

I. Introduction: Economics, the Law, and Society

- A.** Law and Economics is an area of study that uses economics to understand why laws look the way they do and how the laws that exist affect the choices of individuals and the society that emerges.
- i. There are four main areas of analysis in law and economics.
 - ii. First, there is the logic of civil law.
 - In what ways do property rights and liability law (torts) help or harm a community?
 - The economic approach suggests that these areas of law help make economic life more predictable, reduce transactions costs, and encourage prosperity.
 - Property rights, as we will see, can solve the Hobbesian problem, reduce commons problems, and encourage value increasing exchange and flows of resources.
 - Civil rights are similar to property rights except that they characterize a person's rights with respect to him or her self and with respect to government, rather than to things that might or might not be controlled or owned.
 - Tort laws encourage persons to take precautions so that they do not accidentally harm their fellow citizens or damage their property.
 - iii. Second, there is the logic of criminal law.
 - Criminal law is to a large extent the logical compliment of civil and property rights.
 - Criminal law provides economic incentives (punishments such as fines and jail time) to discourage "B" from violating the rights of other persons or groups.
 - If person A has a right to "x", then person B or group C should not intentionally violate A's to "x."
 - Thus, murder is illegal and punished, because everyone has a right to their own person.
 - Similarly, stealing is illegal and punished, because if A has the property rights to X and those rights include the right to control X, then when B takes X, he or she has violated A's rights over X.
 - iv. Third, there is the logic of public law, which includes economic, health, and environmental laws. Some of these laws are ancient, but many are more recent products of recent political decisionmaking. Are such laws efficiency enhancing or not?
 - Public law is in many cases an alternative to the use of civil law.
 - Public law is made by legislative and bureaucratic decisions rather than by judges.
 - (Although judges often play a role in interpreting public law and regulation as well as civil law in the US.)
 - v. Fourth, there is the study of how laws come into place and why they continue in place once adopted. This area includes consideration of both day-to-day politics and constitutional law.
 - a. Laws are adopted through a variety of government decisions: legislation, bureaucratic decisions, and court rulings.
 - b. However, there is a good deal of convergence in the types of law that one sees among countries.

- That suggests that “the law” is partly evolutionary in character.
 - Old laws that work well are kept and/or copied. Old laws that do not seem to work well are not enforced or repealed and so are not copied by others.
 - Similarly, procedures for making laws tend to stand the test of time when they have worked well enough in the past. Others will disappear or be modified to (hopefully) work better.
 - Constitutional laws also include constraints on the laws that can be "legitimately" adopted.
- vi. Not all laws are “economic” in their direct intent, but most laws have economic consequences. They have such consequences because they affect marginal net benefits or rates of return for a wide range of activities and persons at the margin.
- a. For example, rules that allow or promote hunting and farming imply that some fauna and flora become more common and others less so. They also imply that “hunting” and “farming” may be rewarding activities and so persons are more likely to take up those professions.
 - b. Property rights which encourage mining and manufacturing increase the accumulation of individual and community reserves, and support careers and investments in mining and manufacturing. They also imply that some minerals become less common and others more so.

B. For the most part, the law and economics literature argues **that laws are not simply “norms” or products of ideas about “right and wrong,” **but rather are rules that solve a broad range of problems that emerge when people live in more or less the same place.****

- a. That is to say, the law and economics literature argues that laws, for the most part, **are practical solutions** to problems, which help a society function better (to be more productive, more comfortable, and less risky) than it would otherwise have been.
- b. “Good” laws from an economic point of view encourage productive relationships rather than destructive conflict. They encourage the productive use of resources rather than under or over use. They encourage persons to respect other persons life, liberty and property.
- c. Social evolution suggests that the “best laws” tend to “win” in the sense that they are more likely to be adopted and continue.
 - Good laws survive and poor ones fail, because societies based on good laws are more likely to survive and be copied than those based on poor ones..
 - (In what senses can the law be said to improve through time? Or does it?)
 - (Are bad laws always eliminated? What if a bad law helps rulers, while undermining production?)

C. To understand why laws are adopted it is necessary to understand both their economic effects and the political systems that produce and support them.

- a. For example, as we will see, a good deal of property law--especially rules that deal with use and exclusion rights for land and water--can be regarded as addressing environmental concerns by solving commons problems

- Similarly, the effects of enforcement, punishments and liability claims affect a wide range of behavior inside and outside markets.
- b. Both the resources available to enforce laws and most laws are determined by political processes.
 - Both the law and enforcement efforts affect behavior.
 - One's speed on the highway is determined partly by the speed limit, partly by the number of policemen that enforce the law, and partly by the size of the fine paid for speeding.
- c. Indeed, it might be argued that law enforcement budgets substantially determine how "law abiding" (or rights observing) people tend to be.
 - Of course, personal norms also matter, but these may be reinforced or undermined by public policies.

D. This course provide students with the tools to think systematically about laws, law enforcement, and legal systems using rational choice models from economics and public choice.

- i. The course begins with a short review of key tools from economics and game theory.
- ii. The next third of the course focuses on the origin and economic effects of basic civil laws (property, contract, and torts).
- iii. The other sections are shorter and focus on the logic and effects of law enforcement (economics of crime), the logic and effects of public and regulatory law (antitrust and patents). The course ends with some discussion of constitutional laws, including an analysis of the commerce clause and takings clause.
- iv. Exams take place after the economics of crime block and after the constitutional block.

E. Coverage of "the law" includes both relatively new rules and regulations adopted by regulatory agencies, and also a good deal of civil law and older regulations that have been in place for thousands of years.

- i. The course does not attempt to persuade students to favor or oppose specific laws, but to induce them to think systematically and carefully about legal issues using the tools from economics, game theory, and public choice.
 - a. Sensible persons may disagree about what "good law" looks like at the margin, but all such persons should take account of effects of the laws when thinking about them.
 - b. Many of these effects become clearer when rational-choice based models of the economics and politics are used to analyze laws and regulations, and support for them.
- ii. Laws and regulations determine "man's" relationship with nature and to other persons.
 - a. Laws affect technological rates of growth by affecting the extent to which innovation is possible or not, and the returns earned by successful innovators.
 - b. Marriage and inheritance laws affect the distribution of wealth through time.
 - c. Laws affect population magnitudes and densities through affects on birth rates, mortality rates, land use and patterns of migration.

- d. Political and judicial decisions, thus, have large effects upon the feasible uses of natural resources by defining and enforcing fundamental property rights and entitlements over matters with both economic and environmental consequences.
 - iii. To understand “the law” and the extent to which it varies through time and among countries, it is useful to understand how politics and political institutions affect the incentives of the “rule makers.”
 - We will, if time permits, spend some time analyzing the laws for making laws--eg constitutional law.
- F.** Law can be argued to be a defining characteristic of civilized society, however, it is important to understand that law does not completely determine outcomes.
- i. Rather, the outcome is determined by how individual adjust to those rules
 - a. Most laws simply “frame” an economic or political “game.”
 - b. **It is behavior under the rules of the game that determine the outcome.**
 - Here one should consider how the rules of a chess game or boxing match define the “rights” of players
 - The rules of chess (and other board games) also implicitly define “crimes” (things that you should not do), and punishments. If you violate the rules you may be thrown out of the game.
 - It is play under the rules that determines who wins, rather than the rules per se.
 - Societies rules are much more elaborate than these, but similarly frame the game rather than determining outcomes.
 - ii. However, we can often predict how “rational players” will interact under a set of rules and therefore predict the outcomes that tend to follow from a given set of rules.
 - a. For example, we can predict that the first mover of a tic-tac-toe game will win the game or there will be a tie if he or she is rational. [We can predict this even though there are more than 300,000 possible series of moves to the game! (e.g. 9 factorial)]
 - b. We can predict that in a “prisoner’s dilemma game” the Nash equilibrium will tend to emerge because of the rational (economic) interests of the prisoners (as will be shown later in the course).
 - c. We can predict that if demand curves slope downward, there will be less crime with high certain penalties than with low uncertain ones.
 - (IF these points are not immediately obvious, don’t worry we will be demonstrating a lot of this during the course. If it is obvious, you intuition is already well-aligned with some of the main results of the course.)
 - iii. **Expertise Warning:** although this course deals with US law for the most part, it is not a law course and I am not a lawyer.
 - a. Although I know quite a bit about the law and most of you will learn things about the law that you do not know in the class.
 - (I do know more about international history of law better than most economists or lawyers.)
 - b. The aim of this course is to teach you how economic principles can be used to understand the origins and effects of the core areas of civil, criminal, and public law.

II. Appendix: some legal theories implicit in ancient law

A. One of the oldest legal codes in the world is the Code of Hammurabi, which can be used to show how general and old many basic legal theories and principals are.

- “The law” is not an American or Western invention.
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B. The first twelve laws of the Code of Hammurabi (chiseled into stone about 1750 BC):

- i. If any one ensnare another, putting a ban upon him, but he cannot prove it, then he that ensnared him shall be put to death. (Right to free movement)
- ii. If any one bring an accusation against a man, and the accused goes to the river and leaps into the river,
 - if he sinks in the river his accuser shall take possession of his house.
 - But if the river prove that the accused is not guilty, and he escape unhurt, then he who had brought the accusation shall be put to death, while he who leaped into the river shall take possession of the house that had belonged to his accuser. (Right to be free from false accusation)
- iii. If any one bring an accusation of any crime before the elders and does not prove what he has charged, he shall, if it be a capital offence charged, be put to death. (False charges involving murder etc are dealt with very harshly)
- iv. If he satisfy the elders to impose a *ne* of grain or money, he shall receive the *ne* that the action produces. (Fines or penalties for the person damaged by the crime or accident should be received by the victim.)
- v. If a judge try a case, reaches a decision, and presents his judgment in writing;
 - if later error shall appear in his decision, and it be through his own fault, then he shall pay twelve times the *ne* set by him in the case, and he shall be publicly removed from the judge's bench, and never again shall he sit there to render judgment. (Judges punished for mistakes)
- vi. If any one steal the property of a temple or of the court, he shall be put to death, and also the one who receives the stolen thing from him shall be put to death. (Crimes against the church or state are dealt with harshly)
- vii. If any one buy from the son or the slave of another man, without witnesses or a contract, silver or gold, a male or female slave, an ox or a sheep, an ass, or anything, or if he take it in charge, he is considered a thief and shall be put to death. (Purchases from slaves and minors are not truly purchases, but theft.)
- viii. If any one steal cattle or sheep, or an ass, or a pig or a goat, if it belong to a god or to the court, the thief shall pay thirty fold therefor; if they belonged to a freed man of the king he shall pay tenfold; if the thief has nothing with which to pay he shall be put to death. (One of many situations in which there is unequal protection of the law in Hammurabi.)
- ix. If any one loses an article and it becomes in the possession of another: if the person in whose possession the thing is found says :
 - A merchant sold it to me, I paid for it before witnesses,
 - and if the owner of the thing says: “I will bring witnesses who know my property,”
 - then shall the purchaser bring the merchant who sold it to him, and the witnesses before whom he bought it, and the owner shall bring witnesses who can identify his property.
 - The judge shall examine their testimony both of the witnesses before whom the price was paid, and of the witnesses who identify the lost article on oath.

- If the merchant is then proved to be a thief, he shall be put to death. The owner of the lost article receives his property, and he who bought it receives the money he paid from the estate of the merchant.
 - If the purchaser does not bring the merchant and the witnesses before whom he bought the article, but its owner bring witnesses who identify it, then the buyer is the thief and shall be put to death, and the owner receives the lost article.
 - If the owner do not bring witnesses to identify the lost article, he is an evil-doer, he has traduced, and shall be put to death. (Explains due process in cases of theft or accidental loss, with punishment for theft harsh)
- x. If the witnesses be not at hand, then shall the judge set a limit, at the expiration of six months. If his witnesses have not appeared within the six months, he is an evil-doer, and shall bear the ne of the pending case.
- xi. If any one steal the minor son of another, he shall be put to death.
- xii. If any one take a male or female slave of the court, or a male or female slave of a freed man, outside the city gates, he shall be put to death. (stealing slaves and/or attempting to free slaves is dealt with harshly)
- xiii. [Note the broad use of the death penalty, fairly uniform application of the laws, but some clear inequality before the law (eg slavery), the effort to define "due process," and property rights.]
- The code is much longer than this and also includes provisions dealing with family law, contract breach, trespass, and accidents (tort law).
- xiv. For more on this ancient code see: L. W. King
(<http://www.general-intelligence.com/library/hr.pdf>)

III. Positive and Normative Law and Economics

A. In areas dealing with public policy and most public policies are laws of one kind or another, it is often important to distinguish between the scientific problems of explanation and prediction and the ethical problems of evaluation and recommendation.

- i. Prediction and evaluation are two separate activities.
 - And it is possible for people to agree about the future (predictions) yet still disagree about the ideal policy (evaluation).
- ii. The scope for disagreement is generally larger for the **NORMATIVE** analysis than for **POSITIVE** analysis.

B. Many philosophers of science emphasis the distinction between normative and positive statements. (see for example Karl Popper)

- i. A **Positive Statement** is a statement about **what is**, has been or will be. It is a statement about the world.
- ii. A **Normative Statement** attempts to evaluate the **desirability** of alternative states of the world.

C. In contrast, a positive theory is concerned with whether a claim is "true" or "false" rather than whether an alternative is "good" or "bad."

- i. Generally, normative statements conclude that a particular policy is good or bad, is Pareto optimal or not, should be undertaken or not, etc. Confusion often occurs because reasoned

normative statements often include some positive statements to support their conclusions. E.G. X is a bad policy because X increases unemployment.

- ii. (X increases unemployment is a positive statement; the conclusions about whether X is a bad policy or not depends on whether you believe unemployment is a bad thing or not--even if you accept the positive claim.)
- iii. Positive statements are often confused with operational statements. *Operational statements* are statements that can at least conceptually be tested to determine whether they are true or false. Not all positive statements are testable, and moreover, give a coherent normative theory, some normative statements are testable!
- iv. **Puzzles/Examples:**
 - a. Under common law, A does not have the right to use B's property. (p, and usually true)
 - b. Minimum wage laws always increase unemployment. (p, probably true)
 - c. The death penalty discourages criminal activity and therefore is justified. (n)
 - d. Reducing the speed limit from 70 to 35 saves both gasoline and lives. (p, probably true)
 - e. Therefore the speed limit should be reduced to 35. (n)
 - f. Crime can only be reduced with very high penalties. (pos, but false)

D. Examples of Normative Theories used by economists

- i. The Pareto Criteria
 - Seek outcomes where no additional gains from trade exist. that is a place where it is impossible to improve one person's welfare without making anyone worse off.
- ii. Utilitarian Social Welfare Criteria
 - Maximize the sum of individual utilities or net benefits.
 - Cost Benefit Analysis
- iii. Contractarianism
 - Seek changes that can secure unanimous agreement.
 - In principle, ideal institutions are those that can (at least conceptually) elicit unanimous agreement.
 - Rawls: agreement from behind a veil of ignorance
 - Buchanan: agreement from behind a veil of uncertainty
 - (Controversies with utilitarians include: the compensation principle, immeasurability of utility)
- iv. Other common normative theories of law include:
 - a. Natural rights (I can do X because I have a right to X.) (Is "natural" simply what you grew up with?)
 - b. Various intuitive "justice" theories
 - c. Civic egalitarianism: all laws should apply equally to all persons
 - d. Elitism: more rights for the "deserving" and/or fewer rights for the undeserving