

Report - Chapter 1 and 9

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Chapter 1. THE POWER OF INCENTIVE

- How Seat Belts Kill

In every happenings and incidents around us, there should be causes and effects. Most of the economists agree to this, saying, " People respond to incentive ". According to a dictionary, the incentive means a kind of motif that encourages people to do something. Now we can see how the incentive works and how much it is powerful with many given facts and experiences.

In around 1965, the U.S. federal government issued automobile safety legislation, responding to the opinion that various design elements in cars are more dangerous than necessary. So the automobile safety legislation required the use of seat belts, padded dashboards, collapsible steering columns, dual braking system and penetration - resistant windshields to prevent car accidents. However, the result was the increase in the number of accidents. The reason is the threat of being killed in a car accident is a powerful incentive to drive carefully. And because people respond to incentive, less threat with seat belt and padded dashboard in this issue, drivers are less careful and the number of accident is increased. When we look into this issue closely, there's interesting phenomenon. After the legislation entered into force, there were more accidents by encouraging driver's reckless behavior and fewer death per accident by making it easier for people to survive an accident. So the effect of the auto safety legislation is the total number of driver deaths remained unchanged. On the other hand, pedestrians are the only victims from the legislation because the number of pedestrian deaths has been increased. This can be said as another side effect of the incentive, automobile safety legislation.

Another car-related incentive is Baby on Board signs. This signs are designed to let other drivers know that there is a baby in car and they should exercise more care, Economics suggests drivers are more careful in the presence of the sign. But there can be another effect. The parents who put the signs know the sign elicits caution from others and they can afford to be less vigilant themselves. This leads to more accidents. These two different expected effects can be solved by many research projects.

The third example to account for the economic term, incentive, is a better birth control technique which was originally invented to reduce the number of unwanted pregnancies. The result of the number of unwanted pregnancy can go up or down. The intervention of better birth control technique has an effect to reduce the "cost" of sexual intercourse and so the number of sexual encounter that lead to pregnancy per sexual encounter goes down. Same "price" logic applies to Low-tar cigarette, which could lead to higher risk of lung cancer and also applied to Low-calorie synthetic fats, which could increase the average weight of people.

The notion that people respond to incentive works in law, especially in criminal law. Many people have studied the different effect of the death penalty. And most econometric researches reveal a substantial deterrent effect of capital punishment. According to professor Issac Ehrlich of University of Buffalo, each execution in America during 1960s prevented about 8 murders. This shows murders also respond to incentive.

Finally, people respond to incentive even in situations where we do not think their behavior is rational. For instance, people tend to hold a hot cup of coffee rather than drop it if they think the cup is expensive. In here, the value of the cup plays role of incentive. This experimental situation shows that the respond to incentives may be as innate as any other instinctive behavior.

Incentives, a cause or motif, which make something to happen, play a pivotal role in every situation. It is closely related to a cost or risk of doing something in the perspective of economics. For example, a typical incentive in Economy is the interest rate. The increase of interest rates could trigger people to save more money and so the business sector can easily borrow money from banks to invest. Like this and as we can see above there are incentives and subsequent effects in every events and incentives always matter in every fields of society. Therefore, what kind of incentive can induce and establish the results what we truly want to be happen and how much precisely we can predict what kind of results and

effects will be made by an incentive will be a benchmark of success. And this can be applied to cultural, social, political, and legal as well as economical projects.

Chapter 9. OF MEDICINE AND CANDY, TRAIN AND SPARKS - Economics in the Courtroom

In chapter 9, the topic is Coase Theorem, an economical term in the perspective of law. The Coase theorem was first made by Coase Ronald, British-born American Economist, who was awarded the Nobel prize in Economic Science, 1991. Coase did pioneering work on the ways in which transaction costs and property right affects business and society. In his famous paper, "The problem of social cost"(1960), he challenged the classic logic of prohibiting behavior that damages others. His work was a call to legal scholars to pay attention to the importance of an efficient marketplace and to negotiation rather than litigation. The Royal Swedish Academy of Science cited Coase for this research and also for "pioneering the study of how property rights are distributed among individual by law, contract, and regulations, showing that this decisions are made and whether they will succeed. Ronald's Coase theorem is that if there are zero transaction costs, the efficient outcome will occur regardless of legal entitlement. If the property owners can deal costlessly, it does not matter from an efficiency standpoint who has the legal "right". Here the transaction cost includes the time and trouble of finding out who their neighbors are, getting together with them to discuss the spark problem, agreeing on a negotiation strategy and getting together to strike a bargain. But, the real world, transaction costs are never zero, and frequently too great to allow a cooperate solution

And now we can see how this coase theorem applies to legal cases and how it is different from the traditional perspective with some examples. The first example is the conflict between the railroads and farmers, in which railroads sometimes run tracks through farmland and the trains throw off sparks, which occasionally ignite the surrounding crops. Farmers suffer damage, for which they demand compensation from the railroad. This case is either expensive or impossible to apply Coase theorem because the number of parties is very large. Prior to 1961, in the perspective of economists, the railroad hold liability because the railroad creates sparks and the sparks create damage. And they argued the railroad should take account of that damage when it decided to run a train. However, Coase pronounces this argument wrong. He insists what creates damages is the simultaneous presence of sparks and crops in the same place. That is, both of the sparks and the crops create damage. So if either sparks or crops are removed, the problem can be settled. But let's try to solve this with Coase theorem under the preconditions that the court wants to encourage allocations of the resources, which are economically efficient. Suppose that the train brings \$100 worth profit and whose sparks interact with crops to create a \$200 loss and the farmer can remove to different location or install firebreak for a cost of \$10. When the court sentences the railroad is liable, the farmers will be fully reimbursed for damage and the owner of the railroad lost \$100. But of the railroad were not liable, the farmers have no choice but to spend \$10 in installing firebreak to protect their crops. In this case, the economically efficient outcome is \$10 loss of the farmers instead \$100 loss of the railroad. (The railroad is not liable) By reversing the number, the efficient outcome is achieved if the railroad is liable. Like this case, when the circumstances prevent negotiation, entitlements from the courts come to be important. Then what is the court to do to maximize coase theorem if the goal is economical efficiency? The first one is the court should lead the parties to negotiation. Subsequent negotiation will lead to efficient allocation of resource which is independent of what it rule. Second one is not to decide a case by deciding who is at fault. The party who can prevent the damage more cheaply made the cost of damage. And so such decision makes efficient decision in negotiation difficult.

Second example for Coase theorem is the case of the coal miners and the owner of the mine. Coal miners suffer a lot of work-related diseases. And the number of injuries can be reduced if owner install safety equipment. According to the Coase theorem, the decision whether to install equipment is independent of whether owner is liable for the injuries. Because no matter what the owner is required to pay the medicine cost or not, he will install the equipment by negotiation outside the court. In this case, therefore, the judge can not go wrong whatever he rules. Another way to prevent accident is to force the

miners behave more cautiously. To do that, the owner can raise the wages of miner in return for their cautious behavior. But this way has a problem. The unenforceability of the contract and the unobservability of the miners' behavior render the Coase theorem false. And what the judge know for sure is if the miners hold their own medical costs, they'll voluntarily cautious and will pay the owner to install safety equipment, So what the judge can do in this situation is to assign liability in such a way to maximize the opportunities for negotiation after trial. Because the participants in this case know the most efficient solution, costs and consequences of their actions.

Coase theorem applied in courts brings a new way of balancing issues to us. The condition for Coase theorem in court can be summarized as followings: First, property rights are clearly defined. That is, there should be a marketplace. Second, both parties will gain from a transaction. Third one is transaction costs are low. This makes posttrial negotiation possible. But the problems of Coase theorem are still found. First one is that transaction costs are not usually zero in real world. And an externality price cannot be established by the victim, since it is superfluous to the decision making. Lastly, applying a 2-party case may not apply to the more general case, since the former does not consider exit and entry (affects the number of victims and generators.)

* Evaluation Paper

Before I signed on this class, I was a little bit balking at because the professor decided to do the same topic with the one of last term, Weber's definition of rights and I like the liberal atmosphere of the class. (There are many researches, presentation and discussions, a lot of things to prepare, though) However, when the class starts, new issues based on the same topic prop up and it was new opportunities for me to see the same thing from a different view. And there was a very interesting case, the speluncean case. Actually, it was difficult for me to read and understand the whole articles and information while preparing the examination for graduate school at that time. After finishing the report, I feel a kind of satisfaction and I was so into it. However, it is shame that we can not discuss about the case with classmates. Many classmates didn't show up in classes and some of them did not appear for several weeks. So the discussion and presentation scheduled to be made did not work well. And it is also shame that the professor's late for classes. Considering teacher's job as a lawyer, it is understandable that he is busy. However, it was almost impossible to proceed with the class without a teacher. So we lost many valuable classes.

For me, this class, Constitutional, was helpful to reconfirm the fact and recognize different opinions on the Weber's definition of rights. The assignment of the speluncean case was also a good opportunity for me to come close to the law although it was a burden at the time when I prepare a report and exams. And as I also feel content in the last term, it was also good chance to meet and familiar with new people, juniors and seniors.