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LAW AND ECONOMICS IN AUSTRALIA

ANTHONY DUGGAN[*]

The difficulty of talking compendiously about law and economics should not be underestimated. I have witnessed various attempts in the past, and they have usually failed. The presenter tends to make one of two mistakes. The first is to concentrate on the concepts without giving examples of their application. The second is to concentrate on applications without adequately explaining the concepts. When a mistake of the first kind is made, eyes very rapidly glaze over as the audience tunes out. A mistake of the second kind tends to the opposite outcome: hackles rise because an inadequate account of the underlying theory makes the applications appear unprincipled. Judge Easterbrook's paper avoids both of these pitfalls. It is a readily digestible blend of pure and applied theory. [1]

In the course of his paper, Judge Easterbrook referred to numerous areas about which economics has something to say. These include patent law, criminal law and sentencing, rent control, the regulatory and legislative processes, environmental law, restrictive trade practices, takeover regulation and choice of law. The range of these illustrations lends support to the proposition implicit in the title of his paper, namely that law and economics is inevitable. It is inevitable in the sense of being pervasive. Its applications are diverse and wide-ranging. It is inevitable also in the sense of being persuasive. It gives rigour to legal analysis, and forces account to be taken of possibilities that might not otherwise have entered into the equation at all.

Judge Easterbrook mentioned towards the end of his comments that economists are imperialists. That point goes to the pervasiveness of economic analysis. Economic analysis is pervasive in its application to law, and in other applications as well. There have been economic studies done of almost every field of human activity imaginable, from prostitution to brushing teeth. There was even a microeconomic study a few years ago on vampire control. It appeared in the *Journal of Political Economy* in 1982 under the title, Microeconomic Policy and the Optimal Destruction of Vampires. [2] It is a wonderful endeavour, replete with graphs and mathematical modelling. It addresses the issue of vampires' utility from blood intake and how this is optimised. It also talks about vampires' inter-temporal consumption problems, and queries the assumption of the Invisible Fang, namely that vampires in pursuing their own interests pursue those of human beings as well. Optimal destruction of vampires is discussed, the conclusion being reached that it is socially undesirable to drive the species to extinction. The study ends by suggesting an area for further research, namely, the formulation of optimal microeconomic policy when vampires have rational expectations.

Given the inevitability of law and economics, it is surprising that economic analysis has not made the same impact in Australia and New Zealand as it has elsewhere in the common law world (most notably, the United States, Canada and Britain). For the purposes of today's proceedings I conducted a short and very unscientific survey relating to

interest in law and economics in AULSA's affiliated institutions. There were replies from 16 institutions. From the responses it appears that law and economics is taught as a separate undergraduate subject in six institutions (four in Australia and two in New Zealand) and as a postgraduate subject in three. Of the seven institutions where law and economics is not taught separately at all, most claim to offer one or more subjects taught wholly or partly from an economic perspective. However, the subject most frequently mentioned in this connection was trade practices law, which is not entirely apposite since trade practices is explicitly about economics anyway. Teaching trade practices without reference to economics would be like teaching torts without reference to damages. There is no law and economics interest group that I am aware of, nor is there any established workshop programme as there are at various law schools in the United States and in Canada.

Very little research and writing is done in Australia and New Zealand from an economic perspective. This is true even of trade practices, where the focus tends to be on competition policy rather than on the wider efficiency consequences of prohibiting particular practices. From my survey, it appears that there are at least six institutions (possibly more) where there is no-one claiming a substantial research interest in the law and economics field. This is particularly surprising, given the demonstrated predisposition of economists in recent times to say and write uncomplimentary things about law reform proposals emanating from lawyer-dominated law reform agencies. One would think there might be rather more interest in responding to these challenges than appears to be the case. It may be instructive to ask why.

Ideology, I think, has a lot to do with it. There is a quite widespread perception that law and economics is biased to the right, and people tend to be suspicious of it for that reason. To a large extent, I think, the allegations of bias are misplaced. They often reflect a misunderstanding of the economic approach. Judge Easterbrook touched on some of the sources of misunderstanding in his paper: in particular, the difficulty non-economists have coming to grips with ex ante analysis, and with the concept of marginal effects. Additionally, economic analysis provokes mistrust because it attacks shibboleths. Most of us were schooled in the tradition that standard form contracts necessarily entail inequality of bargaining power. Any suggestion that this might not be so is likely to be quite unsettling. The easy course is to reject it out of hand. Arthur Leff who is, incidentally, no friend of law and economics, made the point very colourfully 14 years ago in a scintillating review [3] he wrote of the first edition of Posner's *Economic Analysis of Law*. [4] The passage is an appropriate note to end on:

> It is a most common experience in law schools to have someone say, of some action or state of events, "how awful," with the clear implication that reversing it will de-awfulise the world to the full extent of the initial awfulness. But the true situation, of course, is that eliminating the "bad" state of affairs will not lead to the opposite of that bad state but to a third state, neither the bad one nor its opposite. That is, before agreeing with any "how awful" critic, one must always ask him the really nasty question, "compared to what?" Moreover, it should be, but often is not, apparent to everyone that the process of moving the world from one state to another is itself costly. If one were not doing that with those resources (money, energy, attention), one could be doing something else perhaps righting a few different wrongs, a separate pile of "how ghastly's."

One can illustrate this basic kind of economic analysis by working with quite simple fact situations. There is this old widow, see, with six children. It is December and the weather is rotten. She defaults on the mortgage on her (and her babies') family home. The mortgagee twirling his black moustache, takes the requisite legal steps to foreclose the mortgage and throw them all out into the cold. She pleads her total poverty to the judge. Rising behind the bench, the judge points her and her brood out into the swirling blizzard. "Go," he says. "Your plight moves me not." "How awful," you say?

"Nonsense," says the economic analyst. "If the old lady and the kids slip out into the storm, they most likely won't die. There are people a large part of whose satisfactions come from relieving the distress of others, who have, that

is, high utilities for beneficence and gratitude. So the costs to the widow, are unlikely to be infinite. Moreover, look at the other side of the (you should pardon the expression) coin. What would happen if the judge let the old lady stay on just because she was out of money? First of all lenders would in the future be loathe to lend to old widows with children. I don't say that they wouldn't lend at all, they'd just be more careful about marginal cases, and raise the price of credit for the less marginal cases. The aggregate cost to the class of old ladies with homesteads would most likely rise much more than the cost imposed on this particular widow. That is, the aggregate value of all their homes (also known as their wealth) would fall, and they'd all be worse off.

More than that, look at what such a decision would do to the motivation of old widows. Knowing that their failure to pay their debts would not be visited with swift retribution, they would have less incentive to prevent defaults. They might start giving an occasional piece of chicken to the kids, or even work up to a fragment of beef from time to time. Profligacy like that would lead to even less credit-worthiness as their default rates climbed. More and more of them would be priced out of the money market until no widow could ever *decide* for herself to mortgage her house to get the capital necessary to start a seamstress business to pull herself (and her infants) out of poverty. What do you mean "awful"? What have you got against widows and orphans?" [5]

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[*] Faculty of Law, University of Melbourne.

[1] See FH Easterbrook, The Inevitability of Law and Economics [1989] LegEdRev 2; (1989) 1 *Legal Educ Rev* 3.

[2] DJ Snower, Microeconomic Policy and the Optimal Destruction of Vampires (1982) 90 *J Pol Econ* 647.

[3] AA Leff, Economic Analysis of Law: Some Realism About Nominalism (1974) 60 *Va L Rev* 451.

[4] R Posner, *Economic* Analysis *of Law* (Boston: Little Brown, 1972).

[5] Leff, *supra* note 3 at 460-461.
