f->-.;.



## Economic Behavior and Legal Institutions An Introductory Survey

## Lars Werin

r|d Scientific New Jersey • London 'Singapore ° Hong Kong

## CONTENTS

PREFACE			v
1		ECONOMIC-LEGAL SYSTEM AND THE ROLE OF PERTY RIGHTS: AN INTRODUCTION	1
	1.1	A View of Human Society .	1
	1.2	A Grand Hypothesis	5
	1.3	Founding Fathers and Jurisprudential Traditions	9
	1.4	Property Rights '	13
	1.5	Various Types of Property Rights	15
	1.6	Contracts and Rights of Transfer	21
	1.7	A Survey of the Book	23
	1.8	Some Methodological Points	29
PART I		FOUNDATION STONES	33
2	POL	ITICALLY-BASED VERSUS JUDGE-MADE LAW	35
;	2.1	Statutory Law and Case Law	35
	2.2	•	37
	2.3	The Domains of Judge-Made Law and Politically-	
		Based Law	41
3	EFF	ICIENCY '	47
	3.1	The Meaning of Efficiency	47
	3.2		50
	3.3	•	
	_	to Their Effects on Wealth	55

## xii Contents

4	TWO	BASIC PROPOSITIONS	61
	4.1 4.2	The Proposition on the Contents of the Law The Proposition on the Constitution	61 66
5	TWO	MAJOR THEOREMS ON PROPERTY RIGHTS	71
	5.1	Introduction	71
	5.2	The Reciprocity Theorem	72
	5.3	The Coase Theorem	75
PA	RT II	SOCIETY'S MACHINERY	83
6	COO	RDINATION AND CONSTITUTIONS	85
	6.1	The Problems of Part Two	85
	6.2	The Invisible Hand	88
	6.3	The Idea of a Social Contract	92
	6.4	The Emergence of Constitutional Structures and	
		Other Social Institutions	95
7	MAR	KETS AND FIRMS	105
	7.1	A Brief Survey and Costs of Organizing Interaction	105
	7.2	Markets versus Firms	108
	7.3	More on Markets, More on Costs	110
	7.4	An Alternative Layout	114
	7.5	Firms	117
	7.6	Complications Concerning Costs, and a Conclusion	122
	7.7	A Note on Information Economics	124
	7.8	An Observation on Objects of Contracts	130
8	POLITICAL PROCESSES		133
	8.1	Legal Sanctions Only: An Interlude	133
	8.2	Political Processes: Some Basic Aspects	134
	8.3	Buchanan and Tullock's Analysis	136
	8.4	Results, of Simple Majority Voting	140
	8.5	Broadening the Perspective	144

PAR	ТШ	PROPERTY, BREACH OF CONTRACT,		
		TORT, CRIME		149
9	9 FORMAI	MALIZED PROPERTY RIGHTS		151
	9.1	The Legal Toolbox		151
	9.2	Formalized Property Rights — Basic Aspects		154
	9.3	Formalized Rights to Land in a Historical Perspective		160
	9.4	Detachment of Particular Rights to Land		165
	9.5	Formalized Property Rights to Other Components		
		of the Physical Environment		170
	9.6	Intellectual Property Rights: Patents		175
	9.7	Copyrights, and Further Intellectual Property Rights		179
	9.8	A Brief Summing-Up		183
10	INJU	NCTIONS		185
	10.1	Injunctions in Principle		185
	10.2	Injunctions in Practice		187
11	DAM	IAGES OR PUNISHMENT?		191
	11.1	Introduction		191
	11.2	Property Rules and Liability Rules		192
	11.3	More on Property and Liability Rules		194
	11.4	The Calabresi-Melamed Proposition		196
	11.5	Examples		200
	11.6	Do Actual Rules Accord with the Calabresi-		
		Melamed Proposition?		204
	11.7	How is the Victim Involved?		208
	11.8	Compulsory Acquisitions		210
	11.9	Regulatory Takings		213
12	NEG	LIGENCE: THE SIMPLEST CASE		217
	12.1	When Is Harm Done a Violation of Property Rights?		217
	12.2	Care-Dependent versus Strict Liability .		218
	12.3	Negligence in the Simplest Two-Person Case		221
	12.4	Implications for Incentives and Behavior	>	224
	12.5	Hand's Rule Illustrated		229

	More than One Victim	232
12.7	Negligence with a Variable Level of Care <	233
13 JOIN	T RESPONSIBILITY	237
.13.1	Introduction	237
	Responsibility of Victims	239
13.3	Joint Responsibility on the Acting Side	244
13.4	The Contingency of Property Rights under Negligence	245
14 INTE	ENT, STRICT LIABILITY, INSURANCE	247
14.1	Intent	247
	Strict Liability .	252
	The Choice between Negligence and Strict Liability	254
14.4	The Role of Insurance	256
14.5	Concluding Remarks • -	259
15 THE	STRINGENCY OF SANCTIONS	261
15.1	Generally on the Size of Damages	261
15.2	Pure Economic Losses	265
15.3	More on Regulatory Takings	268
15.4	Punishment	269
16 THE	BEHAVIOR OF DISPUTANT PARTIES	
AND	COURTS	275
16.1	Introduction	275
16.2	Litigation versus Settlement	276
16.3	The Behavior of Courts	282
PART IV	CONTRACTS, COMPANIES, REGULATION	289
17 CON	TRACTS: PROBLEMS AND SOLUTIONS	291
17.1	Introduction	291
17.2	When Is There a Contract?	294
17.3	Contracts Made Less Incomplete by General Clauses	299
17.4	Contracts Made Less Incomplete by Non-Binding	
	Statutory Rules	304
17.5	Breaches of Contract and Case Law	305

18 THE	CONTRACTUAL AND LEGAL STRUCTURE	
OF F	IRMS ,	313
18.1	Introduction	313
18.2	Legal Identity	314
18.3	The Role of Investors	318
18.4	Limited Liability and Priority Orderings of Claims	321
18.5	Basic Properties of Corporations	323
18.6	The Efficiency of Shareholding	329
18.7	Mandatory Legal Rules: Basic Function and	
	on Bankruptcy	332
18.8	Legal Arrangements for Mitigating Agency	
	Problems in Corporations	336
19 LIM	ITS OF FREEDOM OF CONTRACT	341
19.1	Introduction	341
19.2	A Survey of Restrictions on Rights of Transfer	344
19.3	Some Notes on the Regulation Literature	349
19.4	Restrictions on Employment Contracts •	352
19.5	Rules on Safety and "Fitness for Use" of Products	358
<sup>3</sup> 19.6	Price Control	360
19.7	Taxation	362
19.8	Legal Restrictions on Money and Payments	364
19.9	Restrictions on Rights of Transfer in the Setting	
	of the Constitution	367
PART V	EPILOGUE	369
20" CON	ICLUSIONS AND FINAL COMMENTS	371
APPEND	X: A NOTE ON EXTERNALITY .	379
REFEREN	ICES -	389
INDEX		411
INDEA		411