

SEE ALSO *Bubbles; Demand; Economic Crises; Gold Standard; Mercantilism; Monetary Theory; Money, Demand for; Quantity Theory of Money*

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## LAW AND ECONOMICS

Since the 1970s, a new approach to the analysis of law has developed. Known as *law and economics*, its focus is on identifying the effects of legal rules. Law and economics addresses questions like these: What is the effect on the number of automobile accidents of legal rules that hold negligent drivers responsible for harms that they cause? What is the influence on the amount of pollution of laws that penalize firms for releasing harmful wastes into the environment? Does the death penalty reduce the number of murders, and if so, by how much? In seeking to answer such questions, economic analysts generally assume that individuals and firms want to avoid legal sanctions, and the analysts often use data and statistics to verify their theoretical predictions.

Despite its name, the law and economics approach is not necessarily concerned with matters of money or markets. Determining the effects of the death penalty, for example, involves, among other things, consideration of whether an incensed individual would be deterred from shooting someone by fear of the punishment of execution.

The *economic* aspect of law and economics lies in its emphasis on incentives in predicting behavior. In the field of economics proper, the incentives are to make profits or to find a good price; here the incentives are to avoid legal sanctions.

Because economic analysis of law allows the effects of legal rules to be ascertained, the approach is useful for evaluating and comparing rules with regard to their social desirability. If, for example, it is found that the death penalty fails to deter murders carried out by incensed individuals, then it might be concluded that the death penalty is undesirable as a punishment for such murders.

Economic analysis of law has been controversial, mainly because it is centered on identifying the effects of legal rules rather than on the fairness of the rules, the focal issue of traditional analysis. The economic approach to law can be traced in significant respects to the English philosopher Jeremy Bentham (1789), and its modern pioneers include Ronald Coase (1960), Guido Calabresi (1970), and Richard Posner (1972). Posner is also an exponent of the hypothesis that the legal rules that exist are approximately rational in the sense that the consequences of their use are socially desirable.

This entry will provide two illustrations of the economic approach to the analysis of law and will make comparisons with traditional analysis of law. The first illustration concerns legal liability for harm caused in accidents, such as automobile accidents, oil spills, and construction mishaps like the collapse of a crane. A major effect of legal liability is that it fosters the taking of precautions. For instance, in order to avoid being held liable for harm due to an oil spill, the owner of a supertanker might install better navigation devices or hire more experienced crews. Or consider a numerical example: Suppose that if a person does not take a precaution, it is certain that his activity will cause harm of \$100,000, for which he would be held liable. If he takes the precaution, however, he would definitely prevent the harm. The precaution would cost \$30,000. Then the person would be induced to spend the \$30,000 because it would save him a liability expense of \$100,000. Such logic underlies the conclusion that, under many forms of liability, parties will be led to take socially desirable risk-reducing steps, and empirical evidence suggests that the liability system has often substantially reduced harm from accidents.

A number of complications arise in assessing how the threat of liability for accidents affects behavior. One issue involves liability insurance, which covers insured parties if they are held liable for harm. If the owner of a supertanker has liability insurance protecting it against having to pay for harm caused by an oil spill, the owner's reason to invest in navigation devices to prevent spills might be dulled. However, the liability insurer might insist that the

owner install such devices. Another complication is that parties who cause harm might themselves suffer harm in accidents, as is true in automobile accidents. In this situation, parties have a strong reason to avoid causing accidents, regardless of the threat of being held liable. Taking such factors into account is necessary to obtain good estimates of the influence of liability on accidents.

Given analysis of the effects of liability in reducing accidents, questions about legal policy can be addressed. For example, would raising the amount that has to be paid for oil spills significantly reduce the number of oil spills? A radical question is whether, in some areas of activity, it is worthwhile using the liability system at all. This question is an important one in view of the high costs of the liability system. It is estimated that for every dollar that an accident victim receives through the liability system, approximately one additional dollar is spent on lawyers, making the liability system extremely expensive for society to employ. For that reason, economic analysis suggests that, unless the liability system substantially reduces the number of some type of accident, the system may not be worthwhile for that type of accident. Consider automobile accidents. Liability may not much reduce the number of automobile accidents, since the fear of being injured in an accident (or of being arrested for drunk driving) may already provide most drivers with a sufficient motive to drive with reasonable care. Hence, it might be advantageous for society to do away with the liability system for automobile accidents (something that has largely been done in a number of American states).

The foregoing economic analysis of legal liability for accidents may be contrasted with traditional legal analysis of the topic. Traditional analysis stresses the perceived fairness of liability, and notably, the view that an individual who wrongly injures another ought to compensate the victim for his losses. Under traditional analysis, liability is often seen as desirable *without* real regard to the degree to which it reduces the number of accidents or the costs of its use (or to the ability of accident victims to obtain compensation through their insurance policies). At the same time, economic analysts have generally not considered notions of the fairness of liability, although this issue is now beginning to receive some attention from them.

The second illustration of the economic approach to the analysis of law relates to a specific legal doctrine. When a person is making a contract, the law may impose on the person an obligation to disclose material information to the other party to the contract. For example, if a person is selling a home with a leaky basement, the person might be required to disclose this fact to the buyer. Or if an oil company is purchasing land and believes oil is likely to be found there, the company might have a duty to disclose this information to the seller.

Under the economic approach to law, emphasis is given to ascertaining the effects of a disclosure obligation. In the case of leaky basements, a principal effect of a disclosure obligation is that buyers will know about problems and will be able to take appropriate remedial steps, such as not storing valuables in the basement. Hence, a disclosure obligation for such problems as leaky basements may be socially desirable. However, the case of oil and land is different. If oil companies must reveal their knowledge about the high oil-bearing potential of land, they will have to pay significantly higher amounts to purchase land with promising potential. This will tend to reduce the willingness of oil companies to make investments, such as in geological surveys, to locate land with good oil-bearing potential. (Note that this issue of acquisition of information is not relevant in the case of leaky basements—homeowners will automatically learn about leaks, just because they live in their homes.) Therefore, it might not be desirable to obligate buyers to disclose what they know in situations like that of an oil company purchasing land (and, in fact, the law sometimes does not impose an obligation to disclose in these situations).

Under traditional analysis of law, the consideration of a disclosure obligation has mainly to do with whether it would be seen as unfair or immoral not to disclose information at the time of contracting. From this perspective, it might be thought that both a homeowner with knowledge of a leaky basement and an oil company with knowledge that there is probably valuable oil under a person's land ought to reveal their information, for it would be underhanded, and perhaps akin to a lie, not to do so. Under traditional analysis, there would be no obvious reason to draw a distinction between the two types of cases, and the effects of the disclosure obligation on behavior and outcomes would not be the focus of attention.

These two illustrations show the importance of economic analysis of law, that is, of identifying the effects of legal rules, and the contrast between economic analysis and traditional analysis of law. Over time, economic analysis of law is likely to have a major, if not a revolutionary, influence on the understanding of law and on law-making activity.

SEE ALSO *Information, Asymmetric; Insurance; Mechanism Design*

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## LAW AND ORDER

The term *law and order* refers to a prominent theme of Richard Nixon's (1913–1994) successful 1968 campaign for the American presidency. Law and order became a potent campaign symbol for Nixon, and related themes have sometimes surfaced in later Republican presidential campaigns—especially in 1972 and 1988. The term *law and order* is a political symbol capturing public anxieties about civil unrest, urban riots, black militant groups (which, some charged, fomented violence), and rising crime rates. Later events, such as the violence in the Boston area in response to court-ordered busing, widely publicized crime sprees like the Son of Sam murders in New York City, and continued rising crime rates, stoked fears of societal breakdown during the 1970s and gave law-and-order appeals additional resonance. These developments, sometimes connected with subtle racial appeals, contributed to the erosion of the Democratic Party's dominant position in American politics after 1968.

### 1962 TO 1965: VIOLENT RESISTANCE TO CIVIL RIGHTS

After a period of relative domestic tranquility in the 1950s, the 1960s came as a rude shock to many Americans. Between 1961 and 1964, violent actions by southern whites bent on defending racial segregation became commonplace. Demonstrators at sit-ins and freedom riders, black and white, faced actual or threatened violence and mass arrests on fabricated charges. More violence erupted as federal officials attempted to carry out court-ordered desegregation. When black student James Meredith sought to enroll at (and integrate) the University of Mississippi, thousands of segregationists rioted, resulting in two deaths and forcing President John F. Kennedy (1917–1963) to mobilize thousands of troops to restore order.

As the civil rights movement continued, it was met with more violence. Police in Birmingham, Alabama, deployed dogs and high-pressure water cannons against unarmed civil rights demonstrators in 1963. The murders of National Association for the Advancement of Colored People (NAACP) leader Medgar Evers in Jackson, Mississippi, in 1963 and of three civil rights workers near Philadelphia, Mississippi, in 1964 fed fears of mounting

social unrest. A 1963 bombing of a Birmingham black church killed four little girls, and Alabama state troopers attacked unarmed voting-rights marchers with dogs and electric cattle prods in March 1965. These cumulative shocks to the national consciousness were amplified by the 1963 assassination of President Kennedy in Dallas, Texas.

### 1965 TO 1970: BLACK MILITANT GROUPS AND URBAN UNREST

In response to white violence against civil rights activists, some black leaders adopted increasingly belligerent rhetoric. The rise of black radicalism was personified in militants like Stokely Carmichael (1941–1998) and H. Rap Brown. As political scientists Donald Kinder and Lynn Sanders noted, the new rhetoric frightened many whites. There was “less talk of nonviolence and more of self-defense; less yearning for integration and more for solidarity and black nationalism; ‘We Shall Overcome’ was replaced by Black Power and ‘burn, baby, burn’ ” (1996, p. 103). The image of neatly-dressed blacks pummeled by vicious white violence faded, replaced by images of blacks rampaging through city streets, torching cars and buildings and looting stores. The initial trigger for the changing imagery was the August 1965 Watts riot in Los Angeles. As Kinder and Sanders described the Watts riot:

The violence raged unchecked for three days, and three days longer in sporadic eruptions. Blacks looted stores, set fires, burned cars, and shot at policemen and firemen. Before the violence was halted, 14,000 National Guard troops, 1,000 police officers and 700 sheriff's deputies were pressed into service.... In the end, 1,000 buildings were damaged, burned, looted or completely destroyed; almost 4,000 people were arrested; more than 1,000 were injured seriously enough to require medical treatment; and 34 were dead, all but three of them black. (Kinder and Sanders 1996, p. 103)

Watts was only the beginning, as 1966, 1967, and 1968 each brought more unrest. In 1967, 250 serious uprisings occurred, including the Detroit riots, which killed forty-three people. More disturbances erupted in multiple cities after the assassination of Martin Luther King Jr. in April 1968. As Kinder and Sanders observe:

For one long, hot summer after another, Americans watched what appeared to be the coming apart of their own country. On the front page of their morning newspapers and on their television screens in the evening appeared dramatic and frightening pictures of devastation and ruin: cities on fire, mobs of blacks looting stores and hurling rocks at police, tanks rumbling down the avenues of American cities.... Discussion of the “race