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ECONOMIC ANALYSIS
OF LAW

*Eighth
Edition*



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Law & Business

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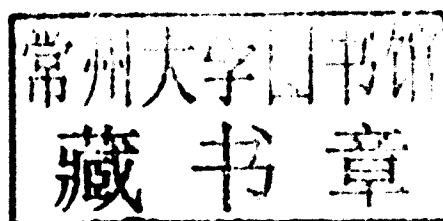
ECONOMIC ANALYSIS OF LAW

EIGHTH EDITION

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Wolters Kluwer

Law & Business

AUSTIN BOSTON CHICAGO NEW YORK THE NETHERLANDS

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Aspen Publishers
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PO Box 990
Frederick, MD 21705

Printed in the United States of America.

1 2 3 4 5 6 7 8 9 0

978-0-7355-9442-5

Library of Congress Cataloging-in-Publication Data

Posner, Richard A.
Economic analysis of law / Richard A. Posner. — 8th ed.
p. cm.

Includes bibliographical references and index.

ISBN 978-0-7355-9442-5 (alk. paper)

1. Law and economics. I. Aspen Publishers. II. Title.

K487.E3P67 2010

349.73-dc22

2010044264

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PREFACE

This is the eighth edition of a textbook-treatise first published in 1973. Its subject is economic analysis of legal rules and institutions, or, as it is more commonly called, “law and economics.” It is the foremost interdisciplinary field of legal studies. The former dean of the Yale Law School, a critic of the law and economics movement, nevertheless has called it “an enormous enlivening force in American legal thought” and says that it “continues and remains the single most influential jurisprudential school in this country.”¹ More recently we read that “there is no dispute that law and economics has long been, and continues to be, the dominant theoretical paradigm for understanding and assessing law and policy.”² The centrality of the field to the modern understanding of law is suggested by the number of specialized journals,³ amount of encyclopedic coverage,⁴ and number of sophisticated book-length treatments.⁵

Economic analysis of law has changed the way law is taught. The reason has to do with the extreme surface complexity of the law. The law is divided into numerous fields, each of which has a complex structure of rules. The fields are traditionally studied in isolation from one another, and within each field the rules tend also to be studied as separate, often self-enclosed

1. Anthony T. Kronman, Remarks at the Second Driker Forum for Excellence in the Law, 42 Wayne L. Rev. 115, 160 (1995).

2. Jon Hanson & David Yosifson, The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture, 152 U. Pa. L. Rev. 129, 142 (2003). See also *id.* at 144.

3. Journal of Law and Economics, Journal of Legal Studies, Journal of Law, Economics and Organization, European Journal of Law and Economics, International Review of Law and Economics, Review of Law and Economics, Research in Law and Economics, Economics of Legal Relationships. Harvard Law School’s new faculty-edited journal, the Journal of Legal Analysis, appears to be concentrating heavily on economic analysis of law, if we may judge from its first year’s contents. In addition, a great many articles applying economics to law appear in the conventional law journals. A recent example is Eric L. Talley, On Uncertainty, Ambiguity, and Contractual Conditions, 34 Delaware Journal of Corporate Law 755 (2009).

4. The New Palgrave Dictionary of Economics and the Law (Peter Newman ed., 1998) (3 vols.); Encyclopedia of Law and Economics (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (5 vols.).

5. See, for example, Steven Shavell, Foundations of Economic Analysis of Law (2004). Of particular value as a research tool is Handbook of Law and Economics (A. Mitchell Polinsky & Steven Shavell eds., 2007) (2 vols.).

bodies of thought. Yet it turns out that a relative handful of economic doctrines—such as decision under uncertainty, transaction costs, cost-benefit analysis, risk aversion, and positive and negative externalities—can, by repeated application across fields of law and legal rules, describe a great deal of the legal system and enable the student to develop a more coherent sense of the system—to grasp the relation of its parts and understand its essential unity.

This book differs from other books of economic analysis of law in the breadth of its coverage (*almost* the whole legal system) and in its emphasis on the legal regulation of nonmarket behavior—not only familiar examples such as crimes and accidents and corporate conduct and lawsuits, but also less familiar (to economists) examples such as drug addiction, thefts of art, sexual acts, surrogate motherhood, rescues at sea, flag desecration, public international law, presidential pardons, democratic theory, terrorism, and religious observances. It also differs in the principle of organization, being organized around legal rather than economic concepts. This approach enables the law to be seen, grasped, and studied as a system—a system that economic analysis can illuminate, reveal as coherent, and in places improve. By the same token, the approach enables economics to be seen as a tool for understanding and reforming social practices, rather than merely as a formal system of daunting mathematical complexity. The explication of economics in this book stresses the unity, simplicity, and power, but also the subtlety, of economic principles. The presentation is informal, and no prior acquaintance with economics, or mathematical competence, on the part of the reader is assumed.

You cannot learn economics from a single book. A feel for, skill in, and comfort with economics grows gradually, just as with law. This book slights the formal, systematic side of economic theory in favor of the applications side and is thus a complement to, rather than a substitute for, a more conventional economics textbook. It covers more ground than an ordinary microeconomics or price-theory text because its scope is defined by the law rather than by some predetermined field of economics, and thus it includes topics more often studied in courses in welfare economics, labor economics, the theory of finance, public finance, demography and family economics, public choice, game theory, public economics, industrial organization, and (new in this edition) business-cycle economics, as well as the standard topics in price theory. This breadth is purchased at the expense of depth in many of these areas. Even in the central areas of economic analysis of law—such as the economic analysis of property rights, contracts, torts, antitrust law, and corporate and tax law—the march of research has been so rapid⁶ in recent years that in many places I have found

6. Falsifying the prediction of Harvard legal historian Morton Horwitz, who wrote in 1980: “I have the strong feeling that the economic analysis of law has ‘peaked out’ as the latest fad in legal scholarship.” Morton J. Horwitz, *Law and Economics: Science or Politics?*, 8 Hofstra L. Rev. 905 (1980). Nine years later, another prominent legal scholar, Owen Fiss, ventured more

it possible only to skim the surface. EconLit, the online economics literature search program, lists hundreds of books and thousands of articles under the heading “law and economics,” published since 2006. The references in the footnotes and at the end of the chapters are illustrative rather than exhaustive, but they will guide the reader who wishes to pursue any of the topics further into the scholarly literature.

The continued rapid growth of economic analysis of law since December 2006, when the seventh edition went to press, is reflected in a number of changes. Many of them reflect the economic crisis that began with the financial crash in September 2008 and at this writing is continuing. The crisis has led me to reexamine some of the economic principles expounded in previous editions of my book, and, indeed, to express a degree of skepticism, missing from my previous work, about them. These changes appear throughout the book, but are most extensive in chapters 1 (nature of economic reasoning) and 15 (financial markets); the latter chapter discusses the economics of the crisis. There are also a number of changes (mainly additions) in the chapters dealing with property, contracts, torts, regulation, taxation, and civil and criminal procedure. Chapter 19 reflects recent academic work by me and others on judicial behavior. And throughout there are lesser changes, corrections, and citations to books and articles published since the last edition.

I thank Elizabeth Chou, Gary DeTurck, Martin Kohan, Sonia Lahr-Pastor, Ruoke Liu, and Steven Weisman for excellent research assistance, and the following readers for pointing out errors in the preceding edition: Terry Bennett, Ron Garet, Daniel Klerman, Seok Min Moon, Richard Wright, and Ziran Zhang.

Richard A. Posner

November 2010

cautiously, but still erroneously: “law and economics . . . seems to have peaked.” Owen M. Fiss, *The Law Regained*, 74 *Cornell L. Rev.* 245 (1989). Here is a more sober assessment by another outsider to the movement: “Law and economics represents the one example of a social science that has successfully found a place at the core of the legal arguments made in courts, administrative agencies, and other legal settings.” Bryant G. Garth, *Strategic Research in Law and Society*, 18 *Fla. St. U. L. Rev.* 57, 59 (1990). On the continued growth of economic analysis of law, see William M. Landes & Richard A. Posner, *The Influence of Economics on Law: A Quantitative Study*, 36 *J. Law & Econ.* 385 (1993). The number of changes (especially additions) in this eighth edition attests to the growth in the scholarly literature in just the last four years. Of course, there are still plenty of skeptics. See, e.g., Ugo Mattei, *The Rise and Fall of Law and Economics: An Essay for Judge Guido Calabresi*, 64 *Md. L. Rev.* 220 (2005).

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