

# Economics 463

## Law and Economics

**term:** Fall 2015  
**instructor:** Dan Graham  
**email:** [daniel.graham@duke.edu](mailto:daniel.graham@duke.edu)  
**class:** Tuesdays and Thursdays 3:05pm - 4:20pm in 124 Social Sciences  
**office:** 242 Social Sciences  
**office hours:** Immediately after class on Tuesdays and Thursdays. Please email for appointments for other times.  
**texts:** David Friedman, *Law's Order*, Princeton University Press, 2000, ISBN: 0-691-01016-1; Douglas Baird, Robert Gertner and Randal Picker, *Game Theory and the Law*, Harvard University Press, 1994, ISBN: 0-674-34111-2  
**requirements:** Daily homework assignments, class participation, term paper, midterm and cumulative final exam.  
**course web site:** [http://www.duke.edu/~dgraham/ECO\\_463](http://www.duke.edu/~dgraham/ECO_463)

## Law and Economics

Law provides the rules of various games which govern how we live. Microeconomics and Game Theory help us to understand the equilibria of these games and thus the likely consequences of having these rules. To the extent that the predicted consequences match what is observed, we might be emboldened to predict consequences of alternative versions of the rules that might be imagined. We might then even be so bold as to ask why the rules take the actual form that we see and not one of the alternative forms that we can imagine.

Law based on judicial decision and precedent rather than statutes will be the primary focus of our analysis. Examples include the basic law of contracts, torts, property and civil procedure. Here is a particularly apt description:

Take the fundamental question, "What constitutes the law?" You will find some text writers telling you that it is something different from what is decided by the courts of Massachusetts or England, that it is a system of reason, that it is a deduction from principles of ethics or admitted axioms or what not, which may or may not coincide with the decisions. But if we take the view of our friend the bad man we shall find that he does not care two straws for the axioms or deductions, but that he

does want to know what the Massachusetts or English courts are likely to do. I am much of his mind. The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law.

—Oliver Wendell Holmes, *The Path of the Law*, pp. 459-60

Our strategy will be to review the various concepts from Microeconomics and Game Theory that are most relevant to legal analysis and, in the course of this review, to explore those aspects of the law that the concepts permit. Here are the key concepts:

- Expected utility analysis, risk and stochastic dominance
- Normal form games, dominant strategies and Nash equilibria
- Extensive form games, backward induction and subgame perfect equilibria
- Games with imperfect/incomplete information and perfect Bayesian equilibria
- Beliefs and assessment equilibria

## Problem Based Learning

I hear, I forget.

I see, I remember.

I do, I understand.

—Chinese Proverb

This process of “learning by doing” recommended by the proverb has come to be called problem based learning or PBL. It dates back to the early 1970’s when it was developed for the Medical School at McMaster University in Hamilton, Ontario. It was then adopted as the organizing principle for the University of Limburg in Maastricht, The Netherlands, and has subsequently been used in a variety of forms in countless other professional, undergraduate and secondary schools. The central premise is that problems are intended *not* to test understanding but to assist in the development of the understanding itself.

Learning by *doing* problems is the focal point of this course.

## Homework

Each class period will be devoted to a discussion of the assigned problems from the class web site lead by *randomly* selected students. You may, on at most two occasions during the course, request an exemption from being subject to random selection by emailing me *at least two hours before* the beginning of class. You need not state a reason when submitting such a request.

You are strongly encouraged to work in groups the membership of which can change from assignment to assignment.

Groups of no more than three students can submit a single homework assignment that lists the names of those submitting. By including your name in this list you assert that you and the others listed *actively participated* in the solution of *each* of the assigned problems.

A copy of the homework to be submitted should be dropped off on the desk at the front of the classroom as you enter. Keep another copy to refer to during the class discussion.

## Classes

Class sessions will be devoted to discussion of the on-line problems and assigned readings. I will randomly call upon students to answer questions and/or contribute to the class discussion.

I try to be the last person to leave the classroom. Please hang around after class if you have anything you would like to discuss.

## Exams

Examination questions will be very much like the homework problems but modified in recognition of the time available for completion. There is no better preparation than doing the homework problems. Each exam will also involve one or two trivia questions that will be easy for anyone who has read the assignments. What, for example, was the hanging verse? (Friedman)

## Paper

The requirement for the paper is to identify an *interesting* aspect of the law and then use Economic analysis to analyze it. The paper should have three parts:

1. A motivating question or questions. Examples:

- Why have a Statute of Frauds? What is the purpose of the statute? Could the purpose be better achieved by an alternative statute?
- Why have a Felony Murder Rule? What is the purpose of the rule? Could the purpose be better achieved by an alternative rule?
- Why have a Parol Evidence Rule? What is the purpose of the rule? Could the purpose be better achieved by an alternative rule?
- Why have a Doctrine of Impossibility in contract law? What is the purpose of the doctrine? Could the purpose be better achieved by an alternative doctrine?

2. A model, e.g., an extensive form game, in which the motivating question(s) can be resolved.
3. A compelling resolution of the motivating question(s) within the context of the model. Any reasonably intelligent person armed with your question and model should be able to deduce your answer.

The paper should be **no longer than three double spaced** pages. Other things equal, **the shorter the better**.

The primary purpose of the paper requirement is to encourage you to look at the world of law as an Economist with the question “Why?” firmly in mind.

As with homework, you are strongly encouraged to work together and share ideas. Team submissions, however, are not allowed. You must individually submit original analyses. This does not, however, preclude two or more people addressing the same question in different ways.

Please don't hesitate to discuss your ideas with me -- it's one of my favorite activities.

## Grades

**Homework:** Based on your homework assignments after dropping the two lowest grades.

**Exams:** Numerical grades for both the midterm and final will be obtained by “curving” the raw scores.

**Course Grade:**

30%: Your homework / class participation grade.

20%: Your puzzle grade.

20%: The better of your midterm and final examination grades.

30%: Your final examination grade.

All averages will be computed numerically and then converted to letter grades with an A+ for 97% or better, an A for 93%-97%, an A- for 90%-93% and so forth.

## Academic Integrity

You are strongly encouraged to form study groups and to work together on the homework assignments and puzzles by discussing ideas and approaches. Please refrain, however, from merely sharing answers.

If you benefitted from conversations with someone in preparing a written assignment, it is customary to mention this in the paper or online submission. It is necessary to cite any written sources that you used including materials obtained electronically.

Examinations are closed book - you are allowed neither to seek assistance from nor provide assistance to anyone else during the examination, nor to consult any written materials other than the examination itself. The use of a calculator is permitted.