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THE EFFICIENCY OF PROPERTY RIGHTS DEFINITION.¹ THE EXAMPLE OF SHAPING THE RELATIONSHIP BETWEEN THE HOMEOWNER AND THE TENANT IN POLAND

Summary: The short- and long-term efficiency of the definition of property rights over socially important resources is analyzed in the paper. This was done with the example of housing resources due to the fact that they constitute a very important component of national wealth.

Key words: efficiency, property rights, housing resources.

“In essence, economics is the study of property rights over scarce resources. [...] The allocation of scarce resources in a society is the assignment of rights to uses of resources. So the question of economics [...], is the question of how property rights should be defined and exchanged, and on what terms.”

Armen Alchian [1967, pp. 2-3]

1. Introduction

The institution of ownership is the right of the owner (or owners) – formally confirmed by a public authority² – for the exclusive use and dispose of owned assets. The “birth” of property rights was associated with the biological survival instinct and the need to have various goods (commonly observed among animals) and – usually very expensive – the necessity to use physical force to protect possessed resources. One of the reasons for establishing a state (and a legislation) was a need to create the respected institution of ownership. This was necessary due to shifting away from societies based on blood ties to the state systems based on territory and land cultivation. This process entailed the intensification of competition in the use of natural resources. Probably Rome was the first state in history which expanded the

¹ The greater the total market surplus, the greater the efficiency of the definition of property rights over the given market resources.

² This way it differs from the possession or the exercising physical control over goods.

fullness of legal rules and procedures governing both private and public life – in its statutes property rights reached their fullest expression [Pipes 2000, p. 161]. However, the elevation of private property to the rank of the most important institutions was the result of supporting the development of trade and industry in Europe during the eighteenth and nineteenth century [see Pipes 2000, pp. 179-181].

It is obvious that two physically identical goods may have a different market price if the property rights to them are different, because the possible use of these goods depends on how these rights are defined (formed). The economic theory shows that both (1) the definition of so-called “relative property right” and (2) market transactions are used to increase the value of resources (and ultimately to maximize the general welfare³). The definition of relative property rights is based on limiting (“fragmentation”) the complete package of owner’s rights to the subject of property, called “absolute property right”. As already mentioned, the full traditional owner’s rights were determined on the basis of ancient Roman law, and they include [see Ignatowicz 2000, p. 72]:

- rights to use: to possess (*ius possidendi*), to use and get services/benefits⁴ (*ius utendi-fruendi*), to use up (to consume), and wear out (*ius abutendi*);
- rights to dispose (*ius disponendi*): to transfer, surrender, sell, or charge the subject property.

In other words, a property right is the exclusive authority to determine how a resource is used. But society is able to approve or to reject the uses selected by the holder of the given property right with governmental administered force and/or with social ostracism – and this is the way of forming various institutions creating the pattern of property rights in the given society. In the Polish Code of Civil Law⁵ (Article 145), one can read that “the owner may use the subject of property (to the exclusion of other persons):

- within the limits set by the law,
- within the limits defined by the rules of social life,
- in accordance with the socio-economic purpose of his rights.

Within the same limits the owner may dispose of the subject of property rights”.

For example, full property rights include the right to delegate or sell⁶ any portion of rights to use by exchange at whatever price the owner determines. If one is not

³ More precisely, if we want to get the optimal allocation of existing scarce resources, we should make the optimal definition of rights to them.

⁴ For example, the owner of a flat has the right to determine whether to rent it out, to live in it himself, or to use it in any other way. That is the right to determine the use. If the owner rents out the apartment, he or she also has the right to all the rental income from the property. That is the right to the services of the resources.

⁵ Or shortly *The Civil Code*, see Dz.U. 1964, Nr 16, poz. 93 (signatures used in the paper are according to the Polish denotation of legal acts).

⁶ It is Roman *ius disponendi*, the second part of classic owner’s rights.

allowed to sell such separated portion or if there is a limit of price, then it would mean that the owner's absolute property right was reduced and the specific relative right was formed.

The essence of this problem is that the different economic actors can define property rights in the special way to affect their market value. Such a definition is mainly made: (1) by the law or (2) using the rules included in private contracts.⁷ The example of the legal (statutory) construction of relative property rights in Poland is "The Act on Protection of Tenants' Rights"⁸ (which is the subject of analysis in the third section of this paper). The example of the contractual fragmentation of absolute property rights may be establishing the traffic speed limit in the territory of gated communities (e.g., not greater than 30 km/h). The developer – building such a strictly private estate – introduces this solution in order to raise the price of houses by increasing security on the estate. Finally, it may be beneficial for both the developer as well as for residents, but it obviously depends on the level of the raised price of real estate. As one can see, such a private rule is likely to turn into the established institution, because of that the welfare of at least one of the parties of the market transaction will be increased.

Normatively defining relative property rights (with a fragmentation or a defragmentation of absolute owner's rights) should increase the welfare of the given socio-economic system. In the economic theory, there are two approaches to the process of creating or reorganizing institutional order: (1) the optimistic one assumes that institutional innovations will become part of the economic system if they lead to a Pareto-improvement; (2) the moderate approach concludes that new institutional arrangements may be permanent if they increase the welfare of at least some of the beneficiaries of the given economic system.

Residential real estate constitute a very important component of national wealth; therefore, the wrong definition of property rights over these resources leads to a significant loss of national prosperity. The fundamental problem here is the question of the appropriate relation between rights of housing owners and of tenants. The law of most civilized countries protects residential tenants from losing the right to use premises (it guarantees, commonly speaking, "a roof over your head"). Indeed, in extreme cases the loss of this right may cause the homelessness of entire families, and this contradicts the principles of social solidarity which is the foundation of the functioning of developed societies. So there is no dilemma: whether to protect residential tenants or not – there is only a question of how to protect them. Therefore, two research questions were posed:

⁷ One should remember that property rights may also be shaped by customary or religious norms.

⁸ The full name of this act is "The Act on Protection of Tenants' Rights, Communal Housing Resources and Amending the Civil Code", see Dz.U. 2001, Nr 71, poz. 733.

- Whether property rights over residential real estates in Poland were (are) well defined?
 - If not, whether their definition was (is) being improved?
- The answers to these questions are presented in the next sections of this paper.

2. Rental markets as the indicator of efficiency of property rights over residential real estates

It seems that a good measure of “quality” of the existing definition of property rights over dwellings is the degree of development of the rental housing market in a given country. If this market is widely, fully developed then on the one hand the owners will derive benefits from it, and on the other hand tenants will be able to rent a flat easily and cheaply (and it obviously greatly increases the social welfare). The “maturity” of this market in Poland can be demonstrated by comparing to the situation in other European countries (see Figure 1).

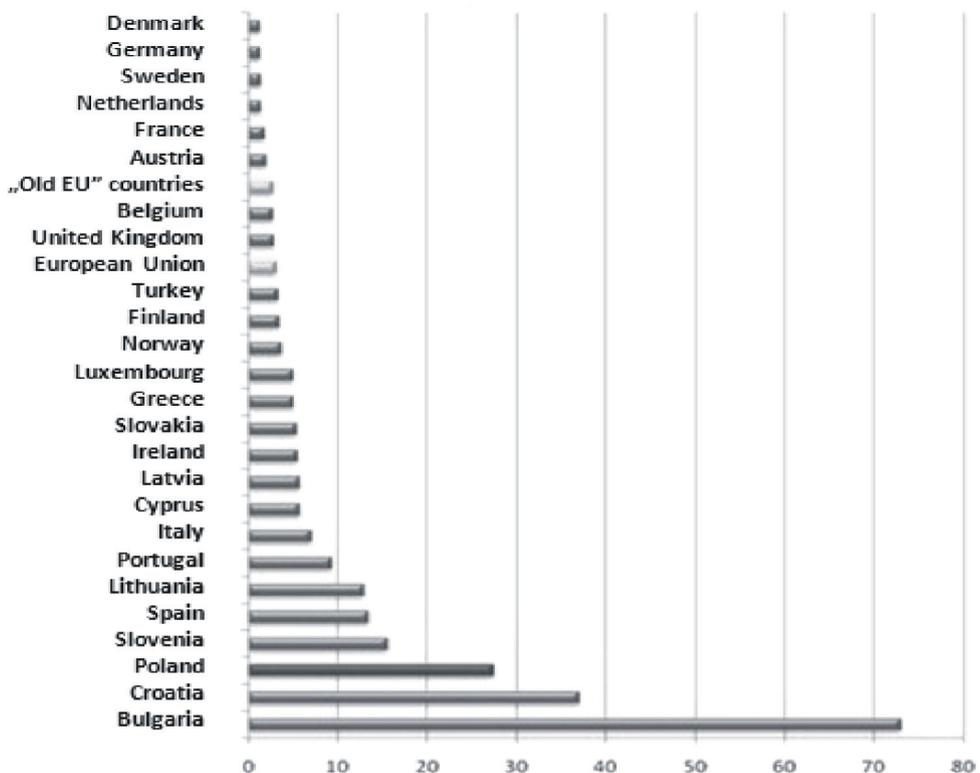


Figure 1. Owner-occupied dwellings per one rented flat in various European countries

Source: Turek [2010] (estimates based on Eurostat data).

In Turek [2010] the “size” of these markets in various countries was determined by estimating the number of the dwellings occupied by their owners per one rented flat. This was done based on Eurostat data – adopting the simplifying assumption that the structure of rented and owned housing is qualitatively the same⁹ – by comparing the expenses incurred by the tenants to the hypothetical amounts that the owners would have to pay if they rented their own real estate. As shown in Figure 1 the legal rental housing market in Poland is one of the least developed among the countries being compared.¹⁰ More specifically the indicators of the “size” of the examined markets are presented in Table 1.

Table 1. Rental housing market – the analysis of selected countries and social groups

Country	Estimated number of owner-occupied dwellings per one rented flat		
	Families with one child	Single-person households	Total
Poland	30.8	26.4	27.4
Italy	7.5	5.1	7.0
United Kingdom	4.4	1.9	2.9
Germany	2.5	0.6	1.4
European Union	8.4	5.7	3.1
“Old EU” countries	8.1	5.4	2.8

Source: Turek [2010].

As one can see, in Poland there are 27.4 flats occupied by the owners per one which is rented. A quite different situation takes place in such countries as Denmark, Sweden, Germany, and the Netherlands (see Figure 1). However the relation (observed on housing markets) between the level of rents and of purchase prices is not the main cause of differences shown in Figure 1. In most of these countries this ratio is in fact similar to the European average, and in the Netherlands renting apartments can be even regarded as relatively expensive.¹¹ The analysis conducted in Turek [2010] also indicates that in most countries the families with one child more often acquire their own flat than single-person households (see Table 1). In Poland, this difference between singles and the rest of households is negligible – one can see that the vast

⁹ Accurate estimates probably would be different, but not enough to change significantly the general picture shown by received data.

¹⁰ It should be noted that the methodology of studies conducted by Eurostat does not take into account the housing expenditure connected with the tourist traffic, so the size of the rental market in countries such as Croatia or Bulgaria is underestimated.

¹¹ The sum of rents paid by a tenant in Amsterdam will equal the market value of property in 15 years, while in Europe the average is 10 years longer [see Turek 2010].

majority of singles buys flats, while for example in Germany among three singles almost two decide to rent, and only slightly more than one to purchase.

The data presented above shows that the rental housing market in Poland can be perceived as an “immature” one (in fact very weakly developed). It seems that the primary reason for that situation is the arrangement of legal institutions forming the property rights over residential real estates.¹² This will be explained in more detail in the next section.

3. Institutional analysis of the relationship between the homeowner and the tenant in Poland

It is often pointed out that in Poland the housing needs are not properly satisfied.¹³ It could be improved by the dissemination of a tenancy, as happens in many other countries. Paradoxically, the obstacle is not the lack of flats, but the existing law. “The desirable balance of rights and interests of homeowners and of tenants has not been preserved [...]. This may turn against the tenants because the homeowners – knowing that it is related to a high risk – may want to avoid renting their dwellings” [Bończak-Kucharczyk 2002, p. 22]. One can indicate some important legal regulations which are responsible for this situation:

- The existing eviction procedures¹⁴ which cause that in practice tenants are irremovable. For example, in 2009 the courts received nearly 2100 lawsuits for eviction, but only 240 (11.4%) of them were executed¹⁵ (because of the insufficient number of social housing for the evicted, which is required by law). It is important to remember that evictions are carried out usually in certain extreme situations, such as a lack of rent payments or the devastation of occupied premises.
- The overly restrictive regulations of tenancy termination, e.g., Article 11, Point 5 of “The Act on Protection of Tenants’ Rights” specifies that: “not later than 3 years ahead, at the end of the calendar month, the owner may terminate the legal relationship to the tenant, if he or she intends to live in premises belonging to him and does not provide a replacement dwelling, and the tenant has no title to other premises”. It seems that the three year period of tenancy termination – in cases when the owner wants to move into his or her own flat – is too excessive and particularly onerous.

¹² Transactions in the black market are not included in the estimates which are presented in Section 2. But as one can see in the next section of this paper, the significant part of illegal transactions is mainly caused by wrongly shaped property rights over housing resources.

¹³ For example see Nykiel [2008, pp. 62-69]. Although one can argue with this statement – as it is resulted from various international comparisons the current housing situation in Poland does not deviate from the reached level of socioeconomic development [see Łaszek 2004, p. 186].

¹⁴ More detailed discussion of this issue one can find in Jakubowski [2010, pp. 126-129].

¹⁵ According to data of the Urban Development Institute (*Instytut Rozwoju Miast*) [see Wielgo 2010].

- “The Act on Protection of Tenants’ Rights” (Articles 7-9) contains a number of limits for raising rent payments. The inefficiency of regulated rents is commonly described in textbooks for economics (and it requires no special explanation here). The economic historian R. Pipes in his book *Property and Freedom* shows that there is a general consensus among economists – practically all of them, regardless of their political views, consider controlled rents as a real disaster and argue against them¹⁶ (with exceptions for special temporary situations).

It is not necessary to carry out any particularly deep analysis to see that such institutional arrangements may strongly limit the development of the rental housing market and also create incentives to make contracts outside the formal economic turnover, where transactions are not restricted by legal rules.

But this reasoning answers only one question posed in the introduction to this paper. There is still the second question left: whether the definition of property rights over residential real estate in Poland was (or is) being improved?

First of all, it should be underlined that some of the legislation of “The Act on Protection of Tenants’ Rights” were repealed by the Constitutional Court. For example, Point 6 of Article 11 specified that the owner was required to pay the tenant a statutory penalty of 15% of replacement value of the real estate if he or she terminated the legal relationship and he or she did not start to live on the premises, or ceased to dwell in it before the expiry of six months from the termination. Such a controversially high penalty seems to be in contradiction with the essence of ownership (even intuitively understood), and one cannot be surprised that it was found to be unconstitutional.

The Constitutional Court also annulled part of Article 9 (specifically, Points 1 and 1a) which concerned a ban on raising the rent yearly by more than 10%. As mentioned earlier in this article, the institution of controlled rents is criticized by the vast majority of economists.

In addition to the elimination of unconstitutional regulations, completely new solutions were introduced to the tenant protection law. One of the most important institutional innovations is the agreement of occasional tenancy. This form of renting – available only for those owners who are not carrying out a business consisting in rental of dwellings – allows entering into agreements for a specified period of time (no longer than 10 years). And, what is most important, there are no limitations as to the motives for which the owners can terminate the contract – in case of traditional tenancy there is a specified number of allowed reasons justifying termination agreement on the part of the owner.

¹⁶ See Pipes [2000, pp. 388-391]. However, the idea of controlled rents is sometimes strongly advocated for the political or ideological reasons, although for example in New York (which was called ‘the world capital of rent control’) it led to the collapse of the city on an unprecedented scale.

4. Conclusions

As one can see, in Poland the inefficient definition of property rights over housing resources has been gradually improved (“The Act on Protection of Tenants’ Rights” was amended many times¹⁷). Moreover, the Polish government adopted in 2010 a housing strategy of further liberalization of the rental market [see Wielgo 2010] – among others it is planned to change ineffective eviction procedures which means that existing and newly built housing stock are practically not offered for rent.

In general, property rights over important resources are not formed always and only in the direction of greater economic efficiency. However, the evolutionary approach allows one to have a moderately optimistic opinion about the way in which property rights will be shaped in the long-term under conditions of democracy and a free market.

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¹⁷ Consider the following from the Journal of Acts (*Dziennik Ustaw*): Dz.U. 2004, Nr 281, poz. 2783, poz. 2786; Dz.U. 2005, Nr 31, poz. 266; Dz.U. 2006, Nr 86, poz. 602; Dz.U. 2006, Nr 167, poz. 1193; Dz.U. 2006, Nr 249, poz. 1833; Dz.U. 2007, Nr 128, poz. 902; Dz.U. 2007, Nr 173, poz. 1218; Dz.U. 2010, Nr 3, poz. 13.

EFEKTYWNOŚĆ DEFINICJI PRAW WŁASNOŚCI. NA PRZYKŁADZIE KSZTAŁTOWANEJ W POLSCE RELACJI WŁAŚCICIEL MIESZKANIA – LOKATOR

Streszczenie: W artykule została poddana analizie krótko- i długookresowa efektywność definicji praw własności do ważnych społecznie zasobów. Dokonano tego na przykładzie zasobów mieszkaniowych z uwagi na fakt, że stanowią one bardzo ważny element bogactwa narodowego.

Słowa kluczowe: efektywność, prawa własności, zasoby mieszkaniowe.