

SWEDISH SCHOOL OF ECONOMICS AND BUSINESS ADMINISTRATION

LAW AND ECONOMICS

“To me the most interesting aspect of the law and economics movement has been its aspiration to place the study of law on a scientific basis, with coherent theory, precise hypotheses deduced from the theory, and empirical tests of the hypotheses. Law is a social institution of enormous antiquity and importance, and I can see no reason why it should not be amenable to scientific study. Economics is the most advanced of the social sciences, and the legal system contains many parallels to and overlaps with the systems that economists have studied successfully.” **Richard Posner**

“Once [judges] must deal with scarcity, they must deal with economics. They may discharge this obligation expressly or by implication, well or poorly, but deal with it they will ... Hopes for a better society do not justify unreflective treatment of the tradeoffs we must make in a world of scarcity.” **Frank Easterbrook**

Law and Economics (*L&E*), a short name for Economic Analysis of Law, is the field of Economics that analyzes the legal system with two purposes: First, a normative purpose which consists of devising laws that induce an efficient allocation of resources. Second, a positive purpose which consists of analyzing the reaction of consumers and firms to changes in the law. Both approaches use microeconomics as the tool to analyze the legal system.

At the heart of *L&E* lie two ideas: First, laws generate explicit or implicit prices; and, second, consumers and firms take these laws as given and attempt to maximize their utility or profit. From these two ideas, two other ideas follow: First, a necessary condition for a socially-efficient allocation of resources is the existence of laws that generate “correct” prices; and, second, microeconomics can (and should) be used to analyze the reaction of consumers and firms to changes in the law. In short, *L&E* plausibly assumes that consumers and firms react to changes in the legal system, and that such reactions must be taken into account in the design of optimal laws, which, in turn, must appropriately balance all costs and benefits.

This 18-hour introductory course analyzes, from an economic point of view, different aspects of four core areas of the law, namely, property, contracts, torts, and crime. As an example, consider the following questions: Why do restaurants have smoking and non-smoking sections? Why do courts should not revoke voluntary but “unfair” contracts? Why are car manufacturers hit from time to time with damages worth hundreds of millions of dollars? Why do many countries have been experimenting with income-based fines? A tentative list of topics to be discussed is outlined below. Knowledge of microeconomics and the legal system are not necessary; the course is self-contained in this respect.

LAW AND ECONOMICS OUTLINE

I- INTRODUCTION

- ◆ Irrelevance of the difference between legal systems
- ◆ Definition, premises, and implications of *L&E*
- ◆ Positive and normative approaches in *L&E*
- ◆ Pioneering work in *L&E*
- ◆ A preliminary application to current issues

II- PROPERTY

- ◆ The need for property rights
- ◆ Allocation of property rights: The Coase theorem
- ◆ Critiques, extensions, and the modern restatement of the Coase theorem
- ◆ Remedies: Compensatory damages and injunctions
- ◆ Cases and applications

III- CONTRACTS

- ◆ The need for contracts
- ◆ The economic approach: The perfect contract
- ◆ Imperfect contracts: Formation defenses and performance excuses
- ◆ Remedies for breach of contract
- ◆ Cases and applications

IV- TORTS

- ◆ The need for liability rules
- ◆ Differences between liability rules and property rights
- ◆ Liability rules
- ◆ The economic approach: Optimal activity and precaution
- ◆ Cases and applications

V- CRIME

- ◆ Differential characteristics of criminal law
- ◆ Economic approach to criminal and social behavior
- ◆ The economic approach: Criminal behavior, social behavior, and optimal punishment
- ◆ Empirical evidence, cases, and applications

LAW AND ECONOMICS REFERENCES

- **TEXTBOOKS:**
 - ◆ Cooter, Robert, and Thomas Ulen (1997). *Law and Economics*. Addison Wesley
 - ◆ Posner, Richard (1998). *Economic Analysis of Law*. Aspen Law & Business.

I- INTRODUCTION

- ◆ Cooter and Ulen (1997), chapter 1.
- ◆ Posner (1998), chapters 1 and 2.

Easterbrook, Frank (1985). "Method, Result, and Authority: A Reply." *Harvard Law Review*, 98, 622.

II- PROPERTY

- ◆ Cooter and Ulen (1997), chapters 4 and 5.
- ◆ Posner (1998), chapter 3.

Coase, Ronald (1960). "The Problem of Social Cost." *Journal of Law and Economics*, 3, 1.

Calabresi, Guido, and Douglas Melamed (1972). "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral." *Harvard Law Review*, 85, 1089.

Coase, Ronald (1988). *The Firm, the Market and the Law*. University of Chicago Press. Chapter 6.

Hovenkamp, Herbert (1990). "Marginal Utility and the Coase Theorem." *Cornell Law Review*, 75, 783.

Simpson, Brian (1996). "Coase v. Pigou Reexamined." *Journal of Legal Studies*, 225, 53.

Coase, Ronald (1996). "Law and Economics and A. W. Simpson." *Journal of Legal Studies*, 25, 103.

III- CONTRACTS

- ◆ Cooter and Ulen (1997), chapters 6 and 7.
- ◆ Posner (1998), chapter 4.

Epstein, Richard (1985). "The Pirates of Pennzoil." *Regulation*, November/December 1985, 18.

Cutler, David, and Lawrence Summers (1988). "The Costs of Conflict Resolution and Financial Distress: Evidence from the Texaco-Pennzoil Litigation." *Rand Journal of Economics*, 19, 157.

Katz, Avery (1990). "The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation." *Michigan Law Review*, 89, 215.

Malloy, Robin (1990). *Law and Economics. A Comparative Approach*. West Publishing Co. Chapter 9.

Miceli, Thomas (1995). "Contract Modification When Litigating for Damages is Costly." *International Review of Law and Economics*, 15, 87.

IV- TORTS

- ◆ Cooter and Ulen (1997), chapters 8 and 9.
- ◆ Posner (1998), chapter 6.

Landes, William, and Richard Posner (1987). *The Economic Structure of Tort Law*. Harvard University Press. Chapter 2.

Shavell, Steven (1987). *Economic Analysis of Accident Law*. Harvard University Press. Chapter 2.

Malloy, Robin (1990). *Law and Economics. A Comparative Approach*. West Publishing Co. Chapter 13.

Estrada, Javier (1993). "A Note on the Optimality of Strict Liability." *Economics Letters*, 41, 187.

Rubin, Paul (1993). *Tort Reform by Contract*. The AEI Press.

Viscusi, Kip (1993). "The Value of Risks to Life and Health." *Journal of Economic Literature*, 31, 1912.

Viscusi, Kip, and Patricia Born (1995). "Medical Malpractice Insurance in the Wake of Liability Reform." *Journal of Legal Studies*, 24, 463.

Kaplow, Louis, and Steven Shavell (1996). "Property Rules Versus Liability Rules: An Economic Analysis." *Harvard Law Review*, 109, 713.

V- CRIME

- ◆ Cooter and Ulen (1997), chapters 11 and 12.
- ◆ Posner (1998), chapter 7.

Becker, Gary (1968). "Crime and Punishment: An Economic Approach." *Journal of Political Economy*, 76, 169.

Ehrlich, Isaac (1973). "Participation in Illegitimate Activities. A Theoretical and Empirical Investigation." *Journal of Political Economy*, 81, 521.

Ehrlich, Isaac (1975). "The Deterrent Effect of Capital Punishment: A Question of Life and Death." *American Economic Review*, 65, 397.

Polinsky, Mitchell, and Stephen Shavell (1992). "Enforcement Costs and the Optimal Magnitude and Probability of Fines." *Journal of Law and Economics*, 35, 133.

Waldfoegel, Joel (1993). "Criminal Sentences as Endogenous Taxes: Are They "Just" or "Efficient"?" *Journal of Law and Economics*, 36, 139.

Estrada, Javier (1994). "Crime and Punishment: An Introductory Analysis in a Noncooperative Framework." Carlos III University, Working Paper 94-13-05.

Virén, Matti (1994). "A Test of an Economics of Crime Model." *International Review of Law and Economics*, 14, 363.

Levitt, Steven (1996). "The Effect of Prison Population Size on Crime Rates: Evidence From Prison Overcrowding Litigation." *Quarterly Journal of Economics*, 111, 319.