable for foreseeable types of harm although they may not be held liable for all or some unforeseeable consequences. The simplicity of strict liability as compared to a cheap-cost avoider analysis promotes certainty in the informal legal order and contributes to a better definition of property rights.

The pattern repeats with the doctrine of “coming to the nuisance” or “first come first serve” in tort law (Cordato, 1998). According to it a causal agent should not be liable for the effects of negative externalities towards an un-owned resource if she arrived first and/or the effects were not questioned by a present owner. If efficiency requires determination of who would have been the cheap cost avoider, in this case it requires “who should have been here first” in order to maximize total social output.

As in the case before, the doctrine would be efficient in a different way, providing a stable legal environment that reduces the costs of uncertainty. Cordato (1998, p. 289), gives the example of a farmer who builds a pig farm with its associated smells spreading towards neighboring land. If such land has no owner or if the owner does not complain for a certain period of time it is assumed the farmer has homesteaded such a use. If, later, the property is considered for development and the doctrine is in place, prices will reflect the existence of this easement giving information to “potential comers to the nuisance”, who, in knowledge of the existence of the rule would take that into account in the costing and pricing of the project and may even never file suit. The prevalence of the principle of “first comers” in slums has already been stated.

**Conclusion**
Slums are informal worlds where the state is absent in many respects, certainly in the prevention and resolution of negative externalities. It is an interesting case to find out how dwellers deal with problems of such a nature.

According to Coase, in the absence of transaction costs, these problems would be solved and the asset would be allocated to its most valuable use without regard on who has the right. In such case there is no need for governmental solutions, voluntary negotiations would be enough. For Austrians, “costs” are subjective and are only known as “revealed preferences”. Life in slums shows that there are many instances where voluntary solutions take place, showing subjective benefits must be higher than subjective costs.

In the case of high subjective transaction costs an institutional device would help reduce them and slums show such a role is fulfilled by a number of informal organizations, representatives or mediators. These though, do not follow an efficiency rationale but rely on a classical Lockean view of rights and justice, informal strict liability and coming to the nuisance doctrines.

Therefore, the normative advice should be taken with a pinch of salt. Does it make sense to advice judges to change the way they have been adjudicating problems of negative externalities when they do already have one that has been used for centuries? In a way, “The Problem of Social Cost” shows that judges seem not to have a clearly defined criteria and they adjudicate sometimes in one direction, then in another. For example, “Cooke vs Forbes”, “Bryant vs Lefever” and “Bass vs Gregory” are all cases of negative externalities through air pollution and Coase (1960) tries to show the different decisions judges make even though circumstances are similar. And if there is no well established criteria, it may be worth to consider the one of efficiency.
For Austrians, though, “adjudicating efficiency” is difficult if not impossible and it may be the result of a long and evolved tradition of adjudicating “rights”.

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Footnotes


2 “Life-styles that promote survival come to be viewed as ethical, and those that fail in this respect come to be viewed as in poor taste, if not as unethical. Our present preferences and tastes must reflect in large part their survival promoting capabilities”.

3 “In a loose and general way our life-styles, preferences, and ethical beliefs are not arbitrary but are the product of thousands of centuries of biological and cultural evolution”.

4 “We are bound to view the proper resolution of legal problems from the perspective of what presently seems efficient, whether or not efficiency is explicitly applied. Our genetic and cultural endowment contains elements of ethical preference that have survived dramatically different environments. It undoubtedly contains some ethical preferences not well suited to present conditions, but then the present is not long with us”. (Demsetz, 1979, pp 114/115).

5 For example, Venkatesh (2006, p. xv.) comments on Maquis Park, Chicago, Ill.: “Quite literally I saw a world open in front of me that I had never before paid any mind, a world whose significance I couldn’t have imagined. The innumerable economic exchanges that took place every hour, every day, no longer seemed random or happenstance. There was a vast structure in place, a set of rules that defined who traded with whom, who could work on a street corner or park bench, and what prices could be set and what revenue could be earned. There were codes in place for settling disputes and adjudicating conflicts, unwritten standards that tried to ensure that haggling did not get out of hand.”

6 In Spanish, the word cava comes from to dig or to excavate.

7 Administrative judges dealing mainly with the violation of local regulations.

8 “A look at internal conflictiveness, representational disputes, the existence of multiple base organizations taking up particular problems –kindergartens, community restaurants, etc.- or competition to get followers –parishioners for churches or voters for political parties-, shows us there is no pure and undisputed representation”, p. 72.

9 Also Cravino (2009, p. 163): “The political identity of delegates is diverse, and many times fluctuating, and it does not seem to be the main element of their reputation. Politics, more than an ideological question seems to be constructed as a way to channel monetary resources, goods and services to the neighborhood”.

10 “It would therefore seem desirable that the courts should understand the economic consequences of their decisions and should, insofar as this is possible without creating too much uncertainty about the legal position itself, take these consequences into account when making their decisions”. (Coase, 1960)

11 “Guided by a Marxian theory of society and of law in society, the systematic comparison of the different types of legal pluralism will establish the possible relations between official and unofficial law (vertical or horizontal, integration or confrontation, etc.).” (Sousa Santos, 1977, p. 10).

12 “In a dynamic world in which the uncertainties of technological change, the ambiguities of foreseeability, and the absence of a unique objective measure of social cost all conspire to make the efficiency paradigm a delusion, the importance of certainty in the legal order is clear. Strict liability obviates or minimizes the need for courts to grapple, if only implicitly, with such impossibly elusive problems as foreseeability, cheaper-cost avoider, social cost, and second best. It provides a series of basically simple, strict presumptions. The prima facie case is based on straightforward commonsense causal paradigms, whereas the defenses and later pleas minimize the number of issues which must be considered in a given case... This greater certainty
promotes efficiency in the basic institutional sense because property rights, in effect, become more clearly or definitely defined” (Rizzo, 1980, p. 317).

x “Such a rule would send important signals to potential comers to a nuisance. In the example, those considering making use of the adjoining property would do so in full knowledge that the farmer has preceded them and, as such, has certain rights with respect to its use. This knowledge, and the certainty about future rights and obligations that it would generate, would be factored into any decisions that are made with respect to the use of the adjacent land, ex ante. Anyone planning to build a house on the land would do so in full knowledge that they would either have to put up with the odors from the pig farm, incur the costs of insulating themselves from the odors, or negotiate a ‘Coasean’ type bargain with the farmer” (Cordato, 1998, p. 289).