THREE ESSAYS IN LAW & ECONOMICS

by

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A Dissertation
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of
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Three Essays In Law & Economics

A Dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy at George Mason University

by

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Master of Arts
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DEDICATION

This work is dedicated to my Mom for always encouraging me to reach higher and think bigger and being the strongest most inspirational person I know. This work is also dedicated and to my first teacher of economics, Jennifer Dirmeyer. Jen taught me much more than the laws of economics- she taught me why economics matters to the world, and encouraged me to become an economist. I hope I can create an intellectual experience for my students like the on Jen created for me.

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ABSTRACT

THREE ESSAYS IN LAW & ECONOMICS

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Across three chapters, my dissertation marries a market process perspective with traditional law and economics. By investigating the history of thought in modern law and economic analysis, the first paper argues that neoclassical economics inappropriately restricts the domain of law & economics. Chapter one, "Good Economics—Bad Law: A 40-Year Natural Experiment" utilizes Buchanan's 1974 review of Richard Posner's Classic textbook to motivate how law and economics has evolved over the past 40 years under heavy neoclassical influence. By distinguishing between 'efficiency' as instrumental and final values in law & economics literature, the paper argues that neoclassical law and economics is only able to analyze laws within a given institutional context but unable to aid analysis or discussions over larger meta rules and constitutions.

The Second chapter utilizes a case study on property rights to argue that the open ended discovery process taking place in markets requires complementary

support from an open ended legal environment. Chapter two, "Dynamic Property Rights and The Market Process" argues that creating and destroying new forms of property rights bundles is an essential entrepreneurial function overlooked in discussions on the market process. The chapter presents a case study on thirteenth century England and France to illustrate how property rights emerged differently under different legal regimes. Given this analysis, the chapter argues that open-ended law is complementary to an open-ended market process.

Chapter three, argues that government inaction can be a tool for extracting rents. Specifically, politicians can harness governments power to selectively enforce laws and threaten enforcement in exchange for compliance with their demands. Selective enforcement is an attractive rent extraction method for lawmakers because it increases the credibility of their threats, allows them economize on the legislative process, minimizes the amount of voters their actions might offend, and allows them to capitalize on the economies of scale and scope the states coercive power creates in an environment with selective enforcement. This mechanism suggests that zoning laws are ripe for selective enforcement, and this chapter provides a case study to support the thesis that observed selective enforcement in zoning is often rent extraction.

CHAPTER ONE: GOOD ECONOMICS—BAD LAW: A 40-YEAR NATURAL EXPERIMENT

Forty years ago, in 1974, James Buchanan wrote "Good Economics—Bad Law." In his article, Buchanan reviews Richard Posner's textbook, *Economic Analysis of Law*, in an unorthodox fashion (Posner 2011). Buchanan creates a thought experiment, predicting that diligent students who rigorously apply Posner's teachings will be left with a cognitive dissonance. The thought experiment serves to illustrate how, according to Buchanan, Posner's tool kit proves fruitful for making decisions of a "legislative" nature but relatively unfruitful for decisions involving collective action or constitutional design (Buchanan 1974 pp. 483).

Buchanan's argument can only be fully understood by accounting for the context in which he is writing. In the 1960's at the University of Chicago, the law and economics movement shifted into a higher gear, marked both by the founding of the *Journal of Law and Economics* and a distinct shift in emphasis. Articles by Becker, Coase, Demsetz, Landes, and Manne, pioneered using economic analysis of law to understand laws beyond those that regulated financial interactions (Mackaay 1999). Rowley observes that the "distinctive feature [of Chicago style law and economics] is the application of market economics to legal institutions, rules, and procedures which in certain areas (notably in tort and in crime) are not conventionally seen to influence market behavior, but which

indeed are defined in terms of market failure" (Rowley 1989 pp. 125). Mackaay describes three events that lead the Chicago approach to dominate law and economics:

> Three events signal a change in the movement in the direction of capturing the hearts and imagination of lawyers: the foundation, in 1972, of the *Journal of Legal Studies*; the first publication, of Posner's introduction to the economic analysis of law, both at the Law School of the University of Chicago; the organization, from 1971 on, of Henry Manne's already mentioned Economics Institutes for Law Professors, short intensive seminars in economics for lawyers, be they judges, practitioners or law teachers. Together, one might say, they mark the entrance of law and economics into law schools in the United States.

In order to further illustrate the enthusiasm that the economics profession had for the Chicago approach to law and economics, Mackaay also points out that Hayek's *Law Legislation and Liberty* series, which does not utilize the Posnerian paradigm, has been largely unnoticed to law and economics scholars. Even though the first three volumes of *Law Legislation and Liberty* where published in 1973, 1976, and 1979, and Hayek won the Nobel Prize in Economics in 1974, Mackaay argues that Hayek's works were overshadowed by Posner's textbook published in 1972.

In 1974, Buchanan reviews Posner's book at a time when the book and its overarching research program are racing towards their high point of influence. As a critic of the approach in that book, Buchanan is certainly in the minority at the time he publishes "Good Economics—Bad Law."

Section One: Good Economics—Bad Law

Buchanan asks his readers to assume that Posner's textbook is widely adopted as standard material for first-year law students and that the students are sufficiently well-motivated and intelligent to retain Posner's economics teachings when they find themselves in positions of decision-making power and influence later in life, as lawyers, judges, or scholars (pp 485).

Once these law students find themselves in a situation that warrants applying Posner's teachings, Buchanan argues that they will find themselves with a cognitive dissonance (pp. 485). This is because, according to Buchanan, Posner does not fully appreciate the severability of positive economic analysis and the efficiency norm (pp 485). Posner's inability to separate these two concepts critically handicaps his law and economics. For example, when discussing the economics of rape and robbery, Posner must claim that freely negotiated exchanges between parties could emerge to maximize efficiency. Buchanan writes that this "hard-nosed" price theory leads some of Posner's arguments to approach "absurdity" because efficiency is not always the appropriate basis for making legal decisions (pp. 485).

> "If, however, broader *philosophical* criteria are introduced, the law, itself must be evaluated and good economics applied within a bad or misguided conception of legal process need not promote the structural, procedural changes that may be urgently required. It is in this respect that Posner's work fails my test" (pp 484).

Posner's "hard-nosed" price theory utilizes efficiency as both an *instrumental* value and a *final* value in legal decisions. In essence, Buchanan argues that efficiency may function well as an instrumental value that is congruent with many types of social order, but becomes problematic when used as a final value against which all law must ultimately be evaluated. Thus, Buchanan sees Posner's examples regarding rape and robbery as approaching absurdity because the very fact that citizens must bring criminal charges against each other for such crimes indicates that social order departs from maximized efficiency, and "for this reason, suggests the necessity of some replacement of the maximum value criterion for legal resolution" (pp. 485).

However, Posner's failure to distinguish between using efficiency as an instrumental and final value does not render his project, or his method, useless. Buchanan argues that the efficiency norm is effective as an instrumental goal. For example, under the Posnerian paradigm, "If the law fails to allocate responsibilities between parties in such a way as to maximize value, the parties will, by an additional and not costless transaction, nullify the legal allocation" (Posner in Buchanan 1974 pp. 485). Buchanan points out that this does capture a fundamental economics principle: when mutual gains from trade exist, parties tend find ways to realize those gains; by internalizing this lesson, lawmakers and lawyers are in a much better position to use law to help facilitate peaceful interaction amongst citizens.

Although Posnerian law and economics is far from useless, Buchanan argues that truly "good economics" would be based on an understanding of the market as a mechanism for maintaining social order "which is not that of insuring efficiency, or

maximizing value as measured in market-determined prices." In order to illustrate the implications and suggest an alternative framework for treating efficiency as the ultimate, or final, end of law, Buchanan draws on Bruno Leoni's distinction between law and legislation (Leoni 1961).

Leoni draws an important distinction between 'law' and 'legislation.' Legislation is made, planned, and rationally constructed within the bounds of a constitutional framework that governs both the contents of that legislation and the process by which it is made. Legislation also has distinct social goals. Contrarily, according to Leoni, law is not made. Law is the product of independent judges working, in a relatively uncoordinated manner, on an open-ended and never ending search for 'law,' which is the emergent product of the judicial *process*.

Using efficiency as an instrumental value will be very fruitful for legislative purposes, according to Buchanan, but unhelpful for jurors and judicial decision makers charged with determining what 'law' (as Leoni describes it) will be. When it comes to legal decisions that are not legislative, judges are often guided by criteria other than efficiency considerations, and according to Buchanan, rightly so. Judges may be guided by precedent, custom, tradition or other intra-legal criteria dictated by the institutional setting a judge confronts (Buchanan 1974 pp. 489-90).

According to Buchanan, a constitutional democracy has three general parts: 1) constitutional rules; 2) rules that adjudicate conflict; and 3) rules that involve collective decision-making of an ordinary legislative variety (pp. 491). While Posner's paradigm can be fruitful for analyzing legislative questions regarding rules that adjudicate conflict

within a broader institutional context, these are not the only types of questions that lawyers and legal scholars face. Constitutional questions, understood as questions about meta-rules or the rules under which legislative activity can take place, as well as rules that involve collective decision-making, cannot be meaningfully solved by rigorously applying an efficiency or wealth-maximizing standard because such standards are derived "extra-legally" (pp. 492). The Posnerian economist is (1) only equipped to deal with legislation (2) is dumfounded when confronted with constitutional questions and (3) is potentially dangerous when the distinction between these two types of question is unclear as it is with rules that involve collective action.

In the subsequent sections of the paper, I will argue that the assumptions Buchanan asks his reader to make in his mental thought experiment have become a reality in law and economics; thus the past 40 years of evolution in the law and economics field provide a natural experiment for Buchanan's thesis. This gives us an opportunity to evaluate whether Buchanan's argument in "Good Economics—Bad Law" is accurate. I argue that Buchanan's predictions in his thought experiment have become a reality as evidenced by the current divide amongst law and economics scholars and the areas of law where law and economics has been most influential. In light of Buchanan's accurate assessment of the law and economics movement, I ask what economists can learn from Buchanan, and I argue that neoclassical equilibrium theorizing, which underlies Posner's law and economics, is only useful in a given institutional environment; it is not useful for discussions over the meta-rules of the game.

Section Two: A Natural Experiment

Since Buchanan's 1974 article, law and economics has developed characteristics almost identical to those Buchanan poses as hypothetical in his thought experiment. Firstly, Buchanan asks us to assume that Posner's textbook becomes a standard text in the emerging law and economics field. Not only has the law and economics method permeated, in various degrees, the curriculum at most major law schools in the United States, but also Posner's *Economic Analysis of Law* became, and remains, the leading introductory textbook on the subject; the book is currently in its ninth edition. Furthermore, since 1972, a variety of journals dedicated to studying law and economics have formed, including *The Journal of Legal Studies*, *American Law and Economics Review*, *The European Journal of Law and Economics*, and the *Supreme Court Economic Review* to name a few.

Buchanan also assumes that the students are diligent and intelligent enough to retain Posner's teachings once they find themselves in positions of decision-making power later in their careers. We can easily observe this group of people by watching legal scholars in the law and economics literature who arise in the years after 1972 (when Posner published the first edition of *Economic Analysis of Law*).

Writing on the history of the law and economics movement, Mackaay distinguishes between four time periods of importance since the "re-birth" of modern law and economics in the 1950's. According to Mackaay, from 1958-1973 the Chicago law and economics paradigm is proposed; then right after Posner publishes his textbook, from 1973-1980 the paradigm is accepted by the mainstream. During 1976 to 1983 the

paradigm is "questioned" and from 1983 onwards, Mackaay describes the Chicago law and economics paradigm as "shaken."

Of particular interest to our purpose is 1976-1983 period. Veljanovski describes this period as one "of maturation and consolidation" for the law and economics movement (1990). In 1976, Schmid makes the first major critique of the Chicago law and economics paradigm, arguing that since there is a cost minimizing (efficiency maximizing) allocation of resources under any distribution of property rights, cost minimization itself, and thus the efficiency based logic put forth by Posner, cannot be both the basis for both rights and the distribution of resources. Neil Duxbury echoes this critique (1995).

The circularity in Posner's efficiency thesis not only undermines his law and economics paradigm but also undermines one of his most notable conclusions: the efficiency of common law. According to Mackaay, no one has been able to articulate a theory that has gained general acceptance for the emergence of an efficient common law (pp. 92-94). This is most likely because the efficiency thesis is circular and non-falsifiable.

Other scholars argue that the efficiency thesis central to the Chicago law and economics paradigm, exemplified in Posner's textbook, is ahistorical. Veljanovski challenges the efficiency thesis to explain changes in the law over time. Veljanovski argues that the efficiency thesis should imply that legal systems converge over time and

should also preclude legal changes from an efficient allocation to a less efficient allocation, but this is not what we see throughout history.[1]

In addition to criticizing the efficiency thesis itself, scholars also engage in a rigorous application of efficiency to legal questions, which inspires further critiques. Trebilock argues that the incentive and risk spreading logic in Posner does not lead to unambiguous policy conclusions following Posner's welfare maximization criteria (1989). Specifically, if courts are committed to spreading accident costs as thinly as possible, Trebilock suggests that the state should be liable for all accident costs. While Posner may respond that transaction costs prohibit his paradigm from producing these strange conclusions, Trebilock's arguments do point out the operational problems of using Posner's paradigm.

Finally, the efficiency paradigm proposed in Posner requires a judge to be able to access objective empirical information. Motivated by the Austrian proposition that "facts" in the social sciences are determined by actors' thoughts and beliefs, Mario Rizzo critiques Posner. Rizzo (1980a) points out that the Learned Hand test for negligence requires interpersonal utility comparisons and the absence of sheer ignorance, and (1980b) that "efficiency" and subjective value are fundamentally at odds because of how each actor assesses and values his choices.

Several modern day law and economics scholars verify that Mackaay's account of history is indeed still accurate today. A 2011 article published by the University of Chicago alumni magazine asked ten law and economics scholars at the University of

[1] The rise and development of Public Choice has offered economists many tools to explain moves to less efficient laws.

Chicago Law School to submit essays on the future of law and economics (Baird 2011). Every single essay takes time to point out the increasing divide between economists and lawyers, suggesting that the two groups see little ground for intellectual exchange in either analytical methods or research results. While different scholars assign differing normative significances to this view and offer different hypotheses on why this divide occurred, all agree that the increasingly technical field of law and economics is disconnected from law scholars.

Of particular note is Eric Posner's essay on the future of law and economics. E. Posner categorizes the law and economics profession as divided between two sub-disciplines, those engaged in "economics law and economics" (ELE) and "law law and economics" (LLE). ELE is mathematical and descriptive; thus, it is the group where economists dominate. LLE is verbal, philosophical, often normative, and typically done by legal scholars who do not have PhDs in economics, according to E. Posner. To make his distinction clear, E. Posner gives an example of how these groups differ in their methodology:

> This divergence is already evident. To take one of many examples, economists who study contracts are doing something different from law professors who study contract law. Economists take contract law as given and analyze how rational agents would design optimal contracts. Lawyers focus on how to design optimal contract law, not contracts. The two groups are aware of each other, but they exert less and less influence over each other.

In the same collection of essays, Saul Levmore writes about the implications of this methodological divide and predicts that if methodology is dominated by empirical work, the primary audience for law and economics will be regulators as opposed to judges and practicing lawyers. Because of this difference in methodology, the economic approach to law has, in E. Posner's estimation, dominated contract law, commercial law, bankruptcy law, and securities law. On the contrary, economics has had significantly less influence on public law, constitutional law, immigration law, and international law, areas of legal scholarship where a more philosophical and normative approach dominates.

Buchanan's 1974 article anticipates each of these developments in the evolution of law and economics. By criticizing Posner's text for not distinguishing between efficiency as an instrumental value and efficiency as a final value, Buchanan's critique anticipates Shmid and Veljanovski. Buchanan's discussion on the absurd conclusions of Posner's "hard-nosed" price theory leads him to anticipate Trebilock's conclusion about the difficulty in operationalizing the efficiency thesis. Furthermore, Buchanan's discussion about extra-legal norms and ideas anticipates critiques from Rizzo.

Buchanan's mental experiment also anticipates E. Posner's and Levmore's comments about the law and economics profession. Buchanan theorizes that the Posnerian paradigm would be a useful tool for understanding legislation; this is exactly the trend Levmore describes. Furthermore, E. Posner's comments on the divide in law and economics also vindicate Posner. E. Posner argues that legislative laws are laws made within a broader institutional framework; these are the laws that Buchanan predicts Posner's method will prove most fruitful to analyzing. In fact, if we examine the list

detailing the types of law where economics has had the most influence, the reader can observe that every single one of those are types of law that are of a 'legislative' nature. In other words, they are laws that operate within a defined constitutional context. Consequently, those areas of law, which E. Posner claims have been impacted minimally by economic analysis, are also the areas of the law that involve discussions over the rules of the game themselves; the exact type of laws that Buchanan claims Posner's analysis does not lend itself to that have been dominated by more philosophical approaches.

Section Three: Equilibrium Theorizing in Law and Economics

Richard Posner is clearly writing within the Chicago School Economics tradition. His approach is neoclassical in nature: valid assumptions are sacrificed for predictive power, and the world is compared against an equilibrium ideal. Posner is explicit about this method. In fact, on the very first page of his book, *The Economics of Justice*, Posner states that economics is, in essence, "the assumption that people are rational maximizers of their satisfactions" (1983). Neoclassical economic models assume buyers and sellers have perfect knowledge of their utility functions and constraints. Thus, maximizing utility is only a question of coordination, which the market helps them achieve. Given how Posner conceptualizes economics and the economic problem, his law and economics is also constructed around the equilibrium ideal. Zywicki and Sanders describe how Posner sees law as a set of purposive rules (2008). For example, the role of the judge is to make decisions based on efficiency criteria. Law is, therefore, a conscious order, and

judges make a conscious effort to equilibrate coordination problems. Posner clearly says: "the law is not a thing [judges] discover; it is the name of their activity" (1990).

Given this conception of economics and the economic problem, most neoclassical economists engage in "equilibrium theorizing." In equilibrium theorizing, markets tend toward an idealized equilibrium and are evaluated based on how close they come to equilibrium. Equilibrium is of particular importance to economists working on this paradigm, since achieving equilibrium in one market is a pre-requisite for achieving general equilibrium, which in turn is a prerequisite for satisfying the first fundamental welfare theorem of economics: that a Walrasian general equilibrium is Pareto Efficient. Efficiency is therefore the metric with which neoclassical economists evaluate the degree to which a market is in equilibrium.

When used as a tool for evaluating rules within a constitutional context, the Posnerian method, characterized by maximizing efficiency, will "work" relatively well. Within a constitutional context, economic actors tend to exploit opportunities for mutual benefit: laws that prohibit this can easily be judged as inefficient, and laws that facilitate exchange can easily be judged as efficient.

Even though, the neoclassical perfect competition model makes assumptions that will never be true regarding the knowledge of economic agents, this is of little consequence for using the neoclassical paradigm to analyze rules in a given institutional environment. Repeated interactions between buyers and sellers in the market place create prices, or knowledge surrogates of relative scarcities that economize on communicating the tacit and local knowledge necessary for economic calculation (Hayek 1945).

Typically, the exchanges that take place in a given institutional context are very frequent (high "n" number of exchanges). Because such exchanges tend to be more frequent, more knowledge conducive to economic calculation is generated and the market approaches what the neoclassical perfect competition model would predict.

Where exchange is frequent, the market is able to generate the knowledge that buyers and sellers need in order to engage in economic calculation; reality approaches neoclassical perfect competition; and the epistemic demands on judges are low. If knowledge about how economic agents are behaving in a market is relatively abundant because trades are so frequent, then an efficiency maximizing judge can more easily envision an equilibrium, based on his own observations and experience, and help resolve a dispute over conflicting claims or help trading parties move closer to that equilibrium.

For example, a judge can use market prices to estimate the costs of particular actions and then use those costs in a game theoretic model to determine an "optimal" contract rule. With enough information, questions in contract law, commercial law, bankruptcy law, and securities law can easily be reduced to engineering questions. Given an engineering problem, if a judge calculates correctly, he should be able to maximize efficiency since the problem is ultimately one of applied mathematics.

Since in a market with a high number of trades, the equilibrating tendencies of a market do not deviate strongly from the perfectly competitive model, judges can make fairly accurate efficiency claims about law without being concerned about not having access to the complete spectrum of necessary knowledge in order to make such a claim.

However, even though situations with a large number of exchanges typically approximate a competitive market, which puts low epistemic demands on an efficiency maximizing judges, the epistemic demands are not zero. Using the neoclassical model as an approximation is not of zero consequence. Zywicki explains how Posnerian inspired economic analysis failed in light of tradition in strictly liability law (2008 pp. 568).

Unlike when making efficiency claims about laws that adjudicate conflicting claims within a given set of rights and rules (institutional context), the neoclassical method will not be useful for discussions over the rules themselves. Exchanges, or interactions, between economic actors over the meta-rules (constitutional rules) within which this exchange will take place, don't involve a high amount of repeated interactions (they are low "n" markets). Yet judges are still required to make decisions about rules that are not legislative in nature. The current Posnerian law and economics method isn't able to aid judges in such cases.

The fact that the market for constitutional rules is "low n" is not necessarily problematic. Constitutional rule-making is costly because it requires a high level of unanimity to become legitimate, and a willingness to discard the current constitutional regime would require sacrificing whatever current stability exists. Additionally, a willingness to discard a constitution and negotiate a new one might send an undesired signal to one's trading partners that one is unable to commit to long-term contracts. Thus, exchanges and agreements over constitutional rules are necessarily, and probably appropriately, "low n."

Without much repeated interaction, knowledge regarding the efficient constitutional constraints does not emerge, nor do mechanisms that communicate knowledge. By being 'low n,' markets for 'the rules of the game' will typically deviate from the neoclassical ideal, making the equilibrium construct a problematic tool for such questions. Without a number of repeated interactions negotiating meta-rules, or a method to transmit such knowledge, the epistemic burden on judges is quite high.

For example, many constitutional rules constrain government. These constraints exist at the constitutional level because, although there may be clear—sometimes unambiguously welfare enhancing—benefits to breaking them in the short term, the long run costs may not be worth it. However, there is no interest rate or other intertemporal coordinating mechanism, as exists in markets, for constitutional constraints. Because the epistemic burden is so high in the constitutional realm, we can often attempt to make 'efficient' (welfare maximizing) legal decisions without employing a Posnerian wealth maximization legal standard. Posner does admit that efficiency "seems not to explain some important Constitutional rules."

As Buchanan points out, traditions, precedent, and other concepts in jurisprudence do, indirectly, preserve efficiency (1974). Zywicki points out that Hayek argues in *Law Legislation and Liberty* that expectations are preserved (and thus the market's coordinating ability) when rules are internally consistent, as opposed to externally efficient. Zywicki and Sanders further illustrate the high epistemic burdens the judges face under the Posnerian paradigm:

A Posnerian judge will thus face a three-fold challenge. First, the judge must

> possess sufficient learning, information, and expertise to be able to determine the efficient legal rule in isolation. Second, the judge must be able to determine whether the efficient rule in isolation is also the efficient rule when embedded in and interacting with *other* relevant legal rules. But finally, the judge must be able to discern how the legal rule interacts with other *non-legal* rules that may be relevant to the determination (pp. 575).

Without the requisite knowledge that Zywicki and Sanders describe above, questions of efficient rules in public law, constitutional law, immigration law, and international law would be a mere computational challenge. Unfortunately, the reality is that outside of repeated interaction and a mechanism for transmitting the knowledge, such knowledge does not exist and remains to be discovered.

Furthermore, efficiency considerations can only exist with respect to some end goal. When determining the constitutional rules that will govern all other social interaction, there is no contrast class or standard with which to evaluate efficiency, so equilibrium theorizing in which judges try to maximize efficiency is not useful.

Section Four: Spontaneous Order Theorizing—The Equilibrium Alternative

While it may impossible to apply the neoclassical method to questions about meta-rules, this does not exclude the economic analysis of these rules. Even though such discussions tend to be dominated by, what E. Posner describes as law and economics driven by legal scholars, economic analysis is not the consistent and persistent

application of equilibrium to all social order. Economics and economists can still inform normative discussions over constitutional rules.

However, the economic tools to inform this discussion are not found in Posner. Posner's conceptualization of the economic problem precludes them. For this analysis, it is useful to understand the core economic problem as one of knowledge and view the market as an open ended spontaneous order, instead of an equilibrating mechanism.

Buchanan sees the essential value added of studying economics to be an understanding and appreciation of spontaneous order. Friedrich Hayek, possibly inspired by Bruno Leoni, sees law as a spontaneous order just like the market place. Hayek sees law as independent and the product of a larger social order. If we conceptualize law as a spontaneous order, then we don't need to rationally construct an end to use when making efficiency considerations, nor do we need to construct criteria for "efficiency" in evaluating law; both of these things can be products of judicial action without being designed by a single person.

As opposed to the equilibrium construct, when the market exists to solve the knowledge problem, the world is in fundamental disequilibrium. In fact, the disequilibrium is what gives rise to equilibrating mechanisms like prices, profit, loss, and entrepreneurship. In this market process paradigm, efficiency is a by-product of the market process—not an end in itself, as it is in equilibrium theorizing.

By viewing the economic problem as one of dispersed and fractionalized knowledge, and the process through which order—including law—arises as spontaneous, legal concepts like precedent, tradition, and custom can take on economic meaning that a

neoclassical paradigm cannot give them. Just like how prices carry knowledge that does not exist in a single person and may be beyond a human mind's ability to articulate, precedent and jurisprudential customs and traditions can do the same.

Buchanan recognizes that a complete and accurate law and economics system could not be based on a neoclassic equilibrium model. Buchanan argues that "The jurisprudential setting or framework within which his whole economic analysis of law is placed does not seem to have been critically examined" in Posner's work (1974 pp. 484). Instead of rationally constructing a standard, like wealth maximization, and imposing it on judges, legal doctrine should have a place in economic analysis. In Buchanan's eyes, Posner's construct forces economics onto law.

Upon further examination, we realize that law and economics requires an economics that conceptualizes the economic problem as one of knowledge and sees the solution as one that involves the spontaneous order found in the marketplace. In fact, this is the foundation for Buchanan's projects in *Calculus of Consent* (1962) and *The Limits of Liberty* (2000).

While he is critical of the Posnerian paradigm, Buchanan is keenly aware of the limits of spontaneous order theorizing, and he is critical of the idea that such an invisible hand exists in law in the same capacity that it does in markets:

> [T]he extension of the principle of spontaneous order, in its *normative* function, to the emergence of institutional structure itself. As applied to the market economy, that which emerges is defined by its very emergence to be that which is efficient. And this result implies, in its turn, a policy of nonintervention, properly so. There

> is no need, indeed there is no possibility, of evaluating the efficiency of observed outcomes independently of the process; there exists no external criterion that allows efficiency to be defined in objectively measurable dimensions. If this logic is extended to the structure of institutions (including law) that have emerged in some historical evolutionary process, the implication seems clear that that set which we observe necessarily embodies institutional or structural "efficiency" (Buchanan quoted in Gray 1982)

However, my purpose here is not to define all spontaneous orders as inherently "good" or "efficient." Despite Buchanan's criticism of Hayek here, Servant presents a convincing case for why this criticism is not warranted (Servant 2013). My purpose here is to emphasize the importance of spontaneous order theorizing for a law and economics model that succeeds in being a fruitful tool for discussing all laws that are not pure legislation (i.e. constitutional rules and other laws that involve collective action) in light of the very restrictive, and unsuccessful, neoclassical alternative. We can rationally recognize the need for spontaneous order theorizing in law and economics.

Furthermore, Buchanan's evaluation of spontaneous order theorizing here is exaggerated on some margins. He argues, "there exists no external criterion that allows efficiency to be defined in objectively measurable dimensions." This is not to say that there are not ways to approximate efficiency measures. Moreover, just because there may not be an "objective" external criterion that we can use to evaluate a spontaneous order does not mean that no evaluation will take place. In the market for goods and services, entrepreneurs regularly perceive ways to improve that status quo. When these

entrepreneurs are successful, they have effectively improved the efficiency of the spontaneous order. Spontaneous orders can certainly improve and evolve; this does not mean we cannot critique them. In fact, the "criticism" and improvement of inefficiencies can be endogenous to the spontaneous order paradigm itself, as with the entrepreneur in a market; an analogous construct could exist in the spontaneous order of laws.

Section Five: Conclusion

The current state of the law and economics movement and the accuracy of Buchanan's remarks in 1972 remind us that Buchanan's ideas are firmly part of our present (Boulding 1971). At the most general level, Buchanan reminds us that economics is a tool for understanding and not a tool that can be unapologetically used to promote efficiency or wealth maximization.

Buchanan wrote that "[law] is far too important to be left to lawyers," yet the current law and economics movement is one where lawyers are the only ones working on philosophical questions about what the meta-level rules should be. Meanwhile, economists are crippled by a Posnerian paradigm based on neoclassical equilibrium theorizing that only lends itself to analysis of rules within a given institutional context. In this regard, not only does Posner fail Buchanan's test, but it appears that the current law and economics profession would, too.

Buchanan's remarks are not a reason to be wary of economic imperialism. Rather we should ensure that law and economics is employing tools that will lend themselves to fruitful analysis of all areas of the law. I argue that this can done by grounding law and economics in a view of economics that sees dispersed knowledge as the core economic

problem; economic calculation as the essential function of markets; and spontaneous order as the appropriate way of theorizing about social interaction. Because of his accurate predictions, Buchanan's expanded law and economics paradigm—Constitutional Political Economy—warrants our renewed attention.

CHAPTER TWO: DYNAMIC PROPERTY RIGHTS AND THE MARKET PROCESS

Why can't a consumer buy the clock out of an iPhone? Because, iPhones are sold as a bundle of rights: the rights include ownership of a phone, camera, calendar, clock etc. While consumers might not be able to buy the clock out of an iPhone, they can buy airline tickets without having to pay a fee for checked luggage. Other than asserting the obvious: firms select the most profitable bundle of rights to sell their customers, there is little explanation for why bundles of property rights exist in the forms they do.

Clearly defined and enforceable property rights are commonly recognized as prerequisites to economic calculation and the market process. Studying economics is intricately related to, and almost implies, studying property rights in some fashion. Alchian describes the close relationship between economics and property rights by explaining that, "[i]n essence economics is the study of property rights over scarce resources...the question of economics or of how prices should be determined, is the question of how property rights should be defined and exchanged, and on what terms" (1967, pp. 69). Economists have long recognized the inner connectedness of incentives, ownership rights, and economic behavior (Furubotn and Pejovich 1972). For an overview of the ideas in the 'property rights school' see Coase 1960; Alchian 1965; Alchian and Demsetz 1972; Cheung 1970; 1983; Beaulier and Prychitko 2006).

Demsetz (1967) writes that the externality, which prompted the creation of property rights, was *"obviously"* worth internalizing. While Demsetz (1967) offers a convincing account for both *why* and *how* property rights *emerged*, his framework does not offer anyway to understand how property rights *evolve*. Demsetz analysis is unsatisfying because it oversimplifies the problem at hand. While there very well could be 'obvious' externalities, or 'obvious' profits to internalize, entrepreneurs typically face a more complex problem. These analyzes refer to costs and profits as if they are fully known or capable of being perceived without prices in some objective sense absent a discovery process.

This paper argues that when entrepreneurs add or subtract certain rights from the bundle of rights that constitute a property right they face a classic planners dilemma: the need to separate the technologically possible from the economically feasible. Traditionally, prices provide the signals needed to resolve the planners dilemma, but because prices refer to the entire bundle of rights that constitutes property, the entrepreneur is unable to immediately identify the combination of rights that isolates the attribute of a good consumers desire to purchase. This paper seeks to explain how entrepreneurs overcome this dilemma by positing a dynamic theory of property rights; in doing so it builds on current literature that addresses the intersection of the market process, property rights, institutional change, and entrepreneurship. (Acemoglu and Robinson 2013; Hannan 2014). In essence, creating new bundles of property rights results in new prices, which generate new information essential to further developing economically viable arrangements of property rights; hence, property rights are dynamic.

A number of management and entrepreneurship scholars have pointed out that part of the entrepreneurial function is to re-bundle property rights such that they are more valuable to consumers. Andersson explicitly ties all entrepreneurship to property rights concepts. Though entrepreneurial action is traditionally associated with arbitrage, speculation, or innovation- innovation does not need to refer to creating new consumption attributes of a good (product innovation). Innovation could also include new production attributes (process innovation). One type of process innovation is de-bundling or re-bundling the property rights that compose a good (Andersson 2008, pp. 5). Use rights, exchange rights, and cash flow-rights, contingent on a time and place, can all be connected to any number of, subjectively perceived[2], attributes of a good; thus, there are an infinite number of combinations of rights that could constitute a bundle in an exchange. Property rights are thus open-ended. Determining which combination of rights should be offered in an exchange is part of then entrepreneur's role. Leeson & Boettke point out that entrepreneurship over property rights need not only be at the productive tier (which rights are exchanged) but also can take place at the protective tier (what are the rules governing exchange) (2009).

However, according to the entrepreneurship literature, the theory of the property rights entrepreneur is incomplete: "what the theory still lacks is a thorough integration of the dynamic effects of entrepreneurial creativity and subjective expectations" (Andersson 2008, pp. 26). DeSoto (2003) explains how unspecified property rights deny owners the

[2] As an example of how a good's attributes could be subjectively perceived consider a q-tip: many use a q-tip to maintain good otic hygiene but the good can be used for cleaning small spaces; there are certainly many other uses the author is not aware of. How a good's attribute is used provides valuable information to entrepreneurs who attempt to isolate that attribute.

ability to leverage their assets, which limits their access to capital markets thus limiting entrepreneurship.

While there are many accounts about how entrepreneurship is the driving force behind changes in property rights, the literature does little to explain how that process is done. Without an account of how property rights evolve, we cannot account for multitude of property rights arrangements, or regimes, we observe. Nor can we account for the institutions that support those property rights arrangements.

The dynamic theory of property rights described below allows us to (1) understand how property rights evolve and (2) offer an account of different property rights regimes by examining alternative institutional arrangements which highlight the living connection between productive and protective entrepreneurship. The remainder of this paper proceeds as follows: in Section One develops the theory of dynamic property rights, Section Two and Three offer empirical examples, one that applies the theory to productive entrepreneurship, and a second which applies the theory to protective entrepreneurship. Section Four offers some implications.

Section One: Dynamic Property Rights and The Market Process

Lancaster developed the 'bundle of rights' concept for thinking about property rights: In general, goods consist of bundles of rights over their objective attributes (1966). The bundle of rights that make up a property right can typically be divided into use rights, exchange rights, and cash-flow rights, all of which can also be contingent on time and place. Almost all goods and services are bought and sold as bundles of property

rights[3]. For example, after buying a hotel room, guests don't only have a right to use the bed; typically guests can also use the hotel gym, and consume the shampoo in their rooms, but guests cannot sell their hotel room to someone looking to by a small apartment because use rights don't entitle exchange rights. Similarly, typically a hotel guest cannot rent out his access to a complementary breakfast to a willing consumer not staying in the hotel because this property right to a free breakfast doesn't include exchange rights.

A good has value because of some attribute (characteristic) it has; bundles of rights are selected to best isolate (or enhance) the particular attribute of interest to consumers. The attributes that give value to property are not objective, but depend on agents' perceptions and values. Becker utilized a household production function to demonstrate that a good is associated with subjectively valued attributes (1978). Penrose recognized the role that subjectively perceived attributes of a good are often instrumental to giving a firm a comparative advantage (2009). One upshot of the fact that the valuable attributes of an economic good are subjectively determined is that "it is impossible to describe the complete set of rights that are potentially ownable"(Demsetz 1988).

Barzel theorizes that, even though property rights are open-ended, defining rights is costly; therefore all potential rights aren't determined (1997). However, entrepreneurs

[3] The 'bundle of rights' view does not exist without contention. The argument against this view is that by defining ownership as a bundle of rights, the view suggests that those undefined rights, by default, do not belong to the owner of the already defined bundle of rights. According to this tradition, the bundle of rights view can bias the default owner of undefined rights towards the sate. This literature seeks to replace the 'bundle of rights view' with the 'exclusionary' view of property rights. This author finds the bundle of rights metaphor useful, but because eliminating the bundle metaphor would not impact the present analysis, we do not engage this debate.

'search' for value creating combinations, and in this sense "[t]he entrepreneur thus becomes the creator of property rights over subjective attributes."

Traditional explanations of the market process either are not explicit about property rights dynamic relationship to exchange or implicitly assume property rights are static. In this sense, both stories stand to improve from taking each other into account. In order to develop the microeconomic foundations needed to bridge the gap and create a more complete theory of property rights that is integrated with the market process as described by Mises (1949) with the endogenous entrepreneurship described by Kirzer (1978), we need to summarize the market process, placing a special emphasis on the role of property and prices.

In his argument against socialism, Ludwig Von Mises explained that property rights permit exchange, and repeated exchange allows prices to emerge. Prices act as knowledge surrogates that signal information regarding the relative alternative uses of resources (Mises 1920). Without prices, producers would not be able to know what they should produce or what inputs they should use in production. If there were only 20 types of production inputs in the world, there would be 2432902008176640000 different input combinations[4]. In order to engage in rational production, Mises explains:

> "…the mind of one man alone- be it over se cunning, is too weak to grasp the importance of any single one among the countlessly many goods of a higher order. No single man can ever master all the possibilities of production, inumberable as they are, as to be in a position to make straightway evident

[4] 20! = 2432902008176640000

judgments of value without the aid of some system of computation". (1920, pp. 15)

Aside from the number of potential production inputs being 'innumerable,' as actors' plans and preferences change, new technologies are discovered and constraints contract and expand, prices fluctuate. Entrepreneurs must constantly respond to ever evolving economic data when estimating costs and revenues of any possible production process. Entrepreneurs' trial and error, guided by profit and loss, inform their decisions, expectations, and lead them to be alert to potential profit opportunities. The constant interaction between buyers and sellers that gives rise to prices and constant entrepreneurial appraisal of such exchanges form the essence of the market process.

Recall that prices refer to an underlying, exchangeable, bundle of property rights. The single price refers to that entire bundle of rights. Much in the way Demsetz described externalities being 'obvious' some bundles of rights may obviously not maximize economic value for buyers or sellers.

For example, a Boeing 787 can fly from New York to London in less than seven hours. Being able to travel from New York to London in less than 7 hours is extremely valuable for the thousands of travelers that fly that route everyday. A Boeing 787-800 costs about $220 million. If each business traveler had to purchase the plane from Boeing in order fly from New York to London, even assuming that he would be capable and willing to operate the plane, probably none of the travelers would buy the plane.

Before commercial airlines started, an entrepreneur estimated that if he were able to buy one plane, he could sell tickets (use rights) to hundreds of travelers at a time to fly

them between New York and London. This is not 'obvious;' in fact, Mises explains that consumers' desires are not tangible nor can they be perceived by the senses (272). That entrepreneur used prices of other property rights arrangements with similar attributes (perhaps the cost of traveling by boat or bus) in order to determine that such a scheme would be economically viable and was able to create value by selling a property right that isolate the attributes consumers most value.

The fact that people pay $700 to fly to London also tells the entrepreneur several important things. Consumers don't value owning a plane for an economically valuable price, nor do they value traveling alone for an economically valuable price. Then entrepreneur who bought the bundle of property rights that include the Boeing 787 took those rights and de-bundled them into new bundles of rights that included the attributes of the Boeing 787 consumers value most; he then sold those rights in a bundle called 'tickets'.

However, when bundling rights together, or de-bundling existing combinations of rights, the combination that will prove to be profitable is not always obvious to the entrepreneur. In fact, when attempting to modify a bundle of rights an entrepreneur confronts three problems: he does not know what attributes of his good (which are open ended) are most valuable, he does not know which combinations of rights (which are open ended) would best complement that good's valuable attributes, and finally he does

not know which of the above two combinations will be economically feasible[5]. Andersson also describes this problem:

> "What is the expected revenue stream from establishing property rights over an attribute? And what is the expected co-ordination cost stream creating, maintaining, and transforming the property rights?" (Andersson, 29)

In light of the aforementioned constraints, entrepreneurs must rely on prices. Once the bundle of property rights is modified one time, a new vector of prices emerges yielding knowledge about the profitability of that bundle. For example, once a 787 can seat can be 'rented' for a flight; the prices that emerge give the entrepreneur information regarding which rights in the bundle of rights that constitute "ownership" of a 787 are most valuable. New bundles give rise to new prices; our understanding of profit and loss stand to be augmented by considering the specific property rights bundle in question.

Given a new vector of prices for the newly created bundle of rights, an entrepreneur now has additional information regarding which attributes of his good are most valuable. With this additional information, an entrepreneur can, again, change the rights in the bundle he is selling to include the attributes consumers most value.

Furthermore, there is no reason to assume that valuable attributes will remain static. An attribute may only be valuable because of its complementarity to another product. Barzel explains that "Attributes have to be searched for discovered and

[5] Our analysis of property rights could be made even further complex by dehomognzing 'exchange.' Thus far, I have referred to exchange as a homogenous concept, but exchange can be facilitated and complicated by an infinite amount of credit products.

measured, while property rights transfers entail contractual delineation, bargaining, monitoring and enforcement" (1997: pg 65-66).

Not only does re-bundling lead to new prices that guide entrepreneurs towards discovering which attributes of a good are most valuable, prices also signal information about what types of rights over those attributes are most valuable.

For example, the valuable attribute of a 787 is that it can fly from New York to London in less than 7 hours. However, rights to use that attribute come in an open ended number of forms. The right to a seat on a 787 on a flight from New York to London can include use rights, exchange rights, cash-flow rights, each of those could include a time and place dimension, and each of those could be contingent on something else, like, clear weather.

Additionally, an entrepreneur can create new types of rights. A new 'bundle' of rights could refer to a new combination of rights in an exchange, but it can also refer to a new type of right. Metaphorically, if the bundle of rights were a bundle of sticks, we could make new bundles by taking some sticks out of the bundle and, perhaps, adding other sticks to the bundle, but it is also possible to create new sticks.

There is no force to bundle more rights together in an exchange, nor is there a force to de-bundle rights. In fact, different consumers may value the same attribute but different rights bundles of the same good: some people want to rent houses and some people want to buy, yet both can value a house for the same reasons. There is a force however, for entrepreneurs to create bundles of rights that maximize value for both consumers and producers by isolating the attributes consumers' desire.

Unlike the airplane example, there are many products with a fewer qualities and attributes, so their prices more closely mirror the value of these attributes. For example, laundry detergent has only a few attributes that consumers value. We don't typically divide up laundry detergent's attributes or the quantity in which it is sold. The process described above is less complex in this case but still present. For example, laundry detergent often comes with stain remover, color-preserving chemicals, and even fabric softener mixed in, and all of those feature come in a variety of scents. The bundles of types of soap attributes, quantities sold, and their prices present a much simpler bundling process than that of airplanes, but the same process is at work.

When explaining how property rights might emerge, Demsetz writes "[a]t each step of the adjustment process it is unlikely that externalities per se were consciously related to the issue being resolved" (1967). Similarly, entrepreneurs may not know which attributes or rights over those attributes consumers are consciously choosing during exchanges, but prices combined with profit and loss incentivize entrepreneurs to discover, and consumers to reveal, which bundles of rights create the most value. Thus, each new bundle of rights is not by definition an improvement. A bundle might isolate an attribute of a good that consumers don't value very highly; that bundle would prove unprofitable. Of course, though the project proved unprofitable, the loss still yields valuable information to entrepreneurs.

If part of the entrepreneurial function is to re-bundle property rights, then property rights do not simply 'emerge' -they are always emerging. Prices then not only guide

entrepreneurs in what to produce, but also in which rights to exchange. In this sense, property rights are dynamic.

Section Two: Dynamic Property Rights and Productive Entrepreneurship

Recently, a number of very successful entrepreneurial ventures that provide other entrepreneurs with infrastructure needed to trade, have become known as the "sharing economy." What is original to the 'sharing economy' is a new type of property right: the hybrid commercial-personal property right.

The transportation mobile application Uber in was created in 2009. The company originally developed a smartphone app that users could use to call limo services on demand. In most areas livery vehicles could not pick-up customers who did not schedule a ride; this rule distinguished limos services from taxi services. By allowing consumers to request a limo via a smartphone application, limo cars that were not being utilized could connect with customers without breaking regulations.

Despite charging limo prices, the UberBlack service became extremely popular among consumers. While the black car service was more expensive than traditional taxicabs, the service offered many attributes that consumers apparently consumers valued. In the United States, taxis are regulated via a medallion system in almost every major city. The medallion system restricts the supply of taxis and awards taxi operating rights to, typically, 2-3 major taxi companies in a given city[6]. The restricted supply of taxis and high barriers to entry encourage high prices, a lower supply of taxis, and poor

[6] There is a large literature on the taxi industry. The public choice literature explains that few cab companies dominate each metropolitan area because taxi medallions allow governments and interest groups to concentrate benefits and disperse costs. This leads to a transitional gains trap. See Tullock 1975.

service. Because drivers are required to maintain high customer ratings to keep their driving positions, good customer service. The Uber service is able to provide those attributes of a taxi service that the regulatory environment in the U.S has impaired.

In 2012 the company launched an economical service called UberX where anyone with a car newer than 2005 in a model on Uber's approve list, can drive on the Uber platform. In some cities, the service costs about 40% less than a traditional taxi. UberX is not, by far, the most popular product that the company offers. This particular bundle of rights, was only discovered via the information that the company gained through their original product, UberBlack.

The Uber application connects customers requesting a ride with the closest driver, facilitates payment, determines the price, and even provides car insurance for drivers. All of these things certainly lower the transactions costs of being a 'livery driver' but most importantly, the Uber application makes it possible to use your personal car commercially at the flip of a switch. Before Uber, a livery car had to have commercial tags, drivers needed a commercial license, and if you wanted to be able to pick up customers on the street corner, then you would need to paint your car the appropriate taxi color(s). With the Uber service drivers don't have to do any of those.

Uber does not own any of the cars that use its service, nor does it employ any of the drivers. The service facilities a transformation of property rights: your car becomes commercial when you decide, and they deposit the proceeds in your bank account.

Another company called Breeze has discovered a related profitable way to re-bundle the property rights that Uber exchanges with its drivers. Those drivers who don't

own a car, don't own an Uber approved car, or are uninterested in using their personal car on Uber, can get an Uber approved hybrid car from Breeze.

Another highly successful, company that has also re-defined property rights to bring the hybrid commercial-personal property right to another industry is AirBnB. The company provides a forum on which property owners, and occupants can rent out sleeping accommodations for as little as one night.

AirBnB provides renters and owners with access website that attracts worldwide viewers, professional photograph's of their accommodations, over $1 million in liability insurance, an online portal that handles a variety of pricing schemes, and automated booking services.

In order to be in the 'hotel' industry, there have traditionally been very high fixed costs: building a hotel. Furthermore, even if an entrepreneur had the capital to purchase a property in order to rent it, typical lease terms are 12 months. Very similar to Uber, AirBnB provides a service that transforms property rights, your residence (partial or whole) into a hotel, at a moment's notice.

While its not a surprise that idle personal cars can create value for owners and consumers when they are used in a commercial capacity during their off hours; it is more of a surprise that spare bedrooms and empty apartments could serve as substitutes for a hotel. Cars and houses have attributes very similar to taxis and hotels, but as Andersson explains,

> "in some cases [the attribute] is attached to a bundle of other valued attributes from which the new attribute may be difficult to extricate. For such

> sticky attributes the availability of capital may become a real constraint on the ability of the discoverer of the attribute to "create" it and become the residual claimant" (Andersson 8).

The Uber and AirBnB platforms combined the necessary insurance and financial infrastructure so that the commercial attributes of cars and houses property could be separated from personal attributes in an exchange. The companies innovated a way to loosen (lower the transactions costs of utilizing) these 'sticky' attributes by creating a new bundle of exchangeable property rights.

The aforementioned examples certainly illustrate how entrepreneurs re-bundled property rights in a way that isolated attributes of a good consumers valued. However, the value added of the dynamic property rights theory is that is can explain how certain types of property rights develop. Certainly the mobile applications lower the transactions costs of exchanging this new property right but transactions costs economics alone cannot explain how entrepreneurs determined which bundle of rights to isolate and sell.

Unlike most cities in the United States, Peru does not have a medallion system for Taxis. In fact, only some taxis are officially registered- anyone with a car can use it as a taxi. Because the barriers to enter the taxi market in Peru are so low, there is no shortage of supply. The ample supply of taxis leads to competitive prices. Uber exists in Peru, but it is far from popular. The service is likely unpopular because the property rights arrangement does not isolate attributes that consumer's value. The wait time to get an Uber car is much longer than the time it would take a consumer to encounter a taxi, the cost is on par if not higher than a traditional taxi, and most citizens don't have access to

sophisticated types of consumer credit, like credit cards, that Uber requires as a payment method.

However, Uber does offer foreign tourists a way to secure a ride with a driver who, given the Uber background check process, is less likely to be a criminal; because the fares are set by Uber, tourists do not have to worry about negotiating to maximize their consumer surplus in a market they are unfamiliar with, and they don't have to carry foreign currency. These attributes make Uber a profitable venture in Peru but on a much smaller scale, and for different reasons, than in the United States.

Section Three: Dynamic Property Rights and Protective Entrepreneurship

Productive entrepreneurs, will only re-bundle property rights in new and more effective ways so long as the institutional framework will support their changes. In other words, if productive entrepreneurs are in an institutional environment that does not protect or recognize their new bundles of property, property rights will either not evolve or be forced to evolve in a way acceptable in the given institutional context. For this reason, productive entrepreneurship and protective entrepreneurship are intricately linked; the connection is a living one. The following example illustrates the impact of successful productive-protective entrepreneurship interaction, and illustrates the results of a situation where this connection is severed.

Jurisprudence scholar Henry Maine gives an account on the "Decay of Feudal Property in France and England" in which he notes that both countries had a property rights arrangement called 'copyhold,' yet the right evolved differently in each country (Maine 1883). William the Conqueror divided property in England in several different

ways; different tenants received different sized parcels along with different rights according to their respective social class. Among the men with lowest social standing were the bondsmen. Bondsmen received small parcels of land, but William the Conqueror reserved the right to remove them from the land at any time; they were in essence, tenants-at-will (Maine 1883). Bondsmen's status was recorded at the court via an entry in the roll which could be removed at any point in time; hence, the name 'copyhold.'

Once bondsmen attained their freedom, these copyholders could not be thrown off their land at will, but in stead were forced to pay 'taxes' for the right to use the land. Copyholders paid annually, and upon death of either the lord or the head of the copyholder's household. Copyholders were also required to use the mill and market owned by the lord whom owned their land (Maine 1883).

Most countries in Europe used the copyhold property rights arrangement, but our analysis will focus on the evolution of copyhold in England and France. The copyhold property rights regime evolved very differently in these countries.

In both England and France seigniorial courts had jurisdiction over disputes between copyholders and lords. Because the judges were often the landowners (lords) or were experts the landowners appointed, the incentives in these courts were "like having the fox guard the chicken coop when it came to disputes over property" (Fukuyama 2011, pp. 259). However, in the thirteenth century, English royal courts began to compete with seigniorial courts. The royal courts quickly gained the entire jurisdiction previously held by the seigniorial courts because they were considered significantly less biased (Maine

1883). Notably, the royal courts utilized common law, which employed precedent and the legal doctrine 'stare decisis' when issuing rulings.

As England progressed economically, the country developed an extensive wool industry. The soil and climate in England were will suited for wool; the industry supplied wool to all parts of the Mediterranean (Maine 1883). In order to capitalize on the booming wool industry and other avenues of international trade, Englishman would buy and sell copyhold agreements. Perhaps even more interestingly, Lords bought copyholders rights back so that the lords could control the land. The copyholders began to accept leases from the Lords (Maine 1883) and by doing so effectively created a new bundle of property rights.

A similar shift in the copyhold arrangement did not transpire in other European countries. In France, seigniorial courts maintained their jurisdiction over copyholders up until the French Revolution (Fukuyoma 2011). Two legal doctrines came to govern copyhold arrangements in French seigniorial courts. The first, 'Nulle Terre Sans Seigneur' is the rough equivalent of 'No Lord, No Land' (Maine 1883). The doctrine effectively prohibited copyholders from ever using land without paying a lord, presumed liability in favor of lords, and gave lords the right to establish dues by prescription. The second legal doctrine employed by the French courts required that lords must show their 'titres' or 'titles' to the land; without title the lords had little legal standing.

The two aforementioned doctrines are in obvious conflict; depending on the circumstances of a dispute, both copyholders and lords asserted the primacy of the doctrine most convenient to their interests. The 'No Lord, No Land' doctrine did not

incentivize Lords to keep accurate records of their titles; this fact combined with a legal institution biased in favor of lords made it difficult for French lords to buy copyhold rights from French copyholders like English lords had. In order to buy a copyholders property rights, the copyholder would need to be able to sell it to the lord with title to the property, and have confidence that his contract would be enforced in court should a dispute arise.

In contrast to the peaceful agreements that the common law was able to facilitate between copyholders and lords in England, French peasants were in ever increasing litigation with nobility (Maine 1883). In fact, Henry Maine attributes this litigation to the outbreak of several outbreaks of violence in 1789 that began the French Revolution. During many violent outbreaks in 1789, peasants burned Chateaux's all over France; the first place they burned was the 'muniment' room- a room that houses land titles.

A new property rights arrangement in England was met with peace and prosperity, but because the legal institutions in France were unable to permit the same evolution, it ultimately became less costly to resort to violence than forgo the gains from living in a world of static property rights. English common law likely provided the appropriate institutional context for protective entrepreneurs to support productive entrepreneurs (Hannan 2014). The stare decisis doctrine gave copyholders the confidence that in the event of disputes regarding land use with their, socially superior, tenants, the court would view both parties as equals. Furthermore, a living and evolving system of precedent provided a context for creating new property rights arrangements at the productive level, because the protective level could adapt to upholding them. On the

contrary, French civil law did not employ stare decisis or look to an evolving body of precedent for direction; instead, the static, and ultimately conflicting, French legal doctrines that slanted courts in favor of the nobility ended up prohibiting a new property rights arrangement (lords purchasing copyholds from tenants) that could have left all parties better off.

Section Four: Conclusion

This paper has argued that when determining how to de-bundle or re-bundle property rights, entrepreneurs face a classic planners dilemma: they need a mechanism to separate the technologically possible from the economically feasible. When determining which inputs to use in the production process, entrepreneurs can use prices, in conjunction with profit and loss accounting, to overcome the planners dilemma, but this is not the case with property rights because prices refer to existing bundle of property rights in its entirety, not just the particular rights which best isolate the attribute of a good consumers value. Creating new bundles of property rights results in new prices, which generate new information essential to further developing economically viable arrangements of property rights; thus, while property rights are pre-requisites to the market process, property rights are the results of the market process; hence, they are dynamic.

The preceding discussion has attempted to demonstrate that a complete theory of the property rights entrepreneur requires integration with the market process, and that a complete theory of the market process should acknowledge that property rights are dynamic: they are constantly changing, being discovered, combined, and divided. Finally,

the historical case study illustrates that the successful evolution of property rights at the productive level, requires complementary action at the protective level.

Recognizing that property rights are dynamic has several important implications. Restricting the bundling or de-bundling of property rights is a form of intervention in the market process equivalent to price fixing. Similarly, efforts to support property rights protecting institutions need to account for the fact that property rights bundles aren't necessarily static but control over them needs to be stable and predictable. Finally, a more robust and accurate conceptualization of the marking process and what it means to 'economize' on scarce resources does not just include the efficient allocation of property rights, but also the efficient allocation of the underlying rights bundles themselves.

CHAPTER THREE: SELECTIVE ENFORCEMENT AND RENT EXTRACTION

Why aren't all laws enforced? The traditional answer is that there is a cost to marshaling all the resources necessary to enforce a law and the state faces a budget constraint for enforcement (Becker & Stigler, 1974). Rational enforcement occurs when the expected penalties of breaking the law are met with increased punishment such that on net there is no marginal gain from committing larger offenses; this doesn't require laws to be enforced in all instances (Stigler 1970). However, a cost to enforcing the law often neglected by economists is that of the forgone opportunity for extortion. Since laws impose constraints on those subject to the laws, rule followers are often willing to pay in order to avoid being subject to the rule; by choosing to enforce the law, those with the authority to enforce the law effectively sacrifice their subjects' willingness to pay for an exemption.

Economists have well documented how the willingness to pay for a legal exemption from a rule leads government to create rents for firms (Stigler 1974, Krueger 1974, Tullock 2005). However, a willingness to pay for legal exemption from a rule need not manifest itself in rent seeking, it could also result in rent extraction. In the case of rent extraction, lawmakers extort payment in exchange for some inaction. This paper uses public choice theory and the rent extraction framework to explain why some laws are

selectively enforced; specifically, the author extends the rent extraction framework to explain how selectively enforcing laws can also be a form of rent extraction.

This paper contributes to the literature on regulation, specifically regulation that is rent extracting. Beginning the 1970's economists began to question the prevailing welfare model of regulation (Posner 1971 and Stigler 1974). Stigler (1974) explained that if producers stand to gain from regulation, they would demand regulation from politicians. Not only did Stigler cast doubt on the on the welfare model of regulation, but also he framed regulation as an exchange between business and government. McChesney (1997) points out that this view conceptualizes politicians as mere brokers in the exchange. Politicians' own utility functions and constraints are not present in this theory of regulation (McChesney suggests Tullock 1993 pg. 26 as an example).

Peltzman (1976) improved the Stiglerian model by allowing politicians and business to share in created rents and argued that regulators allocate benefits across their constituent (consumer and producer) groups to maximize political gain. Peltzman does realize that politicians threaten to transfer consumer surplus to producers who can regain some of the surplus at a price, but his model does not recognize that this threat leads to wealth losses instead of mere transfers[7].

(3.) For additional problems with the Peltzman approach, see Goldberg (1982).

McChesney (1997) further integrates the politician into the theory of regulation by examining politicians' utility functions, constraints, and the methods politicians employ to improve their gains. By considering politicians' constraints, McChesney is able to highlight a weakness in the Stiglerian approach: "in a standard market model of exchange, including auctions, politician-brokers respond to private demands for rents with a supply of regulation, but they do not actively enter the market for rents with their own demands" (McChesney 1997: 17). McChesney's objection to the standard Stiglerian view gave rise to the theory of rent extraction.

Given a framework that considers politicians as participants, instead of simply brokers, in the regulatory exchange, McChesney theorizes that if the expected costs of the act threatened exceed the value of what the private parties must give up to avoid government action, private parties will surrender what government demands. He calls this phenomena rent extraction (McChesney 1987, 1991, 1997). The McChesney rent extraction framework does not significantly differ from the Stiglerian model, but it denies consumer sovereignty in regulatory models by pointing out that the bidders for a given group's surplus always include the group itself.

The rent extraction framework doesn't exclude traditional rent seeking, rather the framework explains that rent seeking will only occur under certain conditions. "Whether or not a firm will benefit from rent seeking depends on the elasticity of demand. Some firms will pay to keep regulation out" (McChesney 1997: 25). McChesney

also explains "[i]n the absence of transactions costs, all regulatory activity would be rent extraction. Existing owners of rights to future capital flows or present wealth will always pay at least as much, and usually more, to keep what they have rather than have it transferred away." (McChesney 1997: 155).

The standard rent extraction model involves payments to withdraw or retract a proposed law. McChesney explains how legislators often create 'milker' bills to extract rents from different groups. Milker bills are bills proposed with the intention of retracting the proposal once sufficient rents have been collected from those groups or corporations who stand to be adversely affected by the proposed bill. If a legislator is able to credibly threaten to pass the milker bill, stakeholders will be willing to pay the lawmaker to retract it. The rent extraction literature has documented a host of instances where lawmakers have successfully utilized milker bills to extract rents (See McChesney 1997, R. Beck, C. Hoskins and J. M. Connolly 1992, and Schweizer 2013).

While milker bills are the most studied form of rent extraction, rent extraction can occur anytime a politician withholds action that would destroy existing private rents. This paper argues that selective enforcement of law can be another type of rent extraction. Just as politicians are paid to not enact a milker bill, a politician can also extract rents from ensuring that a law is not enforced in exchange for rents. In light of the theory of rent extraction, section II of the paper will develop the selective enforcement mechanism further and explain how it is a particularly effective tool for rent extraction.

Section III will provide a case study of the selective enforcement mechanism, and Section IV will offer some implications.

Section One: The Selective Enforcement Mechanism and its Merits

Selective enforcement occurs when government actors strategically refrain from enforcing a law in order to extort rents from those subject to the law. There are, generally, two types of situations that motivate politicians to selectively enforce law: those subject to rules have become accustomed to lax enforcement such that enforcing the rules would impose a great cost on them; this is extortion. Or, the current enforcement of rules imposes such a constraint on those subject to them that rule bound actors are willing to pay politicians to refrain from enforcing the rule; this is bribery. In both cases, enforcing the law places a high enough cost on those subject to the rule that lawmakers can offer an exchange profitable for both parties- citizens pay politicians to ensure the rules are not enforced. This paper focuses only on selective enforcement that involves extortion.[8] In order for a law to be selectively enforced the gains of breaking the law must be clearly higher than the costs of changing one's behavior in the event the law is enforced. In that instance, the expected costs of the act threatened exceed the value of what the private parties must give up to avoid government action, so private parties choose to surrender to government demands. Recall that in the McChesney rent extraction framework lawmakers extract rents by threatening to pass a milker bill. The same rent extraction framework can be applied to cases where government threatens to

(4.) Extortion and bribery are similar in many respects, since they both involve exchange, but are distinct concepts. Unlike bribery, the nature of an extortive exchange doesn't leave the extorted party with anything besides being free from the present threat.

enforce an already existing law[9]. In both cases government threatens to change the status quo unless citizens comply with the rent extractors' demands.

The language and intent of law is often sufficiently ambiguous to provide for a variety of interpretations and subjective evaluations of different criteria; this ambiguity (whether intentional or not) provides another avenue for rent extraction. The selective enforcement concept encompasses rent extraction that arises from ambiguities in the law. For example, construction permit approvals typically require some kind of subjective evaluation of an applicant's qualifications. Those charged with making those subjective valuations stand in a position to extract rents in exchange for approval. This type of activity is certainly commonplace, but is only a subset of selective enforcement. In circumstances where the law is ambiguous or the law requires a law enforcer to subjectively evaluate citizen eligibility for approval, citizens are asking for permission to do something based on established criteria, but selective enforcement of law can also involve actions that are universally and unambiguously illegal, yet, permitted. Ambiguous and subjectively determined aspects of law could be selectively used against citizens in order to extract rents, but such actions are only a type of selective enforcement as described above.

(5.) An important part of this analysis is the relationship between lawmakers and law enforcers since these groups would have to synchronize their efforts in order for lawmakers to extract rents. The author addresses this point explicitly in a subsequent part of the paper.

Selective enforcement is also distinct from (but supported by) sparse enforcement. As discussed in Section I, law enforcers are typically charged with enforcing more laws than their time or material resources permit them to enforce, so not all laws are enforced. The fact that law enforcers face a trade off between enforcing different laws does not imply that there is a bias in determining which laws are enforced. In other words, law enforcers' constraints necessitate that some laws go unenforced, but it does not necessitate that laws be enforced tendentiously. Extending the rent extraction framework to include selective enforcement provides an explanation regarding which laws are enforced[10]: the unenforced laws are those who affect citizens with rents that can be extracted.

Critical examination of selective enforcement as a mechanism for rent extraction reveals how it is an ideal tool for extracting rents. One merit of using selective enforcement to extract rents is that the mechanism provides lawmakers with a low cost way to make credible threats to citizens. When politicians draft and propose a milker bill, they will only be able to extort rents in as much as stakeholders believe that the milker bill is a credible threat. While extorters can typically place milker bills in front of the appropriate legislative committee without much difficulty, it is unlikely the bill would pass the legislature and become law, but those hurdles do not exist when a lawmaker threatens to enforce an existing law. Enforcing an already existing law is usually less

(6.) Throughout the paper, the author will use the term 'enforcement agenda' to refer to the body of laws public officials decide to enforce.

costly than drafting and implementing a new law; thus, when threatening to enforce a law already on the books, government officials' threats appear more credible.

Furthermore, since milker bills are typically directed at a particular group or industry, identifying lawmakers' true motives is less difficult than in the selective enforcement case. Lawmakers could convincingly claim to be acting in the public interest by working to enforce already existing laws, so it would be difficult for victims of extortion to prove that lawmakers had alternative motives making paying rents more likely to be the cheaper option.

Selective enforcement also allows politicians to economize on the legislative process. Drafting a milker bill requires time, and bringing that bill to vote in a committee requires obtaining and spending social capital with other lawmakers. Because a single legislator cannot easily orchestrate the legislative process, the milker bill proponent will likely have to share the extracted rents with others who help his cause[11]. However, by simply passing one law and then selectively enforcing it in exchange for rents, or by utilizing an already existing law and selectively enforcing it, politicians can extract rents without investing as much time in the legislative process and reduce the need to share extracted rents with other lawmakers. Nonetheless, since most lawmakers aren't also law enforcers, selective enforcement may require lawmakers to share rents with the enforcers.

(7.) See Buchanan 1994 for more on rent extraction and the legislative process.

Economizing on the legislative process saves lawmakers more than just social capital; it also helps them minimize the amount of voters that their extortive actions could offend. Since politicians maintain, and ultimately increase, their power by staying in office, maximizing the votes they receive is of upmost importance. Whenever a politician introduces a bill, he runs the risk of alienating potential voters who would have otherwise supported him. Because milker bills exist explicitly for no public welfare enhancing purpose other than to extract private rents, such bills will almost certainly offend certain constituent groups. There certainly may be circumstances where, on net, a politician decides to introduce a milker bill in light of the costs, but this tradeoff is eliminated when a law is selectively enforced. Because selective enforcement does not require a politician to endorse a bill, he does not run the risk of alienating supporters. While its possible that threatening to enforce an already existing law could alienate supporters, again, a politician could very easily appeal to a public interest defense for why he is choosing to enforce a law without endorsing the content of that law.

Perhaps the greatest benefits of using selective enforcement to extract rents are the economies of scale and scope to extracting rents via selective enforcement. Thus far, the author has argued that the threat of enforcement can be used to extract 'rents' without specifying what 'rents' entail. 'Rent extraction' may refer to extortion of some monetary sum, but extortion need not be limited to a monetary domain. Politicians may easily extort behavior of some sort or compliance with their will. A broader

conceptualization of rent is necessary to understand how selective enforcement provides economies of scope to selective enforcement. A politician can extort a variety of behavior in accordance with his will by neglecting to enforce one law and then threatening enforcement. In this sense by threatening to enforce an already established law, the extorter can effectively enforce a variety of unwritten rules; since selective enforcement need not be limited to a single law each law that is selectively enforced provides government actors with an increasingly wider range of rent they can extract.

Traditional rent extraction, that involves a threat to pass a law instead of a threat to enforce an existing law, may appear to provide equal economies of scope benefits, but further examination shows that this is not the case. Threatening to enforce a law ordinarily may not have any more extortive power than threatening to create a new law with the same content. However, when threatening to create a new law in order to extract rents, government actors face several constraints that are not present when selectively enforcing a law. The most problematic of these constraints is the constitutional rule that no ex post facto law be established[12]. Furthermore, those who would find themselves in violation under the new law can simply change their behavior. Constitutional constraints aside, there are a variety of logistical problems to threatening to pass a new law, which could limit the economies of scope. Politicians might lack the necessary coalitions to successfully pass a law, which limits their ability to credibly threaten to do so. Finally, it is possible that not all constituent groups would be content

(8.) See Article I section 9 of the U.S. Constitution. An ex post facto law is a law that retroactively changes the legal status of an action after the act has already been committed.

with the new law. In this case the politician would need to devise a way to credibly promise to selectively enforce the new law only on the group he wants to extract rents from.

Selective enforcement is not subject to any of the aforementioned problems. By selectively enforcing already existing laws, politicians can avoid accusations of passing a law ex post facto. Unlike threatening to pass a new law where citizens have time to change their behavior, threatening to enforce an existing law is only a threat if citizens are already in violation of the law, so citizens stand to gain little by changing their behavior. Finally, as previously discussed, selective enforcement does not require politicians to navigate the costly legislative process, and this makes their threats all the more credible. Since the selective enforcement method is not subject to the aforementioned problems, it provides lawmakers with economies of scope in extracting rents.

The lower cost of selectively enforcing a law versus threatening to pass a new law drives the economies of scale afforded to politicians by selective enforcement. By selectively enforcing law, the cost of extracting rent is much lower than the traditional milker bill method. Once a politician has either implemented or identified a law that can be selectively enforced, the marginal cost of rent extraction is relatively low. Because with selective enforcement politicians don't need to pass (or threaten to pass) a new law

each time they want to extract rents, the average cost of selective enforcement decreases with each instance of rent extraction.

Of critical importance to there argument presented herein is a clear examination of the relationship between lawmakers and law enforcers. Successful rent extraction via selective enforcement may require complementary action by both political and administrative officers. In some cases, political agents, like a Mayor, may have a wide degree of latitude to hire and fire administrative officers of his choice.

McCubbins, Noll, and Weigngast theorize that legislators design administrative procedures to lead to the administrative outcomes congruent with legislator preferences (1987) and elaborate on how the same mechanisms are adapted as political coalitions change (1989)[13].

Richard Wagner draws a parallel between such complex coordination and Donald Trump's *The Art of the Deal* (Wagner 2014). Wagner emphasizes that while market exchanges are didactic (are composed of two traders) political exchanges are triadic: a political authority exchanges (perhaps via some policy change) with an influential citizen but the exchange also impacts the citizens in the minority or those who have opposing preferences but insufficient influence. Thus, successful triadic exchanges that leave everyone better off (or at least not sufficiently worse off to inspire taking

(9.) For an extended summary on literature pertaining to legislative oversight of administrative agencies, see Coyne 2013.

action to reverse the exchange) require complex coordination. Selective enforcement is another avenue that the aforementioned parties can use to reach agreements.

The standard economics paradigm suggests that there must be gains from trade between political and administrative officers in order for them to coordinate. While such gains from trade may not always exist, there is good reason to believe that they often do: political officers often control administrators' budgets and consequently have some power to set their agendas.

The relationship between lawmakers and law enforcers is even more intimate on the local level. At the local level, executive and legislative officers are often not as distinct as they are at the national level. For example, city (or county level) council members have executive, legislative, and administrative power. Furthermore, mayors and city managers can and do begin city (county) initiatives aimed at improving specific areas of public welfare: better education, lower crime, etc. Such initiatives can manifest themselves in explicit attempts to increase enforcement of a specific law or set of laws. These differences between the structure of national and local governments may explain why, empirically, we tend to observe rent extraction via milker bills at the national level and selective enforcement at the local level.

Section Two: Zoning Laws as Ideal Law for Selective Enforcement

Several aspects of zoning and land use laws make them ideal for rent extraction via selective enforcement. First, nearly all residents in a city are affected by zoning rules making the costs of forming a concentrated interest group large and allowing politicians to enforce zoning laws with less fear of alienating supporters. Second, businesses that stand to be adversely affected by zoning law enforcement or changes are typically capital-intensive businesses that lack close substitutes to their capital. For example, restaurants, clubs, and apartment buildings are all businesses that derive much of their profit from real estate; in most cases there are no close substitutes for buildings, especially when a business' location is part of the business itself. Third, the complexity of most municipal zoning codes combined with the number of dwellings gives law enforcers a convincing and convenient public interest rational for why the code cannot be enforced at all times in all places; finally, zoning violations are often of diminutive consequence.

The standard rent extraction model McChesney lays out predicts that industries least prone to cartelization are most likely to be subject to rent extraction and vice versa (McChesney 1997). The types of businesses which zoning laws stand to impact the most have very low tendency to cartelize. Few landlords, restaurants owners, and bar owners are part of cartels.

The judicial record on selective enforcement of zoning laws gives politicians more reason to be confident in their ability to successfully extract rents via selective enforcement. Aside from having to incur usually significant legal expenses to file a lawsuit against a zoning authority, claiming 'unequal enforcement' has not been a successful defense for citizens in court. Several courts have iterated that selective enforcement is in no way a defense for having broken the law[14].

The Case Study Method

Since politicians and citizens both have an incentive to conceal instances where laws are selectively enforced and rent extracted, finding empirical support for the phenomena will always be a difficult task. Furthermore, the economies of scope afforded to lawmakers via selective enforcement suggests that the rent extorted from a citizen could be distant and unrelated to the content of the selectively enforced law, making identifying coercion even more challenging. Finally, selective enforcement is very difficult to distinguish from public interest motivated enforcement; the distinction between the two ultimately lies in the motivation, intention, and knowledge of the enforcer.

(10.) The fact that a similar violation by someone else has not been prosecuted is not a valid defense. In City of Gastonia v. Parrish, 271 N.C. 527, 157 S.E.2d 154 (1967), the court held that an allegation of unequal enforcement of the zoning ordinance is no defense to an illegal act (an illegal junkyard in a residential district in that case). Laxity of prior enforcement against others does not in and of itself establish a defense. See Owens 2010.

Because of the difficulties in identifying true selective enforcement and rent extraction from public interest motivated increases in enforcement, investigating the selective enforcement mechanism requires a thorough and detailed investigation of instances where rents may be extracted via selective enforcement. A thorough and detailed analysis of the political and social norms and other conditions surrounding the enforcement of a law is best captured by the case study method. Using a case study allows us to isolate a variety of factors that would be difficult to control for in a regression analysis. The tradeoff to using a case study versus standard statistical methods is the generalizability that statistical results justify; thus, the author does not claim to generalize the results of this paper. Not all-selective enforcement is rent extraction; the author remains agnostic as to whether or not selective enforcement is usually rent extraction. Our purpose in this paper has been to develop a framework of rent extraction via selective and investigate whether this framework affords us any explanatory power.

The selective enforcement mechanism for rent extraction suggests that a political environment with selective enforcement will have at least three characteristics, and selectively enforced laws in that political environment will have at least three characteristics. Those six criteria form the basis by which the findings of our case study will be evaluated.

A political environment that uses selective enforcement to extract rents would have the following three characteristics: Since lawmakers are traditionally not also

law enforcers, an environment with selective enforcement would require lawmakers to have a clear and significant influence over the enforcement agenda. Secondly, because those with few substitutes for complying with the law would be most willing to pay rents, we expect victims of extortion to be in open and unambiguous defiance of the law, and such defiance might even occur for an extended period of time. Finally, while violations would be apparent, if rent is actually being extracted in order for violations to be ignored, not all violators would begin to comply or receive punishment after their defiance has been exposed.

In addition to the three aforementioned characteristics of an environment with selective enforcement, selectively enforced laws themselves are likely to have some combination of the following three characteristics: The laws would be structured to ensure that paying rents is cheaper than compliance. Selectively enforced laws would likely afford small social welfare gains for compliance, and thus there would be little consequences to breaking them. Finally, laws that anger organized constituent groups will be either enforced or unenforced but not selectively enforced.

Section Two: A Case Study of Zoning Laws in New Orleans

In 2010 newly elected New Orleans mayor Mitch Landrieu began an initiative to grow New Orleans tourism scene and satisfy new post-Katrina New Orleans residents looking for quieter residential neighborhoods. This initiative manifested itself in

a city beatification campaign, which involved stricter enforcement of the city's zoning ordinances- especially zoning ordinances related to noise levels.

The 2010 mayoral political change in New Orleans provides an excellent case study for selective enforcement as rent extraction since it is a situation where an elected leader is trying to influence the enforcement agenda (of which laws become enforced) and is attempting to increase enforcement with respect to zoning laws. The following case study will explore New Orleans zoning laws and their compliance both before and after this increase in enforcement.

The Mayor's bold campaign angered groups on all sides of the debate over how to improve the city. Town hall meetings became so tense and neighborhood associations so active in local debates that the city government commissioned a sound scientist to prepare a study comparing noise levels and noise ordinances throughout the city. The report explains that the principal problems with the noise ordinances stem from the fact that rules are selectively enforced (Woolworth 2013). Stricter enforcement of the law may have upset the previous balance in an environment where selective enforcement was the norm. This situation provides for an opportunity to examine potential selective enforcement in action.

Heightened enforcement of zoning ordinances revealed that lax enforcement in New Orleans was extensive enough to permit more than just marginal

violations of the law. The 20th Annual NOLA Designer Costume Bazaar was forced to shut down in 2011 for not having the proper operating permits even though the program has operated without the required permits for twenty years (Kjorness 2013A). One resident moved to a street with various nightclubs only to discover that the neighborhood zoning ordinances don't even permit live music in the area (Kjorness 2013A).

Many clubs located in areas where live music was not permitted were asked to shut down, but only some did so (Kjorness 2013A). New Orleans zoning law includes a provision that allows businesses to continue to operate in defiance of the law if they can prove they have already been doing so for five years.

The penalties for breaking zoning laws in New Orleans are not trivial. In fact, breaking the noise ordinances is a criminal offense in many cases. Investigative journalist Chris Kjorness reports that officers threaten musicians with criminal charges, yet there isn't a single case where noise ordinance violations have led to criminal charges (Kjorness 2013A).

Another zoning ordinance that became increasingly enforced in New Orleans involves "bandit signs." Local artists very commonly use posters, flyers and other types of printed materials to advertise their events. Though these advertisements exist in multitude all over the city it is considered littering to post these flyers on any public right-of-way. Fines for violating the law range from $25 to $50. Part of the

Mayor's beatification campaign involved cracking down on these flyers. Musicians had to battle for limited space in coffee shops for a short time, but only a few months after the crackdown began, the flyers began appears throughout the city again (Kjorness 2013A). Kjorness reports that there is no record of anyone complaining about being fined for this violation, yet the zoning ordinance is clearly on the books (Kjorness 2013A).

During New Orleans parades, street vendors typically follow the parade and sell food and drinks from small pushcarts. Street vendors are required to have a license to sell goods during parades, but this ordinance is scarcely enforced. Kjorness reports that there is long tradition of unlicensed vendors providing zero price drinks and food to officials in exchange for selectively enforcing of the license ordinance (2013A).

Mayor Landrieu's campaign to start enforcing more of the cities laws included the law requiring licenses for street vendors. The street vendor complaints were so loud that the City Council unanimously passed an ordinance that allowed street vendors to obtain a permit for only $25 (Kjorness 2013A). The new law made licenses low cost but it also included a provision that assigns street vendors responsibility for keeping the area within 10 feet of their pushcart free of litter. During a parade, many trinkets thrown from floats during a parade are left on the sidewalk, and the large numbers of spectators all create litter that street vendors play no role in creating. Furthermore, street vendors typically walk with their carts alongside the parade making the ten-foot radius they are responsible for one that is continuously changing. A similar

law exists for stationary street vendors, but that law assigns a fifty-foot radius of responsibility to those vendors.

The New Orleans Mayor's campaign to enforce more of the cities laws animated an interest group to discover that dozens of small retailers on the city's French Quarter district were illegally selling t-shirts and other souvenirs (Kjorness 2013B). Even though many of these shops had been in operation for years, the Vieux Care Property Owners, Residents, and Associates (VCPORA) gave the city government a list of dozens of retailers they believed were in violation of zoning laws (Kjorness 2013B). It turns out that the city zoning laws prohibit any store opened after 2011 from selling t-shirts or souvenirs for a majority of its revenue.[15]

Even though VCPORA claimed that dozens of retailers were violating the zoning law, the city announced that only thirteen stores were in violation (Kjorness 2013B). These thirteen businesses were issued citations and asked to remove the illegal souvenirs within 10 days. The business owners have since asked for a hearing before the zoning board, and the hearing has been postponed for more than half a year (Kjorness 2013B). Even though VCPORA claimed that several businesses are violating the law and

(11.) According to the New Orleans city ordinances, a place where the majority of business comes from the sale of t-shirts or souvenirs is an illegal t-shirt shop. *Majority* constitutes at least 35 percent of sales are from "items, exclusive of books, magazines, or maps, which serve as a token of remembrance of New Orleans and which bear the name of the city or geographic areas or streets thereof, or of events associated with New Orleans including but not limited to Mardi Gras, the Sugar Bowl, or the World's Fair." http://www.documentcloud.org/documents/816469-t-shirt-ord.html#document/p5/a130928

the city even admitted that thirteen businesses are in violation, there have yet to be any penalties for such behavior.

Some evidence suggests that VCPORA isn't complaining about selective enforcement per se but rather whom the city is selectively enforcing the law against. Kjorness points out that an upscale boutique called "Fleurty Girl" is in clear violation of the zoning rules yet it has not faced any objection from VCPORA (Kjorness 2013B). Kjorness further explains that poor and middle class Asian immigrants own almost all of the stores that VCPORA highlighted as violators (2013B).

Journalists C.W. Cannon believes "what really drives the loathing of T-shirt shops in the Quarter is the fear that New Orleans will be seen as a minor capital of the Redneck Riviera rather than a paragon of elite culture" (Cannon 2014). Its seems that the battle amongst political groups in New Orleans isn't over whether the city should selectively enforce laws or not but over which groups should be subject to selective enforcement.

Cannon and Kjorness suggest that the difference between t-shirt shops and the remaining shops in the French Quarter is not that the t-shirt shops sell souvenirs; it's the price tag of their products. There are plenty of fancy shops that sell high price art and antiques; these stores have not faced any problems that threaten their livelihood.

Another New Orleans zoning ordinance that became increasingly enforced is the curfew on live music. Though one would never know it by visiting the city, live music is not allowed on the streets after 8 p.m. Since 2002, a group named "To be continued" started playing on Bourbon Street in order to raise money to go on tour. After more than eight years of time on the same street corner, the band became a fixture in the neighborhood. When the local government suddenly attempted to enforce the 8 p.m. curfew, the band came back the next night and played until 9 p.m. Police didn't make a single arrest (Reckdahl 2010).

Since beginning a campaign to clean up New Orleans by enforcing more of the cities laws Mayor Landrieu seems to have completely changed his position on the merits of increasing enforcement levels. In May 2014 the mayor said that he has no intention of enforcing the curfew law on live music (Rainy 2014). Landrieu has even gone so far as to warn residents who, during a city council meeting, were demanding stricter enforcement of many city ordinances to "be careful what you ask for" (Kjorness 2013A).

Given the New Orleans case study, we shall examine Mayor Landrieu's city beatification campaign in light of the six criteria established prior to investigating New Orleans. Recall, we established three criteria pertaining to a political environment with selective enforcement and the three criteria pertaining to laws that would be selectively enforced.

The political environment in New Orleans appears to evidence all three of the criteria that would need to exist for selective enforcement. First, there appears to be a clear avenue for elected officials to influence the enforcement agenda[16]. Mayer Landrieu stated that he would increase enforcement of certain laws and later stated he would scale back enforcement of the noise ordinance; he succeeded in both increasing and decreasing enforcement. The fact that the Mayor was able to move the enforcement agenda in both directions, and publicly announce his intentions, is very clear evidence that political officials can influence the enforcement agenda. However, the mayor's influence over the enforcement agenda itself does not serve as evidence that the Mayor was extracting rents, but as will be examined subsequently, by changing the enforcement agenda, the Mayor's initiative revealed citizen and government behavior that is congruent with selective enforcement.

In addition to evidence that political officials are able to influence the enforcement agenda, the second of three characteristics of a political environment with selective enforcement would be evidence of citizens who are in open and unambiguous defiance of the law. Various nightclubs operating on a street where night clubs are illegal is provides strong evidence of citizens in open an unambiguous defiance of the law. The t-shirt shops, bandit signs, alleged 20 year illegality of an annual conference, and street music are also all examples of citizens in open and unambiguous defiance of the law.

(12.) Enforcement Agenda refers to the rules that actually get enforced due to resources constraints. See the opening paragraph of this paper for a review of this concept.

While these groups could simply have been lucky enough to be governed by regulations that the city chose not to enforce due to resource constraints, the scale and scope of the violations suggests that resources constraints are not the reason for why these laws were unenforced.

Recall that while violations would be apparent, if rent is actually being extracted in order for violations to be ignored, not all violators would begin to comply. An increase in enforcement of particular laws could very well be motivated by a genuine public interest on behalf of politicians, so increased enforcement alone does not indicate imply rent extraction. However, a public interest theory of increased enforcement cannot explain why some violators would be punished and not others while all are in clear and unambiguous defiance of the law. The rent extraction framework can explain this: not all violations are punished since once enforcement is increased, some citizens choose to pay rents and others don't. Kjorness (2013A; 2013B) documents how some violators of the New Orleans zoning laws continue to operate in violation of the law while others are punished. Recall, of the several nightclubs operating in a neighborhood where live music is illegal, only some clubs were shut down. There are no reports of criminal proceedings pertaining to the nightclub owners who still operate. Additionally, the VCPORA neighborhood association reported dozens of illegal t-shirt shops, but the city of New Orleans only claims that thirteen were in violation. Kjorness 2013B documents the stores that are in clear and open violation, yet did not receive a citation. The lack of punishment

(and even punishment proceedings) for select citizens further suggests that these laws were selectively enforced and not simply unenforced because of resource constraints.

The laws that were potentially selectively enforced are congruent with the three criteria that suggest selective enforcement. The first of the three characteristics of a law ripe for selective enforcement is that compliance with the law should be more expensive than paying rents. In all of the instances where citizens were in open and unambiguous defiance of the law, violators were all engaged in activities with few substitutes: night clubs, live music, bandit signs, street vendors, and t-shirt shops are not goods with close substitutes- especially from the business owners perspective. For example, there are not close substitutes to advertising with flyers, and the quantity of flyers in the city is so great that enforcers can easily legitimate selective enforcement by claiming that the costs of catching all violators are prohibitive. A lack of substitutes makes paying rents the relatively cheaper option over compliance with the law.

Aside from being laws that regulated activities with few substitutes, the laws had other characteristics that would make paying extortion the relatively cheaper option: criminal penalties for zoning violations. Contrary to the typical economic theory of punishment, even though catching noise ordinance violators would not be difficult, the selective enforcement framework would predict that selectively enforced laws should have high penalties (since high penalties only exist to extort rents) for those found in violation of them since this makes paying rents the relatively cheaper option.

The rule challenging businesses to operate in defiance of the law for five years before being grandfathered in makes extortion the marginally cheaper option over time[17]. While this law could be interpreted, through the lens of a public interest theory of government, as an attempt to limit selective enforcement of the zoning laws, the provision could also induce extortion. Business owners confronted with the decision to pay rents or face the consequences of being in violation of the law may choose to incur the consequences of the law if there is no clear upper bound in the length or frequency of the extortion. By limiting the potential extortion period to five years, business owners don't face a choice between endless extortion or the one time cost of compliance; thus, the law effectively makes extortion a cheaper option for business owners. After the five-year period expires, the extorter might not be in the same politician office and if he is, could move simply begin selectively enforcing another law to extract rents.

Finally, compliance with other laws is very costly if not impossible: keeping a, continuously moving, 10ft radius free of trash during a parade where floats throw trinkets to the crowd, keeping a 50 foot radius trash free on a city street is nearly impossible to comply with. Furthermore, ensuring the revenue in a retail store (where owners cannot predict which items are most popular nor do they have control over which items consumers buy) is not in excess of the legal limit for t-shirt sales is, at best, a costly enterprise.

The second characteristic of laws suited for selective enforcement is that compliance will afford small, if any, welfare gains while lack of compliance won't result in large, if any, welfare losses. There likely are welfare gains from lower noise and less trash. With regards to the noise ordinance, the independent report commissioned by the city did not attribute the current decibel limits; instead the report explicitly attributed controversy over noise levels to selective enforcement. Furthermore, while lower amounts of trash in the streets are very likely to increase citizens' welfare, the law does not assign responsibility to litterers and instead demands a level of compliance that is likely impossible from an easily identifiable party (street vendors) who have few substitutes for their behavior. Thus, if litter was a true concern, nearly other alternative rule would be more effective. Finally, one would be hard pressed to argue that selling too many t-shirts is a potential detriment to public welfare.

The third and final characteristic of laws that may be selectively enforced is that such laws will not adversely impact an organized group. Conversely, selectively enforced laws are more likely to target an unorganized group of citizens or an individual. Recall that when New Orleans increasingly enforced the zoning ordinance against live music, the result was to effectively outlaw the local favorite 'to be continued.' Public outrage was so strong that the band was allowed to continue playing in the streets after city authorities attempted to enforce the zoning ordinance only one time. Furthermore, by announcing that he would no longer enforce the restriction on live music while

simultaneously warning citizens to be careful what they ask for regarding enforcement, is further evidence that public opinion influences the enforcement agenda.

The political environment in New Orleans satisfies all three criteria that would permit selective enforcement, and the laws placed on the enforcement agenda in our case study all have the three characteristics congruent with laws that would be ripe for selective enforcement. The fact that all six conditions exist simultaneously, and both the mayor and an independent scientist independently and explicitly acknowledge that selective enforcement exists, is clear evidence that the phenomena exists in New Orleans.

Finally, the author would like to distinguish the selective enforcement phenomena from being an anomaly or conspiracy theory. The Public Choice framework emphasizes using symmetric assumptions to understand individual action in both the public and private sectors: if economic actors are purposeful actors who peruse their self interests' in the private sector, they will do the same in the public sector. Consistently and persistently applying public choice framework suggests that in a world of scarcity where all laws cannot be enforced, officials in the public sector must set an enforcement agenda. Insofar as politicians can benefit from strategically constructing that agenda instead of constructing it randomly, selective enforcement is a rational activity.

Section Four: Conclusion

This work has two main implications. The first is that selective enforcement is a powerful and relatively unexplored phenomenon that is an important tool for regulators, especially for those attempting to extract rents. The framework of selective enforcement developed in this paper suggests that both the content of the rules and their enforcement should both be part of discussions on regulation.

The second implication is that focusing on government 'action' will not yield a complete understanding of regulatory behavior. Economists and other social scientists have created lots of scholarship detailing rent seeking and regulatory capture, but the persistent and consistent application of the economic way of thinking suggests that rent seeking is only a part of the regulatory landscape. Recent scholarship has highlighted more of the regulatory landscape by developing a theory of rent extraction strategies that politicians use, but the current rent extraction literature has focused on milker bills and other government 'action.' The selective enforcement framework draws our attention to what government can extort via *inaction*. Incorporating the power government wields via inaction is important in order to fully understand regulatory behavior when studying political economy.

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