Some Implications of Recognition of Property Right Transactions Costs*

The list of fields of economics in the Directory of the American Economic Association contains no references to transactions costs or to property, despite much recent interest and research in that area. Probably the paper in recent times that most stimulated progress was Coase’s “The Problem of Social Costs.”¹ It demonstrated that, with costless exchange transactions and well-defined and transferable property rights, resource uses—aside from wealth effects on relative consumption demands—are independent of initial rights assignments. This statement signifies that transactions costs—the costs attendant to transferring entitlements or rights—destroy the classic standard theorems on market exchange efficiency. It indicates that many so-called market failures are failures of existence of markets or, more accurately, are results of obstacles (costs) to transactions, agreements, contracts, or understandings about uses of resources. These costs arise because of difficulties of communication, information collation, contract stipulation, ambiguities of entitlements or rights that might be traded. A host of activities are encompassed by the rubric “transactions costs.”

* Presented at the First Annual Interlaken Seminar on Analysis and Ideology, Switzerland, June, 1974.


K. Brunner (ed.), Economics Social Institutions
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Transactions

An oral tradition (a euphemism for a rubric of terminology, conjectures, and plausible assertions) exists on the role of entitlement and transactions costs. The conception of transactions remains sufficiently indefinite to permit superficial reference to “transactions costs” as the key to any paradox, externality, public goods provision, etc.

The following activities seem to be worth noting in the transactions conception:

1. Search over society for who has what rights. The cost of this search is reduced by specialists—as for nearly all activity. For land or houses, there are real estate agents and for stocks, stockbrokers. Employment agencies, yellow pages, and advertising convey information about who has what rights available for transfer.

2. The investigation of what rights each person has in each case. Title search firms identify rights holders and their entitlements. Automobile registration gives clearer evidence. Retail merchants provide assurance that goods are not stolen or of bad title, and we can’t forget lawyers.

3. Technological attributes of goods. Investigation of physical attributes is sometimes sufficiently expensive to interdict transactions. Advertising or display of a good or of evidence about its characteristics is often provided by specialist “middlemen” who trade in the good. Indeed, this is a major function of merchants. Should we (a) include only the costs of conveying information about attributes of the goods or (b) take the state of knowledge as exogenous and include only the costs of providing risk-sharing provisions, guarantees, assurances, or remedies—if attributes are not as represented? For the moment, we include both and dub the first “attribute determination” and the second “risk sharing.” Means for providing attribute information are diverse as well as specialized; examples are brand names, franchises, warranties, guarantees, commitments of wealth to a long-run venture (a means of self-imposed losses for bad performance, which thus serves to inform potential customers of the greater loss the seller will incur for unreliable performance), free trials, advertising of attributes, and governmentally imposed standards.

4. Price search and price predictability. The discovery of