

Introduction to Law and Economics

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1. Scope: This file aims to provide the basic appreciation of the interconnection between law and economics as separated disciplines. It also gives the broad understanding of 'law and economics' as an interdisciplinary subject. Some examples and concepts are introduced too.

2. Law: Most people do understand what the law is but cannot explicitly explain the definition. However, the law is one way to control our behaviour. The reason that we need to control human behaviour (Recall: 'Dog is not allowed' sign and there are cats in the lawn; it is meant for the dog owners, not dogs or cats themselves) is that sometimes our course of action conflicts with others'. Thus, the condition for the law to exist is to have at least two persons that may get in the way of each other.

Economically speaking, everyone maximises his/her own utility through committing a certain action which may interfere with others' utility.

If there is no conflict of interest or of utility, there is no point having the law. Even the law exists in such situation, it is simply inapplicable (Recall: 'Keep off Grass' in the desert).

3. Morals, Norms, and the Law: Three are serving more or less the same purpose of controlling human behaviour. But there are noticeable differences.

-Morals are for self-control. It depends on the decision making of each individual for what is right and what is wrong. Morals are established through the socialisation and how each person been raised. But at the end, its effect is purely individual and there is no guarantee that others would have the same level of morals.

-Norms are an alternative way of behaviour control. It is what others do or most people do. Each individual has to observe others' behaviour before making the decision to do something. If one decided not to do the same as the rest, (s)he shall expect to receive a weird look from others or a soft form of *social sanction*. In this situation, what controls our behaviour is the pressure exerted to us by the rest of the society. If our benefit of being an deviant exceeds the cost of social sanction, we will not do the same as others.

-Law is more formalised. It is the way to control human behaviour by using social institutions. Social institutions involving law are i) *legal binding force* to tell people in the society what can be done and cannot be done and what are the consequences of doing and not doing those as well as how the consequences are actually being enforced; ii) *legal authorities*, which are backed by the state and the sovereignty of the state (forcing people to be obedient), who are responsible to enact and enforce laws.

4. Legal Systems: It is generally accepted that there are mainly two legal systems – Common Law and Civil Law.

-Civil Law System could be analogously seen as a deductive scientific method. It starts with many observations of human interactions until the conclusion is reached when all or most observation share a similarity which late be established as a generalised legal concept. This legal concept is codified and then be applied to the real-world conflict by legal

practitioner. The application of such legal concepts is called interpretation of law where legal practitioners try to fit the factual evidence to the generalised principle.

-Common Law System could be seen as an inductive scientific method. It does not bother to observe everything but only when the conflict occurs. Then, when the judge tries to find the solution for the dispute, (s)he tries to find the legal principle behind the evidence of the real case. Once the verdict is reached, it establishes itself as the law (that is why Common Law system is being called 'judge-made' law). The future verdict must follow the precedent verdict unless there is a significant difference.

5. Law and Economics as Separated Studies: Even though the approaches of law and economics are vastly different, both involve human behaviour. Economics look at human behaviour by using the criteria of 'efficiency,' while law look at human behaviour by using the criteria of 'justice.' Moreover, both involve allocation of resources but through different ways. Economics emphasises on how to allocate resources to satisfy human in the most efficient way. Law emphasises on how to allocate rights and responsibility for human to induce justice. Most importantly, both have the same ultimate goal which is *social welfare maximisation*.

It is worth defining 'efficiency' and 'justice' here despite the fact that the exact definitions are still debatable. Something is economically efficient means there could be no other way to achieve the same thing at the cheaper cost. Something is just means it is proper to everyone – everyone gets what (s)he deserves.

It is apparent that there is an intersection between efficiency and justice. In many cases, both are the same but through different perspectives only. Of course, some other cases, they are different and the trade-off must be made. Higher efficiency may be attainable at the expense of justice and *vice versa*.

Examples in Slide 19-20 illustrate such intersection. Though both fields use different jargons, it implies more or less the same thing. Unlawfulness is unjust and it also prohibits the achievement of *Pareto* efficiency when someone has been made worse-off. Compensation resulted from the damage and the transfer of such compensation may induce efficiency in the perspective of *Kaldor-Hick* criterion if and only if the compensation is sufficiently make the worse-off party indifferent between being injured or not.

6. 'Law and Economics' as an Interdisciplinary Study: Since both branches of study share some similarities, it is useful to use each other to understand the nature of human behaviour and reduce the drawbacks each study has. Law can reduce its dogmatic nature by applying economic ideas to analyse the existence of the law, whether the law induces efficiency, the improvement of the law, the conflict of efficiency and justice, and its judicial economy justification. On the other hand, economics is built on very strong assumptions particularly the existence of market is presumed without concerning the reality of property right and contract. The alternative name for it is '*Economic Analysis of Law*.' Law and Economics could be classified into two fields:

6.1 Positive Law and Economics which aims to explain the behaviour of human in response to the law. In explaining that, neoclassical economics could be employed or non-mainstream approaches such as behavioural, institutional, or evolutionary economics may be applied. Moreover, the study of it could be done theoretically by constructing

mathematical model to explain the behaviour or empirically by collecting data and information on subjects of laws.

6.2. Normative Law and Economics aims to suggest the direction of law enactment and amendment. What should the law be in order to promote efficiency? What is the right balance between justice and efficiency? How can we make the existing law better? In general, it is about the policy guideline and recommendations for policy-makers.

7. Examples from ‘Questions of Milinda:’ These examples are taken literally from the book but the reason behind is that, through basic reasoning and simple economic knowledge, we can analyse the situations and make proper decisions based on the concept of efficiency without sacrificing justice.

7.1. On Mango: People planted mango trees because they are expecting the benefits from those trees including its fruits. Therefore, even the fruit being stolen is different from the fruit that had grown into the tree (in other words, stealing the fruit from the tree does not harm the tree), the right to the mango fruit should be of the mango tree’s owner. Allowing the theft to own the fruit creates the wrong incentive for mango-growers. Eventually, no one wants to plant many trees beyond their abilities to protect it privately.

7.2. On Fire: Fire is dangerous, difficult to contain, and dispersed quickly. Thus, the one who lit the fire should be the one who responsible for the fire since his cost of controlling the fire is lowest.

7.3. On Engagement: The engaged girl married to another man. Her fiancé lost his chance to marry her. He can only claim the dowry but not the marriage since the marriage is the willingness of the girl and her husband which shall be respected. Moreover, if the couple has children, the remarriage with fiancé would be troublesome and problematic for kids and so does their properties earned during marriage.

7.4. On Milk: The milk belongs to the buyer; otherwise he won’t offer to buy it (he should value it more than the seller). He, therefore, should take care of his milk. When he forgot the milk and left it behind, he should have something of higher value than the milk; otherwise, he won’t leave it. However, the seller has the better knowledge of the milk when it is going to expire. If he has the technology to preserve it, he should do even it is the buyer’s property. The additional cost should be responsible by the buyer. Also, if someone else wants to buy the milk before the buyer returns, the seller can offer that milk instead and get the new one for the buyer. It is possible that the milk close to its expiry must be sold at the cheaper price; thus, the seller can charge the price difference on the buyer.