

Princeton University
Department of Economics
Economics 324: Law and Economics

T. Leonard
Green Hall 0-S-6
AIs: Konstantinos Rokas; Jade Vichyanond

Fall 2007
Tu,Th 1.30-2.50 p.m.

Course design

This course introduces you to the economics of law. An economic analysis of law comprises two related enterprises. The first enterprise is positive. It uses economic ideas to understand the behavioral consequences of changes in legal rules, an exercise in applying price theory. The second enterprise is normative, and thus more controversial. It appraises legal rules to determine the extent to which they meet the social goal of efficiency, an application of welfare economics. We employ both approaches in analyzing the law — the common law (property, contracts and torts) especially, but also criminal law, and constitutional law.

In so doing, we undertake two ancillary projects. First, we examine the importance of law to economics, that is, consider how legal arrangements enable or impede the functioning of markets. Second, we learn something of legal reasoning, which is traditionally very different from economic reasoning.

What follows are some questions we are likely to encounter during the semester. Can the law put a price on human life? Can it not? Is zero the socially best quantity of pollution, and of crime? Are external costs unilaterally or jointly caused (does it take two to tort)? Why is it legal to reveal (true) secrets about others, but not to let others pay to keep those secrets secret? Does common ownership of resources always lead to tragedy? Is there a way to realize the benefits of patents without their monopoly costs? Should Grokster be made indirectly liable for the copyright infringement its software enables? Is regulation a taking? Under what circumstances, if any, should we condone breaking legally binding promises? Why are some life-saving vaccines scarce? When, if ever, should the law paternalistically protect informed adult consumers from consumption of cigarettes or other dangerous products? Should consumers of less obviously dangerous products – e.g., McDonald’s coffee – bear any legal responsibility for product accidents? How should we account for judges’ lack of omniscience when devising optimal legal remedies? Can severe criminal punishments do the work of deterrence more cheaply than greater enforcement? Why does the United States imprison so many people, at what cost, and at what benefit? Under what information and procedural circumstances do majority voting schemes lead juries to convict rather than to acquit (and vice versa) in capital cases? What voting rules best protect minority rights?

Details

My office is 314 Fisher Hall, 258-4036; tleonard@princeton.edu. My office hours are M,W 1:15-2:45p.m. My assistant is Ms. Geralyn McDermott, 108 Fisher Hall; 258-4004; geralyn@princeton.edu. The course A.I.s: Konstantinos Rokas, krokas@princeton.edu, B-09 Fisher Hall; 258-1614; office hours Tu 3.30-5:00p.m. Th 4:00-5.15p.m., and by appointment; Jade Vichyanond, jvichyan@princeton.edu, B-10 Fisher Hall; 258-5409; office hours W 3.00-4.30p.m., Th 3.00-4.30p.m., and by appointment.

Requirements

The course **prerequisite** is Economics 100. More advanced course work will help but is not required. Your **grade** in the course will derive from three sources: (1) four written assignments (papers of 5-6 pages each), (2) a take-home mid-term examination, and (3) a take-home final examination. In determining your course grade, we will use the following weights: papers (36%), mid-term examination (24%), and final examination (40%). Assignments will be posted on the course page and are due to GERALYN McDERMOTT, as below. **In all cases, no late submissions can be accepted.**

<i>Assignment</i>	<i>Posted to Course Page on</i>	<i>Due to Fisher 108 by 4:00 on</i>
1 st paper	F 9/28/07	F 10/05/07
2 nd paper	W 10/10	W 10/17
Mid-term	F 10/19	F 10/26
3 rd paper	F 11/9	F 11/16
4 th paper	F 12/7	F 12/14 (Note: ECO Junior Prospecti due this week)
Final	M 1/14/08	M 1/21/08

n.b. The academic calendar has scheduled the last class for *Monday*, December 17th.

Readings

The text is *Law and Economics* (5th ed.), by Robert Cooter and Thomas Ulen (*Cooter and Ulen*), available at the U-Store. Other required readings are on reserve (including e-reserve) at Firestone. A packet is also available. Check out www.cooter-ulen.com for cases and interesting supplemental material.

Course outline

Week 1 (9/18, 9/20)

I. Introduction to law and economics

A. The *law* in law and economics

1. Law as an instrument of policy, not of black letter exegesis
2. The reason of rules: enabling coordination and cooperation

- *Cooter and Ulen*: chapter 1
- Posner, Richard. 1998. *Economic Analysis of the Law* (5th ed.). New York: Aspen Publishers, pp. 3-31.
- Baird, Douglas, *et al.* 1994. "Simultaneous Decision making and the Normal Form Game," in *Game Theory and the Law*, Cambridge, MA: Harvard University Press, pp. 6- 49.

B. The *economics* in law and economics

1. Review of price theory
- *Cooter and Ulen*: chapter 2

- McCloskey, D. 1996. “The Economics of Choice: Neoclassical Supply and Demand.” In *Economics and the Historian*, edited by Thomas Rawski *et al.* Berkeley: University of California Press, pp. 122-58.
- Weintraub, E. Roy. 1992. “Neoclassical Economics” in David R. Henderson (ed.) *Fortune Encyclopedia of Economics*. Warner Books.
- “The State and Market.” *The Economist*, 17 February 1996, pp. 64-65.
- “Of Bees and Lighthouses.” *The Economist*, 23 February 1991, pp. 72-73
- (optional) Schelling, Thomas. 1984. “Economic Reasoning and the Ethics of Policy.” In *Choice and Consequence*, Cambridge: Harvard University Press, pp. 3-26.

Week 2 (9/25, 9/27)

2. Efficiency as a social goal: Pareto and Kaldor-Hicks welfare criteria
3. Failure to achieve efficiency: monopoly, externalities, public goods and information problems

- (optional) Coleman, Jules. 1980. “Efficiency, Utility, and Wealth Maximization.” *Hofstra Law Review* 8(3): 509-51.

C. Introduction to legal reasoning

1. Common law tradition and doctrine of *stare decisis*
2. The U.S. court system

- *Cooter and Ulen*: chapter 3
- Cases: *Riggs v. Palmer* (1889), *Butterfield v. Forrester* (1809), *Davies v. Mann* (1842), (in *Cooter and Ulen* or on its web-site).

Week 3 (10/2, 10/4)

D. Inducing efficient outcomes

1. Coase, Pigou or other?
 - i. Causality, transactions costs and market failure
 - ii. The Coase “Theorem” and what to do about social costs

- *Cooter and Ulen*, chapter 4
- Coase, Ronald. 1960. “The Problem of Social Cost.” *Journal of Law and Economics* 3(1): 1-44. (October).
- Sandel, Michael “It’s Immoral to Buy the Right to Pollute,” *New York Times*, December 15th, 1997, editorial page, with responses in *New York Times* Letters section, December 17th, 1997.
- Landsburg, Steven. 1993. “Of Medicine and Candy, Trains and Sparks.” In *The Armchair Economist*, New York: Free Press, pp. 83-92.

II. The economics of property

- A. The Coase Theorem made recognizably Coasean (with transactions costs)

1. Coase's four big ideas
2. So, what are property rights and why have them: to lubricate or allocate?

- Calabresi, Guido and Douglas Melamed. 1972. "Property Rules, Liability Rules and Inalienability: One View of The Cathedral." *Harvard Law Review* 85: 1089-1127

Week 4 (10/9, 10/11)

3. Flaming rails: Do sparks from locomotives or flammable crops cause crops to burn?

- Friedman, David. 2003. "Defining and Enforcing Rights: Property, Liability, & Spaghetti," in *Law's Order: What Economics Has to do with Law and Why It Matters*, chapter 5.

Case: *Boomer v. Atlantic Cement Co.* (1970) (in *Cooter and Ulen*).

B. Should property rights over some goods be "inalienable?"

1. Gifts but not sales: organs, blood, sex

- *Cooter and Ulen*: chapter 5
- Arrow, Kenneth. 1997. "Invaluable Commodities." *Journal of Economic Literature* 35(2): pp. 757-65.
- Archard, David 1998. A Review of Margaret Jane Radin, *Contested Commodities: The trouble with trade in sex, children and body parts*, *Economics and Philosophy* 14(2): 362-68.

Week 5 (10/16, 10/18)

2. Pricing life and the evil-deity parable
3. Blackmail & other puzzles

- Schelling, Thomas. 1998. "Value of Life" in John Eatwell, Murray Milgate and Peter Newman (eds.) *The New Palgrave Dictionary of Economics*, London: Macmillan, pp. 793-796.

C. The "tragedy" of Common Property Resources: no one washes a rental car.

- Hardin, Garrett. 1968. "The Tragedy of the Commons" *Science* 162: 1243-48.
- (optional) Demsetz, Harold 1967. "Toward a Theory of Property Rights" *The American Economic Review*, 57(2): 347-359.

D. Intellectual property

1. Patents, trademarks

- Posner, Richard A. 2005. "Intellectual Property: The Law and Economics Approach"

JEP 19(2): pp. 57-73.

- Barder, Owen, Michael Kremer and Heidi Williams (2006) “Advance Market Commitments: A Policy to Stimulate Vaccines for Neglected Diseases” *Economists’ Voice* (Feb), pp. 1-4
- (optional) Lemly, Mark A. and Carl Shapiro. 2005. “Probabilistic Patents” *JEP* 19(2): pp. 75-98

Week 6 (10/23, 10/25)

2. Copyright: the right to copy

- Richard Posner “*Grokster*, File Sharing and Contributory Infringement,” and Gary Becker “*Grokster* and the Scope of Judicial Power;” Becker-Posner Blog, July 4, 2005
http://www.becker-posner-blog.com/archives/2005/07/grokster_file_s.html
- Klein et al. (2002) “Economics of Copyright ‘Fair Use’ in a Networked World” *American Economic Review* May
- Wu, Tim (2005) “Leggo My Ego: GooglePrint and the Other Culture War” *Slate* Oct. 17

E. Taking property (eminent domain)

1. Is regulation ever a taking?

- Richard Posner (2005) “The *Kelo* Case, Public Use, and Eminent Domain” and Gary Becker “On Eminent Domain,” Becker-Posner Blog, July 26-27
http://www.becker-posner-blog.com/archives/2005/06/the_kelos_case_p.html

Cases: *Penna. Coal v. Mahon* (1922)

Week 7 Fall Break

Week 8 (11/6, 11/8)

III. Contracts: Economics of Promise Keeping

A. Why have contracts?

1. Sequential exchange and making commitments credible
2. Breach of Contract and alternative damage remedies: the cows

• *Cooter and Ulen*: chapter 6

Cases: *Batsakis v. Demotsis* (1949); *Hamer v. Sidway* (1891); *Sherwood v. Walker* (1887) (*in Cooter and Ulen*); *Laidlaw v. Organ* (1815), (*in Cooter and Ulen*).

B. Other remedies

1. Specific performance
2. Efficient breach or opportunism: how to tell
3. “Unconscionable” contracts and other contract doctrines

- *Cooter and Ulen*: chapter 7

Cases: *Domenico* (1902), *Goebel v. Linn* (1882), *Peevyhouse v. Garland Coal & Mining Co.* (1962); *Williams v. Walker-Thomas* (1965); see text and www.cooter-ulen.com/cases

Week 9 (11/13, 11/15)

- C. Contracts wrap up
- D. Rev. Bayes in the courtroom: eyewitness and conditional probability

IV. Life is risky: The economics of torts

- A. Introduction to torts
 1. Traditional tort doctrine
 2. Economics of torts: Calabresi's minimum social cost rule

- *Cooter and Ulen*: chapter 8
- Cooter, Robert. 1991. "Economic Theories of Legal Liability." *Journal of Economic Perspectives* 5(3): 11-30.

Week 10 (11/20)

- B. Drivers & Pedestrians: *Caveat Emptor* or negligence or strict liability?
 1. Caveats: activity levels; extent of precaution, administrative costs, court errors.
 2. The Learned Hand rule

- *Cooter and Ulen*: chapter 9
- (optional) Shavell, S. 1980. "Strict Liability versus Negligence" *Journal of Legal Studies* 9

Case: *U.S. v. Carroll Towing* (1947); <http://www.cooter-ulen.com/cases>

Week 11 (11/27, 11/29)

- C. Product liability: privity to negligence to strict liability to absolute liability
 1. Where are the vaccines?
 2. The case of the exploding Pintos
 3. Computing damages: pricing life or pricing risk?

- Epstein, Richard. 1980. "Is Pinto a Criminal?" *Regulation* March/April: pp. 15-21.
 - Landsburg, Steven. 2003. "Is Your Life Worth \$10 Million?." *Slate* March 3.
- Case: *Helling v. Carey* (1974);

V. Crime and punishment

A. The economics of crime and punishment

1. What is a crime?
2. Why do we need criminal law when we have tort law?
3. Why do people commit crimes?
4. What are the social costs of crime and what is the socially best amount?
5. Methods of deterrence and punishment and their relative costs
6. Risk-aversion: the crime of double parking

- *Cooter and Ulen*: chapter 11
- (optional) Becker, Gary. 1968. "Crime and Punishment: An Economic Approach." *Journal of Political Economy* 76: pp. 167-217 (March/April).
- Bar-Ilan A and B. Sacerdote 2001. "The Response to Fines and Probability of Detection in a Series of Experiments"
- Friedman, David. "Rational Criminals and Intentional Accidents: The Economics of Law and Law Breaking," *Hidden Order: The Economics of Everyday Life*. New York: Harper Collins, chapter 20.

Week 12 (12/4,12/6)

B. Topics in the economics of crime and punishment

1. Victimless crimes (attempts and criminalized consensual exchange)
2. Who commits crime?
3. Social costs of handguns and of handgun control
4. The Economics of Lojack: deterrence or redistribution?
5. Minimizing costs of crime and like treatment of groups: a tradeoff?

- *Cooter and Ulen*: chapter 12
- regarding the gun control and Lojack topics, see the *Cooter & Ulen* web site.
- Levitt, Stephen. 2004. "Why Crime Fell in the 1990s: Four Factors that Explain the Decline and Six That Do Not" *Journal of Economic Perspectives* 18(1): 163-190
<http://miranda.ingentaconnect.com/vl=1320721/cl=50/nw=1/fm=docpdf/rpsv/cw/aea/08953309/v18n1/s8/p163>
- Farmer, Amy and Dek Terrell (2001) "Crime versus Justice: Is There a Trade-off?" *The Journal of Law and Economics*, Vol. XLIV (October): pp.
- (optional) Donohue, John J. III and Steven D. Levitt, "Legalized Abortion and Crime," Stanford Law School, Olin Law & Economics Paper No. 17 (September, 1999). Posted at www.ssrn.com)

VI. The economics of constitutional law and social choice

A. Social contract theory of the state

1. The social contract and its goals
2. Workings of the social contracts' provisions
3. Enforcement of the social contracts' provisions

- Buchanan, James. 1987. "Constitutional Economics" In *The New Palgrave*, ed. John

- Eatwell, Murray Milgate and Peter Newman. New York: Norton, pp. 79-87.
- (optional) De Jasay, Anthony. 1998. "Prisoners' Dilemma and the Theory of the State." In *The New Palgrave Dictionary of Economics and Law*. Edited by Peter Newman. New York: Norton, pp. 95-103.
- Cases: *Jacobsen v. Commonwealth of Mass.* (1905); *Lochner v. New York* (1905); *Bowers v. Hardwick* (1986); *Korematsu v. United States* (1944).

Week 13 (12/11,12/13)

B. Aggregating individual preferences to social preferences choices *by voting*

1. Sen's Lewds & Prudes: when Liberalism and Paretianism conflict
2. Rawls's alternative

- *Cooter and Ulen*, appendix to chapter 4
- Sen, Amartya. 1970. "The Impossibility of a Paretian Liberal." *Journal of Political Economy* 78(1): 152-57. (January/February).
- Landsburg, Steve. "Is Everybody Happy? The cost-benefit analysis of making folks Smile". *Slate Magazine*, Nov. 8, 1999.
- Selections from Rawls, John. 1972. *A Theory of Justice*. Cambridge, MA: Harvard University Press.

C. Crafting constitutional rules

1. Buchanan and Tullock on optimal voting rules

- Buchanan, James and Gordon Tullock. 1962. *The Calculus of Consent*. Ann Arbor, MI: University of Michigan Press, pp. 63-84.

D. Arrow's "impossibility" result: the very idea of a social ordering

1. Acquit or execute: vote cycling in Supreme Court capital cases

- (optional) Arrow, Kenneth. 1950. "A Difficulty in the Concept of Social Welfare." *Journal of Political Economy* 58(4): 328-46 (August).

E. Procedural tricks for circumventing Arrow's impossibility result

1. Agenda control, misrepresenting preferences, logrolling

Week 14 (MONDAY 12/17)

VII. Critiques of the efficiency view of law

1. Public choice: Does the state do what's socially best, whether or not efficiency is made paramount?
2. The liberal critique: why should efficiency trump distribution? (Dworkin).
2. Ellickson's critique: what if Coase is right, but people don't *know* the law?

- Ellickson, Robert. 1991. "Shortcomings of Current Theories of Social Control." *Order without Law*. Cambridge: Harvard University Press, pp. 137-55.
- (optional) Dworkin, Ronald. 1980. "Why Efficiency: A Response to Professors Calabresi and Posner." *Hofstra Law Review* 8(3): 563-90.