

# The most interesting aspect of law

[Law](#), [Common Law](#)



Module Economic Approaches to Law Module Code: LADD040S7 Essay Title: ‘

The most interesting aspect of the law and economics movement has been its aspiration to place the study of law on a scientific basis, with coherent theory, precise hypotheses deduced from theory, and empirical tests of hypotheses. Law is a social institution of enormous antiquity and importance, and I can see no reason why it should not be amenable to scientific study’

(Richard Posner, 1989) Critically assess this statement with specific reference to the material covered in this course. Lecturer: Dr Amanda Perry-Kessari Academic Year: 2010/11 Word Count: 4260 (excluding titles,

footnotes and bibliography) . Introduction Law and economics movement will soon attain its half a century dominance in legal paradigm and scientific theory. The last forty years have seen its spreading beyond traditional stream of explicit market. The economics concepts have been used to explain vividly legal issues, for both market and nonmarket. Nowadays, we witness economics theory of property rights, of corporates, of politics, of crime and punishment, and privacy laws. Some economists who think that economics is just about the market and must not mingle with nonmarket behaviour shrugged this notion. Such thoughts have been misconception of language, because the term “ marginal cost" is just a concept, rigorous and unambiguous. It is argued that economics is not what economists do, and cannot only be said to be the science of rational choice. The most exciting part of the law and economics movement is that it applies social science methods — generating testable hypotheses based on a theory and the theory tested by empirical data — to the study of law. Using social science methods, the law and economics provides a more rigorous, testable way of

studying and understanding the law. The concept of most legal research and methodology uses paradigmatic thinking. The phrase “ paradigm shift” was propounded by Thomas Kuhn in his theory about development of natural sciences. Kuhn concludes that scientists conduct numerous tests before getting their final results. This is exactly what law and economics as social science does. Kuhn’s analysis of natural science can be adaptable to the analysis of law and the method of legal research. Economic analysis of law also affects legal researchers who are not even on the bandwagon of law and economics, as well as judicial decision-makers in their way of thinking and the reasoning of policy-makers. Over 100 years ago Justice Holmes had predicted that the study of law would be necessitated by statistics and economics. His influence had been so great that lawyers by now would have taken him seriously but it did not happen so. And this Posner referred to as “ the decline of law as an autonomous discipline...”From the mid-20th century, legal scholars made several intellectual revolutions, this has been where legal realism, legal positivism and neutral principles had guided the law to support Holmes’s dream. In recent times the popularity of philosophical pragmatism and so-called ‘ conventionalism’ has putting a blueprint in defending legal rules and institutions. From hence the legal formalism has taken shape and has spread beyond the law and society, movement, feminism, and law and economics, all using similar analytical tools to examine legal rules and institutions. Unfortunately, judges are not convinced to decide cases differently because lawyers have not convinced them to think otherwise. This essay is an attempt to define Posner’s economic analysis of law in law-and-economics movement and his empirical tests of

hypotheses to postulate that law is a social science and therefore merits scientific study. Posner is with the view that legal practitioners and judiciary have lots to gain from law-and-economics and therefore must take it serious. I will also attempt to demonstrate that Posner as law and economics realist was no more influenced by the works of Aaron Director and Ronald Coase but rather by Gary Becker. I will also try to posit Posner's claim that law and economics movement must be efficient, testable and can be studied empirically through hypotheses because law, as part of social institution has come afar and important enough to deserve to be tested in scientific study.

Origin of Economic Analysis to Law and its scientific behaviour Economics has been pursued as market, prices, demand-supply, inflation, and unemployment by neoclassical theories. But economic analysis includes nonmarket factors as well. This revolution led to Chicago School of law and economics movement to apply the basic microeconomics market model to the application of law. Another significant breakthrough is that, Posner attempts to present his work using scientific methodology in his efficiency of law theory. His scientific methodology was by far an ideal in his work. One major incentive of economics methodology is that, it is scientific evolutionary, just as a simple model based on assumption. One uses demand and supply and market equilibrium model to deduce the outcome even if there is no information. Other incentive is, there are common grounds for discussion and debate using analysis directed on models and mathematical validity. Economic analysis posits itself with three characteristics; first, it elaborates on the idea of models and statistics and empirical test theory; second, its behavioural description goes deeper than others to proof that

people are rational in their choice; and lastly, in normative evaluation, it explicitly considers social welfare. The economic analysis of law has two distinct fields of scholarship dating from the 18th century. The first branch dates back to Adam Smith, which regulates explicit market-laws in a conventional sense, when he discussed about the effect of economics on legislation. The second originates from the work of Jeremy Bentham, which regulates nonmarket behaviour, such as accidents, crimes, marriage, pollution, and the legal and political processes. While the first branch has matured as economics as a science and expanded to government regulation of the marketplace, the second has recently achieved its scientific status with the work of Bentham's rational maximisation theory. In another spectrum, Marxist legal theory, later termed economics rationale of law, attracted critique of capitalist society, although it had no clear-cut. This proves that European philosophers had been ahead in this field of study over two centuries. But their ideas were rekindled by American scholars in the 1960s. These scholars found out that law is not an independent discipline but part of the instrumental cross-section of complete and competing social norms, ideas and agendas. Coincidentally, at that time, economics was undergoing a revolution from philosophical discourse to mathematical approach to mitigate social and private adjustment. Inclined to by this change, economics favourites started to capitalise on the devising methods to assign economics to law reasoning. Even then the interest was focused on areas as antitrust law, corporate law, tax law and competition law. The first to mount the challenge was the works of Coase, who provocatively tackled the benefits to lessen dangers assigned to property right, externalities and

liability. This was followed by Becker influential article on crime and law enforcement, highlighting more on law relating to economics. Then Calabresi approached it on liability rules and accident problems. And in 1972 Posner's economic analysis of law brought glory to the law and economics movement. These scholars extended their method to areas of tort, property, contracts, domestic relations, procedure, and even constitutional law. This paved the way for law and economics approach in the subsequent decades, by going beyond the normal functioning of the economics system to economic analysis in achieving a better understanding of the legal system. The economic analysis of nonmarket legal regulation forms part of the larger movement of economic analysis directed towards economics model of human behaviour and social institutions to information, marriage, and education which are outside the definition of conventional economics system. Posner "positive analysis" attempt to explain the domain of science, because economics is the science of rational human behaviour. There is a possibility to study behaviour regulated by the legal system and even the behaviour of the system through the methods, economics is a science rather than as an ideology or ethical system. Lipshaw cited Williston as defining law as a pragmatic science; one that must be judged by its real word application. And the same author posited Posner's view of law not just economics, but scientific, based on a kind of post-modern pragmatic scepticism. The assumption is that consumers are rational maximisers of their satisfaction. There is no theory of law parallel to rational-maximization theory of behaviour. The economics theory of common law justifies judge-made rules, better understood as price mechanism, shows an efficient allocation of

resources in the Kaldor-Hicks criteria. This holds in that behaviour change is proportional to changes in law. Lionel Robbins' in his neoclassical economics book defined economics as science which studies human behaviour as relationship between ends and scarce means which have alternative uses. This he means wants are insatiable with limited means. Economics tells us that people maximise utility, such as happiness or satisfaction, companies maximise profit; parliamentarians who want power maximise votes; tax offices will maximise revenues and NGOs maximise social welfare. In the demand-supply theory, people are likely to demand or look for a substitute product when price goes up, and if supply goes up, price will go down, *ceteris paribus*. The economic hypotheses in the legal system can be derived and tested so as the theory of rational choice and demand-supply, making economics as a social science because it is able to relate data for scientific purpose. Every scientific theory is derived from prediction so as people change behaviour because of scarcities, and manufacturers produce because they have the necessary factors of production. The ability to choose an alternative can be mathematically maximised with option of ranking priorities and the same hold true for ranking rational consumer preferences according to want. In economics it is called utility function and the choice can be called feasibility constraints. This means consumer maximises utility according to budget constraints. People in their rightful mind are rational maximisers of their satisfaction. A criminal might decide if he will commit another crime, a litigant has a choice to settle dispute out of court, a parliamentarian might decide to vote for or against a bill, a judge might decide to vote to support peers, or one might decide to break his contract or

not. Activities of economic actors like consumers and firms are also confronted by the legal system. The development of law and economics was the publication of *Economic Analysis of Law* by Posner. His book had a great effect on the grasp of the legal system, breaking otherwise the stagnation of the law to commonality that the rule of law is uniformly efficient. Posner's book purported to prove that individual rules of the common law area of tort, contract, and property achieved economic efficiency but attacking public law as inefficiently ruled by political forces. His economic analysis of law proves that common law evolves toward efficiency than codified law, and inefficient law creates transactions costs. He argues that inefficient legal rules are likely to be litigated over and over until efficiency is achieved. Posner dynamism set the pace for three major effects in the study of law and economics. His shifting from law and economics to economic analysis of law was influenced by the works of Becker where his restrictive definition of economics as a subject diminished. Posner broadened his definition of economics in line with Becker by placing nonmarket ideas and methods at the forefront of his work. His basic idea of law and economics is Becker's argument that economics should be defined according to its method rather than its object of study, which is the rational choice approach. Posner extended economic analysis to all fields of civil law and the entire legal system by deriving the efficiency of common law rules by demonstrating the promotion of market through costs and benefits. Posner attracted most serious scholars with his broad base analysis and those who even disagree could not substantiate their disagreement because of their non-economic base. And most importantly, Posner's work attracted contributions from Calabresi and others who helped



to shape the legal culture of US and worldwide. On one hand, Posner's analysis has created an important effect in the history of legal scholarship, and on the other, considered as a leap in the evolution of the law-and-economics movement. Posner argues that law and economics boasts of engaging scientific efforts and using the theory of demand, are proponents of hypotheses base on the mere fact that people are rational maximizers. It holds true that if someone commits a crime and receives jail or fine based on the severity of the crime, the higher the punishment the crime attracts, the less the criminal likely to commit crime again. Posner succeeded with his scientific theory by expanding scientific method to include indirect verification. To him, it is not a matter of being true but pragmatic as evolution without reference to God. Economic analysis of law is divided into two sub-units: positive and normative. The positive analysis uses to predict the effect of various legal rules. A positive analysis in tort law will assume the impact of liability rather than the effect of negligence. A normative analysis draws on economic impact on different policies, like efficiency such as Pareto and Kaldor-Hicks efficiency. The positive and normative are indistinguishably important, especially for evaluation of the place in law and economics as scientific subject. This is a pacesetter to clarify law and economics arguments of how the law ought to be. A positive analysis explains the law, predicts its effect and points which legal rules are efficient. The outcome of positive analysis can be applied to normative purposes. The concept of normative statements " the ought is derived from presumed"Pareto efficiency is obtained when distribution of strategy exists where one party's situation cannot be improved without making other

party's situation worse off. According to Posner, efficiency in wealth-maximisation is an achievement for common law in that its implicit goal to the norm and also because of its wealth-distribution cannot be realised by civil law. In defending the Kaldor-Hicks efficiency, he argues that wealth is maximized during transactions that allow a net enough wealth to compensate the third-party. Posner let us reason that if you gamble and lose, you should not complain too much because the ticket you bought at a discount had already been compensated. Similarly, landowners who lose money when a factory relocates must not complain because their land prices were discounted with the probability that the factory will relocate one day. He also let us understands why courts are unable to redistribute wealth effectively, because if courts redistribute wealth from landlords to tenants by disallowing lease contract which favours landlords, landlords could charge tenants excessively because of future loss. Law and economics have extended in diverse ways from game theory to legal problems, from behavioural economics to economic analysis of law, and from statistical to econometric techniques. Economic analysis of law assumes the effect of legislative rules on benefits and behaviour of people by looking at the social efficiency by applying price theory, welfare theory as well as public choice theory. Today economic analysis of law postulates the concept of property rights and transaction costs theories. The law and economics movement gives the legal framework in conceptualising an incentive in practice that promotes economic efficiency and economic analysis, and efficiency is fundamental guide to legal practice. For example in the law of negligence, liability usually depends on what is exactly economically efficient. In the

common law method responsibilities are allocated to those engaged in the process of maximising the joint value or minimising the joint cost of the activities. According to Posner, this can be achieved by redefining a property right or framing new rule of liability or acknowledging a contract right. He uses lots of economic theory such as various concept of efficiency mentioned somewhere and applied the concept of diminishing marginal utility by indicating that \$1 given to a beggar has a more effect than same amount given to a millionaire. This he relates to Coase theorem where one results is most efficient. He elaborated a situation where a factory emits pollution to the five nearby residents costing them \$75 each at a total cost of \$375. To prevent such a situation, the factory can install a chimney at a cost of \$150 or buy air filter to the residents at \$50 each. But assuming there is a right to pollute, the residents have also three choices; do nothing and suffer collective damage of \$375, or buy air filter at collective cost of \$250 or buy chimney costing \$150 for the factory. The concept is, the residents might choose to buy the chimney. The outcome will be efficient in legal sense and concludes that the residents will bear no cost in negotiating with the factory. Which Posner refers to Coase as 'zero transaction costs' which states that 'where there are zero transaction costs, the efficient outcome will occur regardless of the choice of legal rule' Posner takes the view that human behaviour is rational and rationality is the ability and inclination to reason using information around him in making decision. The positive information costs are twofold; costs of getting the information and costs of processing it. His description of human behaviour such as those of a judge, the litigant, the parent, criminal in his economic analysis of law are in abstract but amenable

to scientific inquiry. Posner is of the view that economics predictive power has successes in scientific theory which he gives example of the effects of deregulation in airline industry and communist countries as predictions by the economist. According to Posner, using any scientific hypothesis, law can be predicted by testing and replicating in any legal scholarship, such as securities regulation and corporate law, contracts and commercial law, or environmental law and land. At the same time, a comparative study of law can tell us which are accepted global and ones opposed. Posner has stated: “Abstraction is of the essence of scientific inquiry, and economics aspires to be scientific -” The way of “abstraction” underpinning a phenomenon of scientific thoughts is the results of process abstracting hypotheses from empirical evidence that seem to highlight the study of reality in a more visible way. To him, the hypotheses are both verifiable and falsifiable. He also claims the economist prediction of underwriting effective invention that using atomic bomb was not just a castle built in the air. And using economics, modern pricing, financial trading strategies, labour remuneration, laws in aerospace and environmental laws are just few proofs of scientific successes in economics. Scholars in legal field think that economics is only about the study of inflation, unemployment, business cycle and macro-and-microeconomics syndrome. Economics go far beyond that because it is a science of rational choice where human resources are limited to needs. Economics is studied with an axiomatic that man is rational maximizer of his ends in life, his satisfaction and self-interest. Economics should not be assumed to be a theory of consciousness but rational behavioural when it comes to rational choice. Similarly, self-interest as happiness is different

from selfishness. The notion of rational maximizer holds in that people behaviour change in reflection to the atmosphere surrounding them. The fundamental principles of economics are threefold: law of demand (substitution, inelastic demand: wealth reduces because money buys less). Law of demand can also be related in nonmarket concept. For example a prisoner sees his punishment as debt paid to society, that is, the price charged by society for wrongdoing. The hypotheses here is that the higher the fine (price) the lower less crime. Law as a social institution with Scientific Basis Economic analysis of law boasts of its success in America and continues to spread across the global world. Law is defined as bundles of rule and obligation backed by a state sanction. But lawmakers are sceptical about if a sanction affects behaviour or the safety and prices if fines are imposed on manufacturers of defective products. These questions are what Posner tries to answer with his economic analyses. Economics provided a scientific theory to forecast the repercussion on legal sanctions on behaviour. Economists see sanction as prices, and people are rational to sanctions as prices. So as consumers respond to higher prices and consume less, so it is that heavier fines results to less punishable activity. Economics offers a behaviour theory to predict how rational people approach to changes in laws. This is to say that economics has mathematics and empirical formula to analysis the effects of prices on behaviour. Similarly to scientific theory of behaviour, economics gives important normative standard for testing law and policy. Being technically argumentative, laws are social institutions used to achieve social goals and if methodically effectuated by lawmakers and judges, could be important for social values. Posner envisaged efficiency with

the maximisation of wealth of society. He tries to avoid a normative approach that common law must maximise wealth. His economic analysis focuses on formulating logical implication of some fundamental predictions of human behaviour, such as people opting for more satisfaction than less. Posner has indicated that law is scientific rather than legal or moral sense because it is adaptable to observation and experimental. Similarly, a scientific law is prescriptive rather than descriptive. Economics championed the analytical firmness needed for the study of the huge body of legal rules shown in a modern legal system. An essence premise of the Chicago approach to law and economics is the concept that the common law is the end product to realise efficient results. This premise is called efficiency of common law hypothesis. The hypothesis tells us that common law rules make provision to allocate resources in either Pareto or Kaldor-Hicks efficient way. Posner encourages a scientific approach which applies economics to study fairly the legal system, and the behaviour it controls. His idea is that positive economic analysis is susceptible to abuse and misuse for the fact that its explanation and assumptive are advantageous that leads consumers and organisation to seek different legal redress. The initial hypothesis brought forth by positive economic analysis of law is the idea that efficiency is the main factor to maintain rules and procedures of the common law. Posner argues that efficiency is the best way judicial decision-making does not conflict with judiciary process. Instead of using utility-based methods in economic analysis of law, he used the maximisation of aggregate wealth. He argues that utility cannot be measured and impossible to compare. Hence Posner encourages wealth maximisation and proofs that wealth

maximisation merits the level for assessing legal rules. Lawyers do not just look at the uniqueness and definition of the law; rather they look at law as a social instrument and try to weigh its values. Their emphasize are not how unique the institution is, but its societal role in legal perspective. To understand the importance of the law and economics movement requires certain basic concepts, such as understanding that human beings are rational maximizers of utility and are behavioural sensitive. Economic analysis of law has guise of positive and descriptive theory about the use of law, positive as against normative prescriptive “ making and content of law” as against “ impact of law of law on conduct generally”. Posner argues that positive economic theory of law deserves to be taken seriously. His argument can be based on the theory of empirical validity. Posner’s theory offers an objective empirical research, an organic, historical pedigree for plausible, intelligible and trenchant evaluative criterion, a tool scholars can use for critical studies of legal rules and doctrines on. Economic analysis of law transcends “ from descriptive law to legal norm. ” — from the perception of pervasive and simplifying regularity in law to a belief that law ought to conform to the perceived regularity. Scholars of the law and economics movement boast that law is the best useful tool to promote economic efficiency. On one hand, it can be used to prevent situations that lead to market failure, such as dismantling monopolistic nature of the market; and on the other, assure that monopoly situations are hard to be maintained. Similarly, law can be used to enforce economically efficient transactions using genuine contracts. By this means courts guarantee the contract agreements by enforcing parties to the fulfilment of the said agreement. The

game theory has played an important role in 1980s, joining the core from repeat play, asymmetric information, and evolutionary picks of models into the analysis of law. Empirical methods in collecting and analysing data from the court system came to be reliable and feasible. In all angles, empirical methods have shown to be important ways of testing the various predictions formulated with theoretical law and economics. Conclusion Perhaps the most important development of law and economics movement is credited to Posner whose book, *Economic Analysis of Law*, had effect on understanding the legal system. Posner tried to show that the individual rules of the common law areas of tort, contracts and property achieved economic efficiency. He claimed public law because it is controlled by political forces and also interfered by the government cannot achieve efficiency. Posner argues that efficiency is a justifiable criterion for judicial decision-making because biases of “ justice” introduce unacceptable ambiguity into the judicial process. He expanded his scope of law to antitrust, economic regulation to all fields of civil law. He arrived at his efficiency of common law rules with an instinct of costs and benefits by how the market can be improved. Economic analysis of law is not limited to neoclassical understanding of economic factors, rather covers all forms of non-economic issues. It portrays social scientific knowledge in the area of economics by which actors are viewed as forward looking and rational and the ideal of the social good assigned in updating policy are explicitly expressed. Using efficiency, economics predicts the influence of policies on the distribution of income and wealth and the rational behaviour of people. It has considerations of how legislation can better the conditions of market. In the



economic analysis of law it shows how legal practice is best suited to achieve the status as a social tool targeting the promotion of economic efficiency same as any social science. The economic theory of law has an important potential to make ideas, generate testable hypothesis about different important social behaviour. Bibliography 1. Butler, B. E. ' Legal Pragmatism' [2005] University of North Carolina at Asheville 2. Camerer, C. and Talley, E., ' Experimental Law and Economics' [2004] Draft 3. Cooter, R. and Thomas Ulen, Law and Economics (4th edn, Addison-Wesley 2004). 4. Faure, M. and R. v/d Bergh, (editors), Essays in Law and Economics, Corporations, Accident Prevention and Compensation for Losses (Maklu Uitgevers N. V., 1989) 5. Flynn, John J., ' The Role of Rules in Antitrust Analysis' [2006] 3 Utah Law Review. 6. Harnay, S. and Marciano, A., ' Posner, Economics and Law: From Law and Economics to Economic Analysis of Law' [Jul 2008] (Jour. of the History of Economic Thought. 7. Hayek, Fredrich von: was the author of The Road to Serfdom in 1944 and proposed the creation of Society. 8. Kerkmeester, H. ' Methodology: General, in Encyclopedia of Law and Economics, Volume I. The History and Methodology of Law and Economics, ed. Boudewijn Bouckaert and Gerrit De Geest [200] Cheltenham: Edward Elgar, P. 390 9. Lipshaw, Jeffrey M., ' Contract Formalism, Scientism, and the M-Word: A Comment of Professor Mousesian's Under-Theorization Thesis' [2006] Hofstra Law Review Vol. 35: 23. 10. Michelman, Frank I., ' A Comment of Some Uses and Abuses of Economics in Law' [1979] The University of Chicago Law Review, Vol. 46, No. 2. 11. Noonan, John T., ' Posner's Problematics' [May 1998] Harvard Law Review, Vol. 111, No. 7, 1768-1775 12. Parisi, F. and Jonathan Klicke, ' Functional Law and Economics; The

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