

Princeton University
Department of Economics
Economics 324: *Law and Economics*

T. Leonard
Bowen 222

Fall 2011
Tu, Th 11.00–12.20p

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. 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 illegal 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? Will Congress's extension of copyright duration to life plus 70 years promote creative expression? Are GooglePrint and GoogleLibrary benefactors or destroyers of free public access to books? Is value-reducing regulation a compensable taking? Under what circumstances, if any, should we condone breaking legal promises? Why are some life-saving vaccines no longer produced? Can the law put a price on human life? Can it not? 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 more severe criminal punishments do the work of deterrence more cheaply than greater enforcement? Are the goals of minimizing the social costs of crime and requiring similar conviction rates across demographic groups incompatible? 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?

Personnel and details

My office is 418 Robertson Hall, 8-4036; [tleonard@](mailto:tleonard@princeton.edu). My office hours are Tu, Th 1:15 - 2:45p. My assistant is Ms. Bernadette Yeager, 423-D Robertson Hall, 8-4830, [byeager@](mailto:byeager@princeton.edu). The course AIs are Delwin Olivan ([dolivan@](mailto:dolivan@princeton.edu)) and Kai Steverson ([cstevens@](mailto:cstevens@princeton.edu)), both in Fisher B-10. Delwin's hours: M 1.00-2.30p, W 4.15-5.45p. Kai's hours: W 4:15-5:45p, F 3.00-4:30p.

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 (of 3,000 words maximum), (2) a take-home mid-term examination (of 4,000 words maximum) and (3) a take-home final examination (of 5,000 words maximum). In determining your course grade, we will use the following weights: assignments (36%), mid-term examination (24%), and final examination (40%). Assignments and exams will be posted on the course page and are due as below.

<i>Assignment</i>	<i>Posted to Course Page on</i>	<i>Due to Robertson 423D & Course Page by 4.00 p.m.</i>
1 st	W 9/28/11	W 10/5/11
2 nd	W 10/12	W 10/19
Mid-term	F 10/21	F 10/28
3 rd	W 11/9	W 11/16
4 th	W 12/7	W 12/14 (Note: ECO Junior Prospecti due this week)
Final	M 1/16/12	M 1/23/12

For all assignments, please submit one hard copy to Bernadette Yeager and one electronic copy (via the course page on Blackboard). For credit, you must submit both copies. Assignments and exams are open-book and open-notes, so you must credit with citation ideas not your own (citation may be abbreviated). Collaboration with other students is impermissible. Please submit all assignments and exams with a cover sheet containing a signed honor-code pledge. **In all cases, no late submissions can be accepted.**

{{There are four lectures where we will break at 12.00 noon rather than 12.20p. They are Thursdays: 10/6, 10/27, 11/17, 12/8 (and bolded in the course outline, below). A make-up lecture, held during reading period, will be scheduled, time and place TBA, probably Tuesday, January 3, 2012.}}

Readings

The text is *Law and Economics*, 6th edition, (ISBN 9780132540650), by Robert Cooter and Thomas Ulen (*Cooter and Ulen*), available at Labyrinth bookstore. Other required readings are on reserve (including e-reserve) at Firestone. For interesting supplementary material, check out http://wps.aw.com/aw_cooterulen_lawecon_6/178/45815/11728880.cw/index.html.

Course outline

Week 1 (9/15)

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.

Week 2 (9/20, 9/22)

B. The *economics* in law and economics

1. Review of price theory

- *Cooter and Ulen*: chapter 2
- McCloskey, Deirdre (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.

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.

Week 3 (9/27, 9/29)

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).

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 15, 1997, editorial page, with responses in *New York Times* Letters section, December 17, 1997.
- Landsburg, Steven (1993) "Of Medicine and Candy, Trains and Sparks." In *The Armchair Economist*, New York: Free Press, pp. 83-92.

Week 4 (10/4, 10/6)

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

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).

Week 5 (10/11, 10/13)

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.

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) Christopher Costello et al. (2008) “Can Catch Shares Prevent Fisheries Collapse?” *Science* 321 (5896), 1678.
- (optional) Demsetz, Harold (1967) “Toward a Theory of Property Rights,” *The American Economic Review*, 57(2): 347-359.

Week 6 (10/18, 10/20)

D. Intellectual property (ideas and their expressions as public goods)

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) Gleick, James (2000) “Patently Absurd,” *The New York Times Sunday Magazine*, 44-49 (March 12).
<http://www.nytimes.com/library/magazine/home/20000312mag-patents.html>
- (optional) Lemly, Mark A. and Carl Shapiro (2005) “Probabilistic Patents” *JEP* 19(2): pp. 75-98.

2. Copyright: the right to copy

- Oberholzer-Gee, Felix and Koleman Strumpf. (2009). “File-Sharing and Copyright” HBS Working Paper 09-132
- 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

Week 7 (10/25, 10/27)

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_kelo_case_p.html

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

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 8

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*).

Week 8 Fall Break

Week 9 (11/08, **11/10**)

B. Other remedies for breach of contract

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

• *Cooter and Ulen*: chapter 9

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

C. Contracts wrap up

D. Rev. Bayes in the courtroom: eyewitness and conditional probability

Week 10 (11/15, **11/17**)

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 6

• Cooter, Robert (1991) “Economic Theories of Legal Liability.” *Journal of Economic Perspectives* 5(3): 11-30.

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 7

• (optional) Shavell, S (1980) “Strict Liability versus Negligence” *Journal of Legal*

Studies 9: 210-234.

Case: *U.S. v. Carroll Towing* (1947)

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).

Week 11 (11/22)

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 12
- (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." NBER paper W8638.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=293251
- 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 (11/29, 12/1)

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 13
- 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://www.jstor.org/stable/pdfplus/3216880.pdf>

- (optional) Farmer, Amy and Dek Terrell (2001) “Crime versus Justice: Is There a Trade-off?” *The Journal of Law and Economics*, Vol. XLIV (October): pp. 345-366.
- (optional) Donohue, John J. III and Steven D. Levitt (2001) “Legalized Abortion and Crime,” *QJE* 116(2): 379-420.
<http://pricetheory.uchicago.edu/levitt/Papers/DonohueLevittTheImpactOfLegalized2001.pdf>

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 Massachusetts* (1905); *Lochner v. New York* (1905); *Bowers v. Hardwick* (1986); *Korematsu v. United States* (1944).

Week 13 (12/6, 12/8)

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
- (optional) 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: §3, §4, § 26, §46.

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.

Week 14 (12/13, 12/15)

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 methods for circumventing Arrow’s impossibility result

1. Agenda control, misrepresenting preferences, logrolling

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.