Exam for Law and Economics

Answer BOTH questions

Question 1

(a) Consider a piece of property that is jointly owned by two individuals, each with one half share. Suppose that, in order to sell, owner 1 requires $3,000 for his half share, but owner 2 requires $6,000 for her half share. A buyer arrives and offers $10,000 for the entire property.

(i) If the two owners can bargain with each other costlessly, do you expect a sale to occur (assuming both owners have to give their consent)?

(ii) Suppose instead that the two owners cannot bargain with each other (for example, they are a divorcing couple). If each is entitled to one half of the proceeds, do you expect a sale to occur in this case?

(iii) Describe the trade-off involved in a rule that allows either one of the parties to “force” a sale of jointly owned property when they cannot come to an agreement.

(b) A parcel of land in a commercial district is worth $500,000, but the city unexpectedly announces plans to rezone the land for residential use, in which case its value is $300,000. The owner sells the property after the announcement but before the rezoning occurs. How much would a buyer pay if she expects to prevail in a claim for compensation with probability 0.5? What is the resulting loss to the seller from the zoning change?

Question 2

For each of the following examples determine whether, on efficiency grounds, the contract should be performed or breached. If you recommend the former, explain in one or two sentences why. If you recommend the latter, identify the contract doctrine that would excuse promise breaking.

a) Roger, whom is 14 and an avid collector of baseball cards, agrees to sell a particular card to a dealer for $500, when in the fact the market value of the card is at least $1,000. Roger's parents attempt to block the sale of the card.

b) The Finance department at Adams College agreed to hire Joey Fudderman to teach introductory finance courses. In his application Joey indicated that he would have his Ph.D. completed by the time the school year started, a requirement for the teaching position. Upon his arrival on campus, the Finance department learns Joey has not yet received his Ph.D. due to data problems that prevented him from completing his dissertation, and declares the contract void.

c) Franky offers to sell Johnny a pleasure boat they have used together on many occasions. After taking delivery of the boat, Johnny discovers that the motor is unreliable and fails to start from time to time. Arguing that he was unaware of the problem when the sale took place, Johnny demands damages. Franky responds that he assumed Johnny was aware of the problem given their previous trips together and that, therefore, no damages are warranted.

Question 3

(a) Suppose that a drug dealer can earn $1000 from selling drugs illegally and that the probability of apprehension is 0.25.

(i) Show that a penalty requiring drug dealers to surrender their profits in the event of conviction
will fail to deter them.

(ii) What is the lowest fine that will just deter the drug dealer?

(b) Suppose that optimal deterrence of a particular crime requires setting the expected punishment equal to $2000. Assume that the probability of apprehension is fixed at 0.2.

(i) Suppose an offender has wealth of $5000 and incurs a cost of $1000 per month spent in prison. What combination of a fine and prison term achieves optimal deterrence at the lowest cost?

(ii) What combination of a fine and prison term is optimal for an offender with wealth of $7000? (Assume he incurs the same monthly cost of imprisonment.)

(iii) Suppose considerations of fairness dictate that the prison term of offenders who commit the same crime must be the same. What fine and prison term must be imposed on the two offenders to maintain optimal deterrence? Explain the sense in which this policy reflects a trade-off between fairness and efficiency.