Preface

The last several decades have witnessed the development of diverse approaches to the evolving paradigm of law and economics. Each school of thought, from the Chicago school, public choice theory, neo-institutional law and economics, to the New Haven school, and modern Civic Republicanism, has helped both to redefine the study of law and to expose the important economic implications of the legal environment. The challenge to law and economics from critical legal studies has contributed to the debates.

The paradigm has consistently favoured yang economic values and neglected the complimentary *yin* reasoning and observation of the law. In law, critical legal studies, for example, presents a formidable challenge to the law and economics paradigm. But economics needs to re-examine its historical roots, and ask: what if Marshall (1920), in writing his *Principles* the foundations of modern economics, had been persuaded by biology and not mechanical physics?

Throughout this book the *fact-finder* is introduced as the arbiter and commentator on arguments presented in each chapter. In Chapter 1, we set the scene for a *political economy of law* by considering one's moral and legal obligations with arguments founded on a positivist separation of law and morals portrayed in a natural law perspective. Law should be understood twixt the Scylla of the positivist aspiration to remove moral choices from the determination of rights and duties and the Charybdis of the natural law insistence on a moral minimum.

Building on arguments first drafted in McNutt (2005) wherein a variant of Hume's law that no prescriptive conclusion can be deduced from positive analysis alone was introduced, in Chapter 1 we introduce a cornerstone ethic grounded to Kantian ethics. This allows the fact-finder to observe the legal world as an x-law environment. An *x-law* captures some element of the complexity and behavioural characteristics of the many actors who perform law. Political economy of law includes many of the behavioural characteristics within an x-law environment. The x-law is not to be understood in terms of Dixit's (2004) 'lawlessness' — wherein recourse to the courts as an outside option dissipates — but rather as how law is experienced and observed. A key factor in x-law is that an individual sometimes changes their behaviour at the margin and sometimes experiments with a new development in the x-law environment. It is the latter that facilitates a

reasonable solution to the ethical dilemma facing the individuals.

In Chapter 2 we introduce the *s-firm* as a non-market setting for productive non-shirking employees who also realise that information about external threats to job security, for example, can be more usefully processed in the firm. The *s-firm* in Chapter 2 does not restrict its employees' rights allowing sovereign decision-making, and thus a degree of cooperation and coordination. Our analysis requires assumptions beyond the observation that there is an agency problem within a firm; each stakeholder has a (property) right, ϕ_h , the employee-stakeholder's share in the *s-firm*. The nature of the *s-firm* is such that it represents the embodiment of property rights across the various stakeholders in the firm. The firm uses the real resources of society in order to produce; each worker-stakeholder privately holds the rights to the use of the resources and fulfils his or her duty. Chapter 3 we explore the reign of law in terms of social preferences such as honesty, fairness and commitment to common goals — important constituents in understanding the efficacy of the law. It is argued that the law should equally provide a workable definition of honesty and truth. Case Study 3.3, for example, illustrates that when a statement is true there is a state of affairs which makes it true and which is distinct from the true statements about it; but equally we can only describe that state of affairs in words through the language of the law in the *x-law* environment.

Ronald Coase had argued nearly fifty years ago that the market was better than government at allocating a scarce resource. The search for efficiency is certainly not in the context of what is most profitable but rather in the context of doing 'the right thing' at a point in time, $t > 0$, or ensuring that the incentives are in place to do so. A mechanism for licence-holders to trade their property rights on a secondary market might appease a Coasian scholar who fears that the government allocation of spectrum is more inefficient than a market allocation. Alternatively, there are some who would argue that spectrum should be open to all, not as property rights but rather as a commons public good. Maybe it is 'the right thing' to do at this juncture in the twenty-first century. In Chapter 5 we phrase 'the right thing' to do in terms of Isaiah Berlin's essay on liberties.

But many of the problems are problems of binary choice, choice of two rules or choice of two outcomes. The law and economics paradigm provides the cocoon within which both law and economics can gain from their mutual interaction in assessing this binary condition. In some of the chapters we focus on alternatives, we draw analogies and economic answers are drawn into a web of interconnected strands of reasoning. The approach in Chapters 5 and 6 is to make you, the reader, aware of the complex interconnectedness

of the different strands of argument in a political economy of law and to suggest indeed that understanding of the problem can only be obtained by understanding the whole picture. German philosophers in the early years of the twentieth century referred to the *Gestalt*, a kind of 'standing together', a theory of understanding, which rested on the concept that the whole is greater than the sum of its parts.

One's obligation is not enshrined in promise-keeping in the sense that promises create a special obligation on an individual. Rather in a political economy of law perspective it is argued that a Kantian duty could persuade a rational reasonable individual to obey the law. However in an x-law environment wherein law is both experienced and observed in terms of adherence and compliance with the law, rational reasonable individuals fulfil their respective duties differently. In Chapter 4 we agree with Viscusi (1993) that providing a reliable and convincing value of a statistical life (VSL) should become more of an integral part of the broader analysis of liability, and continue to argue that lawmakers should be more aware of the trade-offs associated with speed limits or blood alcohol levels and VSL. The hypothesis that all tortfeasors are rational as players in a game of liability will continue to be discounted within the law and economics paradigm as long as there is the practical impossibility of an exact analysis of the behaviour of all tortfeasors in all circumstances. The decisions to reduce speed limits or to curtail the incidences of drinking and driving may well reflect informed voter preferences, but efficient law needs to infer voter/driver/tortfeasor preferences from their choices. A key is to estimate how individuals trade off life against the probability of a fatality.

Later, in Chapter 7 we examine the trade-off in terms of a stylized trading exchange equilibrium by introducing a caring-defendant model combining an economic analysis of crime as a tradable commodity with the dialectics of duty and obligation. The caring-defendant model illustrates an action that benefits others but not the acting agent, the defendant. Intuitively, a state of 'no crime' benefits the public rather than the criminal, but such a state can only occur if the criminal as defendant fulfils his or her duty. Rather than ascribe the defendant's action to altruism measured in terms of 'other-regarding emotions' or 'morally good actions' the behaviour described in the model converges in part to a *duty-altruism* that arises from a behavioural pattern that presents an anomaly for the standard economic approach. The motivation of a caring defendant has to be understood in terms of stopping x from happening rather than in obtaining self-esteem or status for doing x.

There is a tendency amongst law and economics scholars to break down and analyse the whole, and then study the separate strands in detail. The

inductive or empirical approach of economic analysis in collecting facts is presented throughout the book in the persona of the *fact-finder*. However, it is not enough on its own; an essential second step is to check predictions against events, to deduce from any new facts, which may cause the initial theory to be modified or adapted. There is an equal tendency amongst law and economics scholars to test the theory by collecting more facts, and it is by understanding the whole, for example, that the lawyer can integrate the economic analysis of law into her legal reasoning. She may use efficiency arguments, and the economist can influence a just solution of a problem.

In our approach to the law and economics of antitrust, we introduce both non-market economics and neo-classical economics. However, a non-market economics approach to competition assessment, as outlined in Chapter 9 and Chapter 11, would be more inclined to emphasise that competition is best understood as a process and that the behaviour of rival firms should be explicitly modelled as rational choice. In our approach to antitrust, we argue that competition is a process, and as such can be described, rather than defined. No parameter of interest to competition assessment should be estimated in isolation without reference to the history of prices and quantities in a market and the strategic interactions of the firms.

The law and economics paradigm has become a powerful intellectual force in both legal scholarship and economic analysis. Ask yourself the following question: are you a criminal? Look around your environment, an environment circumscribed by alphanumeric: the pin number for your ATM card, the security code for your house alarm, and the swipe card to enter your office or designated car park. You probably cannot park outside your front door without a permit, your trash or rubbish will remain uncollected unless you pay a requisite fee, and in general your (actual) real opportunity cost of doing x (conforming), $C(x)$, is internalized as the costs of your safe environment — an assurance payment to protect your property right. Your $C(x)$ is the mirror-image of the expected cost of the criminal, $C^e(y)$, imprisoned for doing y (not conforming), equally taking assurance with the prison wardens to protect his life and possessions.

Rationality is at the core of the law and economics paradigm. As a rational person with a Kantian sense of ethics (Chapter 1) you implicitly and inadvertently choose to balance the actual cost of doing x against the expected cost of doing y . The difference is that you the reader at this juncture do not perceive yourself as a criminal but rather you react in a criminalized state of nature, while the real criminal, acting in a criminalized state of nature, is imprisoned and believes himself to be safe. You as a rational person internalize the opportunity costs of your environment as actual costs, as

assurance against the real criminal, the burglar in Chapter 7, the care thief, the uninsured tortfeasor (Chapter 4), who crashes his car into your car or the shirking worker (Chapter 2) in your plant. In these chapters the argument is made that the values (chosen normative criteria) should be explicitly identified and stated so that their limited and relative validity is quite clear.

In most product markets, the primary reason why we prefer competition is so that consumers can get low-priced goods and services. In antitrust circles it is often taken for granted that competition is equally important at providing a relatively large variety of choices and an optimal level of quality. But we have the phenomenon of low-cost airlines, where low prices are not the result of competition but a result of a pricing practice known within the industry as yield management, reducing prices simply to maximize the number of customers and not necessarily as a reaction to rival pricing, which is the essence of aggressive price competition.

We have to break the link that competition *per se* is always good and efficient. In historical retro-perspective one can find proof that cooperative behaviour can be efficient, looking at such historic examples as the economy of the Cistercians in the Middle Ages, the Jesuit state in Paraguay, the kibbutzim in Israel and the cooperation of suppliers and manufacturers in Japan's kanban, kaizen and keiretsu or in the universal adoption of new Internet technologies by cooperating end-users. Although the best-known passage in Adam Smith's (1776 [1937]) *Wealth of Nations* states that 'people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices', he then issues the less familiar warning: 'it is impossible indeed to prevent such meetings, by any law, which either could be executed, or would be consistent with liberty and justice'. In Chapter 5 we introduce the negative liberty of the incumbent as preparation for the later discussion in Chapter 12 on intellectual property rights. Prosecutions in this area will only involve national regulatory and competition agencies and the defendants in an endless game of procedure and natural justice.

Abuse of dominance could be understood in terms of breaching trust or good faith. At the time of writing (August 2009) this book telco providers across Europe are considering blocking access to the Pirate Bay website, an allegedly notorious Swedish website which provides links to places where copyrighted materials such as movies and music can be downloaded for free. The challenge for the law is twofold: whether or not Pirate Bay as a defendant is stealing copyrighted material and whether or not rights-holders should proceed with a threat of legal action to block access. In Chapter 12 we close the discussion by introducing the concept of *frozen market*, a market that

evolves as firms discover new products and new production processes and wherein former beliefs about competing and innovating change as end-user consumers demand more and firms risk lagging behind the technology curve. Within a political economy of law paradigm, markets (Chapter 11) are evolving systems – contest, combat and scramble market systems – and are created by technology. The challenge for the law is how to handle technology not in terms of the application of patent law or copyright law or competition law but in terms of how differences in treatment can be justified.

Today, 12 August 2009, at time period t most of us use electronic devices with closed systems. Each device creates and stores certain types of information. This draft is stored on my laptop, the contact details of my editor and publishers are stored on my mobile phone, and the documentary last night was recorded and stored on my digital recorder enhanced TV. By time period $t + T$ the cloud will have reversed that model of storage. In the cloud the Internet becomes our operating system and our files will be stored in some remote data centre. The cloud is but one example of a paradigm shift in technology that will awaken new frozen markets, each presenting law with a unique set of circumstances, and thus a challenge on protecting rights-holders' interests and assets.

There is a significant role for a *geography of law* in understanding the legal challenges posed by the cloud. For example, cloud providers such as Google, IBM, Microsoft or Apple or X, not yet identified in this frozen market system, insist that our personal data is secure as it is held on servers in different places all over the world. If security is breached, and legal redress sought, wherein lies the jurisdiction? There is also the intriguing issue of cyber gatekeeper to manage the world's Internet domain names. For example, what is to be the future role of Iann, the not-for-profit organisation which is contracted by the US Department of Commerce to manage the domain names at present?

In Chapter 12 we argue that the provision of e-goods and services in frozen markets create end-users who can exploit the technology but do so with a sense of duty and obligation to others, given the positive externalities associated with the e-good or service. Therefore the law should respect the negative liberty of the end-user. If the end-user is acting responsibly and fulfilling his or her duty, then legality should be about conforming to the duty. The rational individual can fulfil his or her duty, and thus act with legality, but not out of legality. The intention that guides individual behaviour is explored in Chapter 7 where a caring defendant acts out of respect for the potential victim of a crime, but it is the intention that is the primary determinant of the morality of the act. Chaliar (2002 pp33) alludes to how the consequences of the act 'go counter to ones' sympathies, even if, in the view of the average

person in particular, that is, *the person who does not have an understanding for the sense of universality and humanity*, these consequences turn out to be harmful to the uniqueness of individuals [our italics]’.

At time period t , the law is protecting the positive liberty of the owner of the intellectual property and relegating the negative liberty of the end-user who is illegally downloading music files or pirating DVDs. If we accept that responsible moral individuals have a claim-right to the satisfaction of their needs in frozen markets, provided that this can be achieved without retarding the similar needs of others, then this claim-right is not time invariant, as needs change through time. Law changes through time. Technology and innovation have ensured that basic needs include, paradoxically, music files and DVDs. How a responsible moral individual obtains the basic needs is often a matter of income and circumstance as it is a deliberate act of deceit or theft. So an appropriate payment system could be considered given the economics of frozen markets outlined in Chapter 12, such as free with advertising or an advert-free fee. At time period t licensed-streaming services such as MySpace Music and Spotify allow users play any song, any time on the laptop through a payment method that combines both.

At time period $t + T$, it is conceivable that the law will face a challenge: protecting the negative liberty of the end-user of e-goods and services who will be ‘responsibly’ downloading music files or streaming DVDs and, thus, relegating the positive liberty of the holder of the intellectual property right. With so many end-users using so many e-goods and services, monitoring their behaviour by a fact-finder or in general will be costly. It may also be the case that as goods migrate from private to e-good status the average fixed cost decreases as more end-users acquire the good or service, and the challenge for law and economics is to present an efficient payment system that can provide continued benefits to both rights-holders as they escape excess capacity constraints and end-users who act responsibly independent of the law.

In Chapter 5 it is argued that the barriers to entry that really should matter are the ones that keep out equally efficient firms, and thus the central question is whether price regulation can be reconciled with competition. We address the issue of real prices, fair prices and unreasonable prices throughout the book and collapse the arguments into an understanding of a behavioural market system in Chapter 11. There is a silent recognition amongst national competition agencies that globalisation of firms has forced a change in antitrust thinking of corporate strategies – they are no longer national but global. In Asia, for example, shame is more important than guilt. In other words, real effective law enforcement should be about taking the asset away from the company rather than a fine or imprisonment. All companies should

continue to be obligated to carry out an antitrust audit to identify risk areas where there may be breaches of the competition law. And whether a company is a public or private company the question is: should a company have to abide by competition law principles or can the market act as a sufficient disciplinarian?

Oligopoly theory gives us tacit collusion, dominance and unilateral effects. They are rooted in the understanding of interdependence. Tacit collusion is akin to a coordinated effect as players match their strategies. A unilateral effect is very much in the hands of the merging parties so any query about what the rivals do should not be regarded as a unilateral effect. Efficiencies are hard to measure, and particularly in the absence of innovation or new product development or when we have a shift in the demand. This is addressed in Chapter 10 wherein we discuss the surplus measures underpinning economic analysis in antitrust cases. So if prices rise by β factor, then competition is lessened by the β factor. We could argue that efficiencies are internal to the firm or are unlikely unless rivals drive costs downward. And the regulatory agency must consider whether or not the harm or injury is an economic or business injury or a property rights dispute about the redistribution of surplus rents in the market.

Within a political economy of law paradigm, the fact-finder has to pursue some problems much further than is necessary for the student of law. To do this she has to establish not only the true starting point of the problem but also to analyse the statements – meaningful observations that can be true or false – that help to marshal the arguments from time period t to time period $t + T$. In Chapter 3 we allude to the Popperian thesis that a concern for truth demands an emphasis upon the possibilities of falsification as understood by Flew (1975). We also argue that a concern for truth demands a permanent critical openness towards truth as a signal of an individual's morality. Notwithstanding the arguments in Chapters 1 and 3 on relative merits of law *v* morality and notwithstanding the argument presented in Chapter 7 on the relative merits of belief *v* knowledge, a fact-finder has the comfort of the law in knowing that it is perjury to swear what we believe to be false. But the uncertainty of the *x*-law wherein what the fact-finder observes to be the truth can be false may influence their observation of the law. If the fact-finder observes compliance with the law by all then is it the case that it is because they are all rational, and if there is a dispute or disagreement that rational argument should be able to resolve it?

In the stylised case of a caring-defendant in Chapter 7, a fact-finder observes rational individuals acting as if they were making the law for themselves based on reason and experience of the law in an *x*-law

environment. For the fact-finder it may be difficult to separate learning from action. As time progresses, law and economics scholars will confirm the ancient Chinese saying that 'the *yang* having reached its climax, retreats in favour of the *yin*'. Observational learning in an x-law environment should attract attention especially when policy-makers and legislators want to expedite a new standard or norm or enact a new law. A good case in point is the rapid introduction of a no-smoking ban across Europe. The Irish were early adopters, indeed pioneers of the new regulations, and once observed by others as complying – a visit to Dublin, for example allowed a sceptic to observe the ban – with the new regulation, other jurisdictions adopted the ban and it has become a universal standard. Observational learning is important in law, but will not be effective if, instead, greater sanctions are used as the main channel of social learning. Herein lies the call for more convincing empirical evidence about the importance of observational learning in an x-law environment and its implications for law.

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