Jolls, Christine

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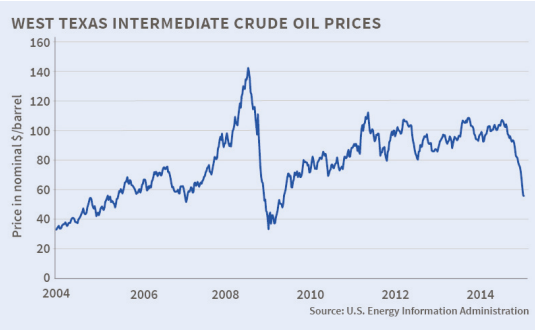

Program Report

Law and Economics

Christine Jolls*

The NBER's Law and Economics Program studies the effects and causes of legal rules in the foundational legal subjects — property law, criminal law, contract law, and tort law — and in additional legal subjects such as the protection of consumers, workplace regulation, and corporate law and governance. The program also studies legal processes within courts, legislatures, and agencies.

Program members meet twice annually, once at a mid-year program meeting and again at the NBER Summer Institute. Recent Summer Institute workshops have included joint sessions with the NBER's Economics of Crime Working Group on several occasions.

This article first describes recent research in the foundational legal subjects and then examines work on the operation of the legal process and on the effects and causes of legal rules in the areas of consumer protection, workplace regulation, and corporate law and governance.

Property Law, Criminal Law, Contract Law, and Tort Law

Prominent early work in law and economics involved theoretical modeling of tort law issues; much recent work has engaged in empirical testing of such models. A recent study by Daniel Carvell, Janet Currie, and W. Bentley MacLeod, for instance, offers both theoretical and empirical exploration of the effects of limiting joint and several liability in tort.[1] The authors' empirical findings suggest that limiting liability increases precautionary behavior by defendants who would be likely to escape liability in the absence of the limits.

Criminal law has also been an active area of empirical research in recent years. Giovanni Mastrobuoni, for example, studies the effect on policing of software-based predictions of future offender behavior.[2]

* *Jolls directs the NBER's Law and Economics Program and is a professor at Yale Law School.*

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Exploiting variation in otherwise comparable Italian police forces' use of such future-crime predictive models, his evidence suggests that predictive policing significantly increases robbery clearance rates.

Research by Jennifer Doleac examines a different crime-fighting tool — DNA databases.[3] Doleac's empirical findings support the conclusion that these databases, which have now been adopted in every state, produce significant increases in the probability of catching offenders. Accordingly, crime rates, particularly in categories in which forensic evidence is likely to be collected at the scene, such as murder, rape, assault, and vehicle theft, decline with the adoption of DNA databases.

Noteworthy in criminal law enforcement has been New York City's "stop and frisk" policy, which is the subject of recent work by Decio Coviello and Nicola Persico.[4] Examining the racial dimensions of the program, the authors find that whites are slightly less likely than African-Americans to be arrested following a stop. This finding, the authors suggest, provides some evidence that unsupported or unwarranted stops are not predominantly visited upon African-Americans.

Turning to contract law, a central area of law and economics inquiry is contractual ambiguity or incompleteness. The optimal legal response to such ambiguity or incompleteness may naturally depend on its cause, and much recent work seeks to explore potential causes. Patrick Bolton and Antoine Faure-Grimaud, for instance, develop a model that grounds contractual incompleteness in the time costs of deliberation among parties.[5] The authors proceed to explore a range of implications of their characterization. In other recent work, Oliver Hart and John Moore, as well as Hart and Maija Halonen-Akatwijuka, link contractual incompleteness to the potential costs of reference points that these authors associate with contractual specificity.[6] The addition of a contractual term governing a specific issue may have costly effects on reference points for other issues.

Within property law, the legal classifications within which real property (land) is transacted are shown to be strikingly consequential in work by Gary Libecap and Dean

Lueck.[7] Exploiting the adjacency of two dominant land-demarcation systems — in Ohio's Virginia Military District, a decentralized system based on the unique features of land, and in adjoining areas of Ohio, a system dividing land into uniform rectangles — Libecap and Lueck find evidence of significant net benefits from the latter system.

The Operation of the Legal Process

A fundamental structural feature of the legal process is the burden of proof in both court-based adjudication and government agency decision-making. Recent research by Louis Kaplow provides a model of the understudied policy instrument of the optimal burden of proof.[8] Kaplow's analysis identifies how the optimum trades off deterrence and the chilling of desirable behavior. Extensions suggest the importance of numerous factors in determining optimality of the burden of proof.

As is well understood, many lawsuits are resolved via settlement prior to court adjudication. High-low agreements, the subject of recent work by J.J. Prescott, Kathryn Spier, and Albert Yoon, present a fascinating hybrid of court adjudication and out-of-court settlements, as litigants agree on upper and lower amounts that bound the recovery the plaintiff may obtain at trial.[9] Such agreements are a form of partial settlement that Prescott, Spier, and Yoon's model shows can limit the risk of outlier awards that might otherwise occur when litigants are divergently optimistic about their trial prospects.

A recent paper by Andrew Daughety and Jennifer Reinganum also addresses agreements outside of court.[10] In these authors' model of lawsuit joinder and settlement, the equilibrium shows a "bandwagon" effect in which lawsuits by early-filing plaintiffs generate additional filings by others. Settlement may exacerbate this effect.

Turning to behavior within the courtroom, recent work by Moses Shayo and Asaf Zussman examines preferential judicial treatment of a judge's in-group in Israeli small claims court.[11] Exploiting random assignment of small claims cases to Arab or Jewish judges, Shayo and Zussman's evidence suggests that judges prefer members of their own group; in addition, favoritism increases with recent terrorism intensity in the vicinity of the court.

Recent work by Shamena Anwar, Patrick Bayer, and Randi Hjalmarsson explores the role of juror age in felony trials in the United States.[12] The authors utilize random variation in the age composition of the pool of eligible citizens called for jury duty to identify substantial effects of juror age on the likelihood of ultimate felony conviction.

Consumer Protection, Workplace Regulation, and Corporate Law and Governance

An extremely active area of law and economics research in the years since the financial crisis has been consumer financial protection. Recent work by Sumit Agarwal, Souphala Chomsisengphet, Neale Mahoney, and Johannes Stroebel, for instance, utilizes a differences-in-differences approach in analyzing a panel data set covering over 160 million credit card accounts before and after the 2009 Credit Card Accountability Responsibility and Disclosure (CARD) Act.[13] The authors find that the CARD Act's limits on credit card fees significantly reduced overall borrowing costs to consumers. Fee limits did not appear to be offset by an increase in interest charges or a reduction in the volume of credit.

Credit card, mobile phone, and other fees are the subject of a recent contracting model by Paul Heidhues and Botond Koszegi.[14] In a setting in which there are two types of consumers, naïve and sophisticated, and the naïve consumers ignore fees, firms with information about consumers' degree of naivete will tend to increase the distortionary exploitation of consumers believed to be naïve. The authors study the conditions under which a legal limitation on seller information about the degree of consumer naivete may increase consumer welfare.

Consumer protection law requires calibration to minimize concerns of moral hazard, a problem addressed in recent work by Christopher Mayer, Edward Morrison, Tomasz Piskorski, and Arpit Gupta.[15] The authors compare rates of mortgage delinquency before and after a legal settlement requiring that mortgage modifications be offered to seriously delinquent borrowers. A differences-in-differences analysis of mortgages that were covered by the settlement compared to those not covered suggests that borrowers with covered mortgages are significantly more likely to become delinquent after the settlement — when delinquency opens the door to mortgage modification — than before.

Recent law and economics work has also examined consumer markets from the perspective of racial and ethnic discrimination. Ian Ayres, Mahzarin Banaji, and I utilize a field experiment on an online auction site with photographs showing a baseball card for sale held in either an African-American or a white hand.[16] The online auction environment means that features of the transaction other than the color of the hand are, by construction, identical across transactions. Transactions with an African-American hand turned out to yield significantly lower seller revenue than transactions with a white hand.

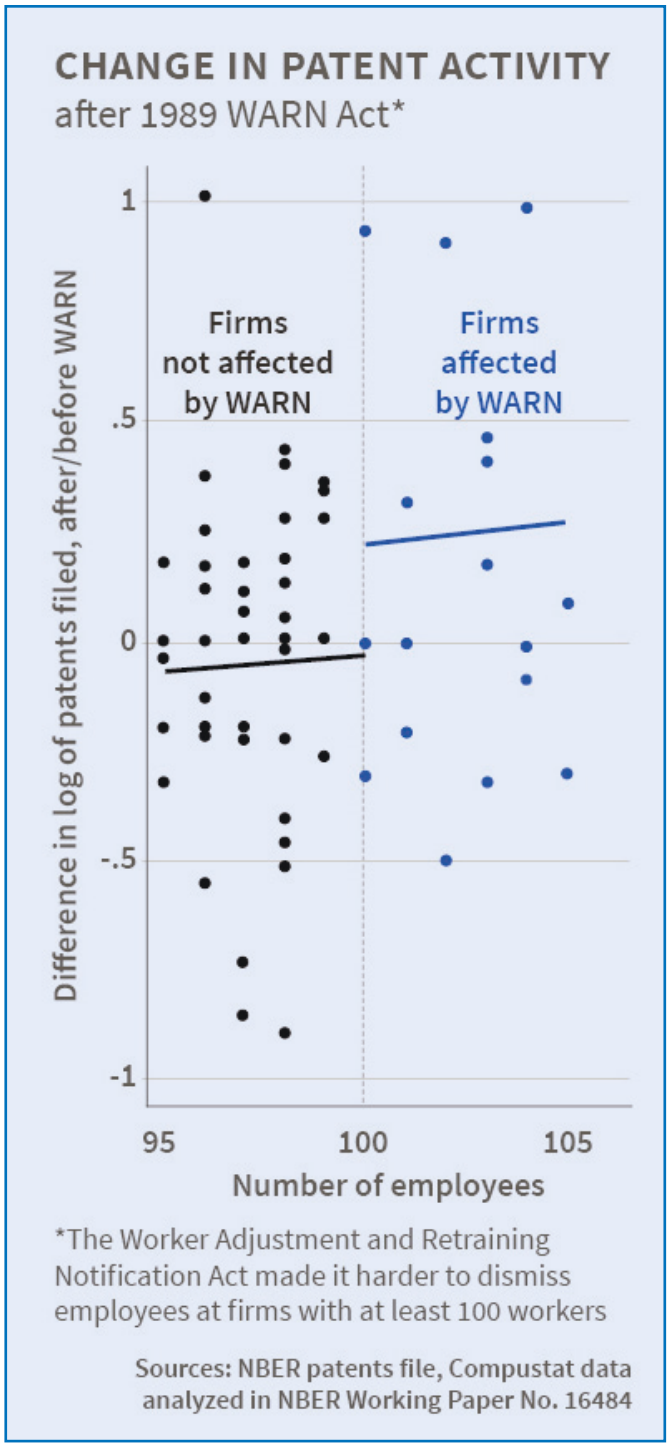
Similar findings of differential treatment on the basis of a group trait appear in recent work by Raymond Fisman, Daniel Paravisini, and Vikrant Vig.[17] The authors find that Indian bank officers, who are exogenously assigned to loan applicants, give preferential treatment to ethnically similar

applicants. Officer-borrower cultural proximity also increases repayment performance, suggesting that the differential treatment of applicants, and the differential performance of borrowers, may be due to information that bank officers have about borrowers who are similar to them.

Consumers facing severe financial hardship may wish to declare bankruptcy, but the legal and administrative fees associated with the bankruptcy process may delay or prevent such filing. Recent work by Tal Gross, Matthew Notowidigdo, and Jialan Wang utilizes the randomized timing of tax rebate checks to assess the potential effect of liquidity constraints on bankruptcy filing.[18] Consistent with the liquidity constraint hypothesis, rebate receipt causes a significant short-run increase in the number of bankruptcy filings.

Analysis of workplace and labor market regulation — particularly in the form of legal limits on discharge — has long been an important focus of law and economics research. A recent addition to this body of work is a study by Viral Acharya, Ramin Baghai, and Krishnamurthy Subramanian on discharge laws and employees' innovative activity.[19] The authors exploit country-level changes in discharge laws, together with industry-level variation in the importance of innovative activity, to explore the relationship between employees' innovative efforts and discharge prohibitions that commit employers not to punish short-run failures. The authors' empirical findings provide some suggestion that tighter restrictions on discharge may help to foster innovation.

Discharge laws' benefit in constraining potential employer opportunism is also at the center of a recent study of causes of discharge limits. Alberto Alesina, Yann Algan, Pierre Cahuc, and Paola Giuliano examine the role of employees' geographic mobility in reducing their vulnerability to hold-up and observe that the value of discharge laws is highest when employees are less geographically mobile.[20] Thus, discharge laws will tend to be most valuable in cultures with strong family ties that make moving away from home costly. The authors' empirical findings suggest a positive relationship between labor market structures at the beginning of the 21st century and family values prevailing prior to World War II.



Corporate law and governance is another longstanding focus of law and economics research. The 2008 Law and Economics Program Report described the activities of the program's Corporate Law and Investor Protection Working Group, directed by research associate Lucian Bebchuk. The working group's activities culminated in the publication of a series of articles on corporate law and governance in a special issue of the *Review of Financial Studies*.

Since that time, research in corporate law and governance has continued to feature regularly in program meetings and at the Summer Institute. Most recently, Kelly Shue and Richard Townsend offered empirical analysis of the evolution of top corporate executives' incentive contracts over recent decades.[21] Shue and Townsend's analysis focuses on the importance of option rigidities that caused compensation to rise dramatically with high equity returns; they also address recent regulatory changes requiring disclosure of the value of option grants.

At a program meeting in 2009, Lucian Bebchuk co-organized a special session devoted to corporate law

and governance. There, Kose John and Dalida Kadyrzhanova presented research on the relationship between firms' risky investments in innovation and the degree of divergence between shareholders' interests and those of relatively undiversified top executives.[22] Firm-specific risk appears to be an understudied but important source of agency costs within firms.

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