Econ 522 Review Session

Topics:

* Efficiency (What is it? How do we evaluate whether private agents achieve efficiency?)
* Bargaining (How are payoffs established? How to figure out bargaining outcome?)
* Property law
  - Normative Coase vs. Normative Hobbes
  - Efficient remedies
* Contract law
  - Bargain theory (When to apply it? How to check?)
  - Damages (ED, OD, RD)
  - Efficient breach / reliance / investment in performance
  - Unite knowledge and control
* Tort law
  - The Hand rule (What is it trying to measure?)
  - Accidents between seller & its customer
* Criminal law
  - Social costs
  - Marginal cost of deterrence
* Others
  - Hindsight bias
  - Self-serving bias

Efficiency

① What is the efficient outcome?

ex. Eff reliance

② What do private agents actually do?

ex. Reliance

Bargaining

From sample exam questions

Ann's uncle dies and leaves her a beautiful 1959 Corvette in flawless condition. Having no interest in old cars, Ann agrees to sell it to Betty for $25,000, a fair price given the condition it's in.

Not wanting such a beautiful car to get snowed on, Betty pays $1,000 to rent an indoor parking space close to her home. This reliance is both efficient and foreseeable, and the $1,000 is not refundable. From having the car and the parking space, Betty expects to get a benefit of $40,000.

Two days before Ann and Betty meet to exchange money and keys, Carol hears about the arrangement, and offers Ann $50,000 for the car.

Two ways to establish payoffs

(a)

(b)

Under (a)

Ann's payoff if selling to Betty:

Ann's payoff if selling to Carol:

Under (b)

Ann's payoff if selling to Betty :

Ann's payoff if selling to Carol :

⇒ Doesn't matter which way you go with,
as long as you're consistent !

If Ann & Betty bargain so that Ann can sell to Carol

(1) Threat points :

- For Ann :
- For Betty :

(2) Gains from coop :

Combined $payoff_{pre}$ =

Combined $payoff_{post}$ =

⇒ gains from coop =

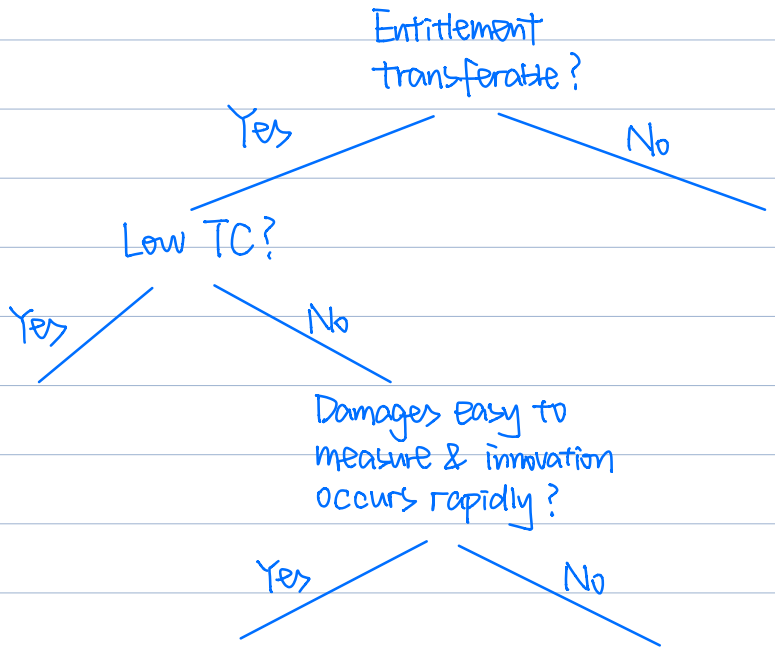
(3) Evenly split

Property Law

① Normative Coase vs. Normative Hobbes

	When to use?	Goal?
Norm. Coase		
Norm. Hobbes		

② Eff remedies?



Contract Law

① Bargain theory
- offer
- acceptance
- consideration ⇐ Both sides need to give up something to the other

② Damages

③ Breach / Investment in perf / Reliance

④ Unite knowledge and control

Tort Law

① The Hand rule

② Accidents between seller & its customers

When is customer's activity level efficient?

↳

Criminal Law

① Social costs

② Marginal costs of deterrence

"The marginal cost of deterring another crime could be positive or negative"

- Social cost of each crime: $10,000
- Cost of trial and punishment: $100,000
- Increase fraction of crimes detected from 15% to 20%
- (a) Suppose this increase in detection would result in a decrease in the number of crimes committed from 1,000 a year to 700 a year.
  - i. Calculate the effect that hiring the new policemen would have on the social cost of crimes committed.
  - **before: 1,000 X $10,000 = $10,000,000**
  - **after: 700 X $10,000 = $7,000,000**
  - **effect: $3,000,000 reduction in social cost of crime**
  - ii. Calculate the effect it would have on the cost of trying and punishing offenders.
  - **before: 1,000 X 15% X $100,000 = $15,000,000**
  - **after: 700 X 20% $100,000 = $14,000,000**
  - **effect: $1,000,000 reduction in cost of trials and punishment**
  - iii. From an efficiency point of view, what is the most that the city should be willing to pay for the new policemen?
  - **$4,000,000, since this is how much social costs are reduced by having higher detection**

"The marginal cost of deterring another crime could be positive or negative"

- Social cost of each crime: $10,000
- Cost of trial and punishment: $100,000
- Increase fraction of crimes detected from 15% to 20%
- (b) Now suppose instead that the increase in detection would decrease the number of crimes committed from 1,000 a year to 900 a year.
  - i. Calculate the effect that hiring the new policemen would have on the social cost of crimes committed.
  - **before: 1,000 X $10,000 = $10,000,000**
  - **after: 900 X $10,000 = $9,000,000**
  - **effect: $1,000,000 reduction in social cost of crime**
  - ii. Calculate the effect it would have on the cost of trying and punishing offenders.
  - **before: 1,000 X 15% X $100,000 = $15,000,000**
  - **after: 900 X 20% $100,000 = $18,000,000**
  - **effect: $3,000,000 increase in cost of trials and punishment**
  - iii. From an efficiency point of view, is there any positive amount that the city should be willing to pay for the new policemen?
  - **No – higher detection increases social costs, so even if the new policemen were free, from an efficiency point of view, we wouldn't want them!**

Others

① Hindsight bias

② Self-serving bias