



University of Zurich

Faculty of Law
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Law & Economics Economic Analysis of Law

Ten Preliminary Remarks
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1. Culture Shock

- Does a rancher have to pay damages if his cattle damages the corn of a farmer in the neighbourhood?
- *Cooter/Ulen* (6th International Edition), p. 82 (in the context of the *Coase* theorem):

"Perhaps you think that fairness requires injurers to pay for the damage they cause. If so, you will approach the question as traditional lawyers do, by thinking about causes and fairness."

"Professor Coase, however, answered in terms of *efficiency*. [...] This approach yielded a counterintuitive conclusion".

→ The cheapest cost avoider should pay. In casu: The injured farmer shall bear the damage himself!



2. Preponderance of Economics

- **What is the relationship between law and economics?**

Cooter/Ulen, p. 55: "An economist who picks up a law journal will understand much more of it than a lawyer who picks up an economics journal. For this reason, it is not hard to convince a lawyer that he does not know economics. (Convincing him that he *should* learn economics is harder!) On the other hand, economists are sometimes hard to convince that any aspect of social life is not, at its root, really economics."

"With respect to the law, economists sometimes wonder what lawyers really study: Is the law a branch of philosophy? Is it a list of famous cases? Is it a collection of rules?"

2. Preponderance of Economics

- *Cooter/Ulen*, p. 9:
"Law needs economics to understand its behavioral consequences, and economics needs law to understand the underpinnings of markets."
- In L&E, are legal sciences and economics on an equal footing?
This is doubtful: Law is rather the object of analysis, economics the scientific method.
- **What can lawyers learn from economists?**
Cooter/Ulen, p. 9: "From economists, lawyers can learn quantitative reasoning for making theories and doing empirical research."

2. Preponderance of Economics

- What can economists learn from lawyers? Two Things
 1. *Cooter/Ulen*, p. 9 f.: "From lawyers, economists can learn to persuade ordinary people – an art that lawyers continually practice and refine. Lawyers can describe facts and give them names with moral resonance, whereas economists are obtuse to language too often."
 2. *Cooter/Ulen*, p. 10: "If economists will listen to what the law has to teach them, they will find their models being drawn closer to what people really care about."
- General attitude: *Cooter/Ulen*, p. 8: "Unfortunately, lawyers without training in economics seldom appreciate these facts."

2. Preponderance of Economics

- What is the economic method?

See *Cooter/Ulen*, p. 70: "Instead of trying to explain what property really is, an economic theory tries to predict the effects of alternative forms of ownership, especially the effects on efficiency and distribution."

3. Preponderance of the English Language

- Does contents depend on language? There is a fundamental discussion in philosophy and linguistics.
- Difference British – American English
- see locutions like "making more money" etc.
- regarding Latin: Lawyers use many Latin quotations. In economics, there is one basic expression: *ceteris paribus* ("all other things being equal").

4. Common Law – Civil Law

- For a short description, see *Cooter/Ulen*, p. 56 ff.
- L&E is often based on common law. Studying the literature, the question has to be asked if the institutional foundations would be the same for civil law.
- For fundamental differences see, e.g., *Cooter/Ulen*, p. 58 fn. 3: Absence of "public law" in the US.
- Very important: The difference between "at law" and "in equity" in common law (see *Cooter/Ulen*, p. 66 fn. 16). "Specific performance" is allowed only exceptionally. In civil law, an "efficient breach" may be stopped by an injunction without problem.

5. Analysis *de lege lata* – *de lege ferenda*

- In L&E, it is not always crystal-clear if the analysis concerns the law currently effective, or if reform proposals are made.
- See for example *Cooter/Ulen*, p. 5: There is a distinction between "dispute resolution" and "rule creation", but both may concern the law currently applicable. On the other hand, "rule creation" may also refer to the situation *de lege ferenda*.
- One important methodological question in Europe is, if L&E methods may be used for the interpretation of the law as it stands.
- A famous German PhD dissertation answers this question in the negative (for German civil law):
Horst Eidenmüller, Effizienz als Rechtsprinzip, 1995

6. Efficiency and Redistribution

- *Cooter/Ulen*, p. 7: "This book rejects the redistributive approach to private law. Pursuing redistributive goals is an exceptional use of private law that special circumstances may justify but should not be the usual use of private law."
- Redistribution should be accomplished by the tax system: "tax-and-transfer"
- Example: Consumer protection law should not aim at transferring wealth from businesses to consumers. Instead, market failures should be corrected, for example "rational ignorance".

7. Efficiency as Sole Goal?

- Does only efficiency matter for legal rules? Is there no space for "fairness"?
- Has law itself to step back if efficiency commands otherwise? Think of "efficient breach".
- Cf. *Cooter/Ulen*, p. 3: "To economists, sanctions look like prices".
- Why no voluntary exchange of human organs (hearts, livers, skin etc.) if it increases efficiency?
- *Cooter/Ulen* mention a (possible) market for votes (see p. 54)

8. Static vs. Dynamic Analysis

- L&E has a focus on "static" equilibrium theory.
 - *Cooter/Ulen*, p. 13: "The comparison of equilibria, called comparative statics, will be our basic approach."
 - *Cooter/Ulen*, p. 28: "This leads to the conclusion that economic profits are zero in an industry that is in long-run equilibrium."
- How does this relate to *Joseph Schumpeter's* "process of creative destruction"?
- *Cooter/Ulen*, p. 116 ff.: Dynamic efficiency only in the context of intellectual property (IP) protection.

9. L&E Applied to All Spheres of Life?

- Not only contracts, torts and property, but also death penalty, politics, family law and mate selection.

10. Rational Choice and Behavioural Economics

- L&E is based on rational choice. It starts from the idea that consumers maximize their personal utility.
- But do human beings fit into the category of *homo oeconomicus*? Behavioural Economics say: No, most of us are strongly biased. Examples of cognitive biases:
 - overconfidence bias: we overestimate our competence
 - status quo bias: greater risk is taken in order to maintain the status quo than to change it.
 - endowment effect: The willingness to pay for a certain good is lower than the willingness to accept compensation to be deprived of the good.
 - hindsight bias: "I knew it all along."
 - confirmation bias: interpretations are preferred which fit to one's preconceptions.

10. Rational Choice and Behavioural Economics

- These biases are inconsistent with standard economic theory.
 - What consequence does behavioural economics have for L&E?
 - *Cooter/Ulen*, p. 51: "Economic analysis should use rational choice theory or behavioral theory, depending on which one predicts the law's effects on the behavior more accurately."
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- Excellent overview: D. Kahneman, *Thinking, fast and slow* (2011)