

Exam Notes for Economic Analysis of Law (LAWS3335)

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1 CRITERIA FOR EFFICIENCY & THE COMMON LAW EFFICIENCY THESIS

1.1 GENERAL NOTES

- ❖ Posner 'Economic Approach to Law'
 - Topic of study
 - Individual behaviour + legal system
 - Market + non-market
 - What are the assumptions?
 - Efficient market hypothesis
 - Rational parties – self-interest maximising
 - Welfare/utility
 - Public goods/externalities
 - Wealth not a simple monetary measure
 - Positive or normative
 - positive analysis refers to the attempt to understand and explain, rather than improve the world
 - Fairness and distributive concerns
 - Over long term, the common law will work itself pure and sort itself out in the long run
- ❖ Relevance of Tabcorp case
 - (1) law and economics as objective principles
 - (2) institutional capacity: efficiency
 - (3) systemic effects/pressure: inefficient outcomes are more likely to be appealed – effect of the appeal system + costs of litigation; differential appeals □ real efficient outcomes
 - judges want to justice == instruments of justice □ ethically attitude; although efficient outcomes are likely to prevail
 - (1) Objective principles and sets of ideas – law and economics
 - (2) Systemic pressures towards efficiency – inefficient outcomes more likely to be appealed
 - Posner says that it is not in the best interest for CL judges to redistribute resources – CL judges are good at efficiency but not at redistribution
 - Piece-meal ad hoc distribution – courts just make the problem worse rather than better
 - Either cause more problems or cause more disadvantage to those who cannot afford
- ❖ Distributive and equity type concerns and economics
 - Two main schools of thought:
 - economic school of thought
 - utilitarian perspective
 - Neoclassical economics believes that its someone else's business and rely on feedback effects

- Capacity for equity – it is not clear whether court or parliament is more likely to do redistribution
- If we leave equity and redistributive concerns for other bodies or institutions, this may not be in the favour of fairness concerns

❖ Some key terms

- Legitimation – giving something the appearance of legitimacy which it may not be
- Legitimacy – basic minimum for the system to be formed and for it to work. Minimally fair and just to pass muster.
- Courts provide legitimacy and parliament provides redistribution?

❖ Pareto efficiency

- Maximum efficiency – where no one can be made better off without someone else being made worse off
- **Pareto superior** – someone made better off without anyone made worse off

❖ Kaldor-Hicks efficiency – an outcome is considered more efficient if a Pareto optimal outcome can be reached by those who are made better off compensating those that are made worse off → all end up no worse off than before

1.2 TABCORP HOLDINGS LTD V BOWEN INVESTMENTS PTY LTD, [2009] HCA 8

❖ Facts

- Tabcorp = tenants; Bowen Investments = landlord
- Lease contained covenant forbidding tenant to alter the premises without the prior written approval of the landlord
 - Tenant was well aware that written consent from the landlord was needed but went ahead with the alterations of the foyer
 - This resulted in extensive damage to the foyer which had been constructed with special materials
- At trial, judge upheld claim for common law damages in relation to breaches of the covenant clause for the destruction of the old foyer and the construction of a new foyer.
 - Awarded landlord \$34,820 – mostly for the difference between the value of the property with the old foyer and the value of the property with the new foyer constructed by the tenant
- Full Court of FCA
 - Increased judgment sum to \$1.38m – sum comprised \$580,000 as the cost of restoring the foyer to its original condition and \$800,000 for loss of rent while restoration was taking place
- On appeal, tenant sought restoration of the trial judge's figure

❖ **Held** – appeal should be dismissed

1.3 RICHARD A. POSNER, "SOME USES AND ABUSES OF ECONOMICS IN LAW"

- ❖ Economic analysis of law has two branches
 - (1) Economic analysis of laws regulating explicit market-laws regulating the ‘economic system’ in the conventional sense (from Adam Smith)
 - (2) Economic analysis of laws regulating nonmarket behaviour-accidents, crimes, marriage, pollution, and the legal and political processes themselves (from Bentham)
- ❖ Bentham
 - One of the earliest who believed that people acted as **rational maximisers** of their self-interest in every area of life – applicable throughout the whole range of human activity rather than confined to explicit markets
 - Since people are rational maximisers, e.g. in regard to the decision whether to commit a crime as well as whether to sell a horse, the problem of crime control is to establish a set of ‘prices’ for crime by manipulating the two variables that determine the cost of punishment to the (potential) criminal: (1) the severity of the punishment, and (2) the probability that it will be inflicted
- ❖ Normative and positive economic analysis of law
 - (Calabresi’s work) mainly normative – wants to show how society can better control accidents by adopting a structure of rules and institutions based primarily on economics
 - (Posner, author) Approach is to discover to what extent the tort system supports the hypothesis that common law rules and institutions tend to promote economic efficiency -- more interested in positive analysis of law
 - Positive analysis of law has two facets:
 - (1) The study of behaviour regulated by the legal system
 - (2) Explaining, not the behaviour of the individuals and firms regulated by the legal system, but the structure of the system itself
- ❖ Positive economic analysis of law hypothesis → **the rules, procedures and institutions of the common or judge-made law (in sharp contrast to the legislative and constitutional rule making) promote efficiency**
 - Within the limits of administrative feasibility, the law brings the economic system closer to producing results that effective competition – a free market operating without significant externality, monopoly, or information problems, would produce

1.4 RICHARD A. POSNER, "THE ECONOMIC APPROACH TO LAW"

- ❖ The approach
 - Basic assumption of economics is that people are rational maximisers of their satisfactions – all people (with the exception of small children and the profoundly retarded) in all of their activities (except under the influence of psychosis or similar deranged through drug or alcohol abuse) that involved choice
- ❖ Economic approach to **legislation** – **a statute is a deal**
 - Legislators are rational maximisers of their satisfactions just like everyone else. Thus they are not motivated by public interest. But if they want to be elected they need money and this money is likely to come from well-organised groups and unorganised individuals.
 - Rational individual knows his contribution is unlikely to make a difference. Only organised group of individuals will be able to overcome informational and free-rider problems that plague collective action.
 - Interest group will trade votes of its members and its financial support to candidates in exchange for an implied promise of favourable legislation. Such legislation will normally take the form of a statute transferring wealth from unorganised taxpayers to the interest group.
 - If another interest group were targeted, the legislative transfer may be effectively opposed.
 - The unorganised are unlike to mount effective opposition and it is their wealth that is therefore typically transferred to interest groups
- ❖ Economic approach to **courts**
 - Courts are agents of the legislature
 - Judges have a **dual role**:
 - (1) To interpret the interest group deals embodied in legislation; and
 - (2) To provide the basic public service of authoritative dispute resolution
 - (1) The role of the courts is to impart credibility and durability to the deals that the legislature strikes with interest groups
 - Courts resist the wishes of current legislators who want to repeal their predecessor’s deals via repealing ‘interpretation’
 - Impediments to legislation facilitate the striking of deals by giving interest groups some assurance a deal struck with the legislature will not promptly be undone by repeal
 - Thus, an independent judiciary is an impediment to change of legislative deals
 - (2) Independence of the judiciary is also important because it is necessary for the resolution of ordinary