Law & Economics of Contract Law

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Contracts

- Bilateral transactions – Exchange between two parties.

- Voluntary exchange – Bargain Theory- Exchange to be result of free bargain.

- Value maximizing exchange – Efficient reallocation of resources Resources move from less valuable use to more valuable use.

- Deferred exchanges –

  - Danger of opportunism and uncertainty – Reduce economic activity.

  - Contracts and protection of contract rights by law – encourage economic activity
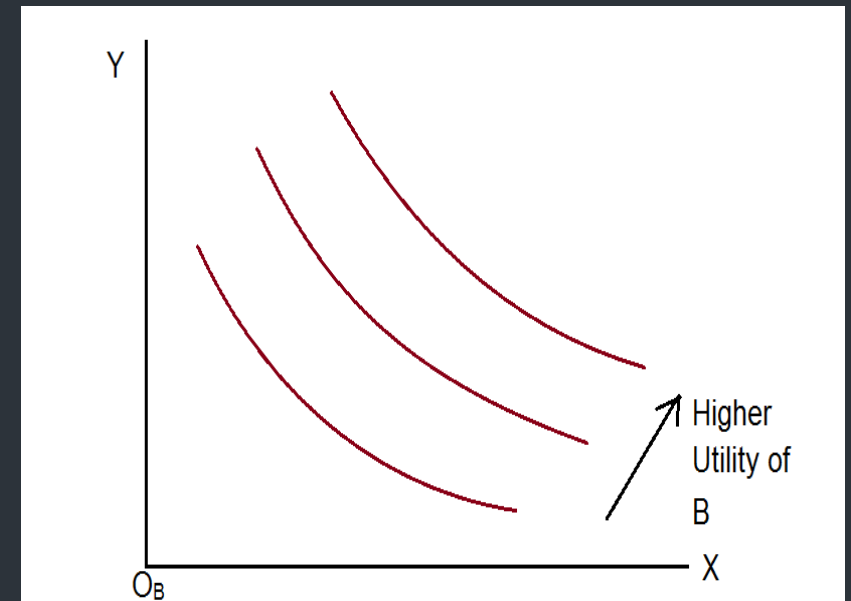
Edgeworth Box

Exchange Analysis – For Static exchange
Exchange between two persons and two goods

Indifference Curve for A
Two goods- X and Y
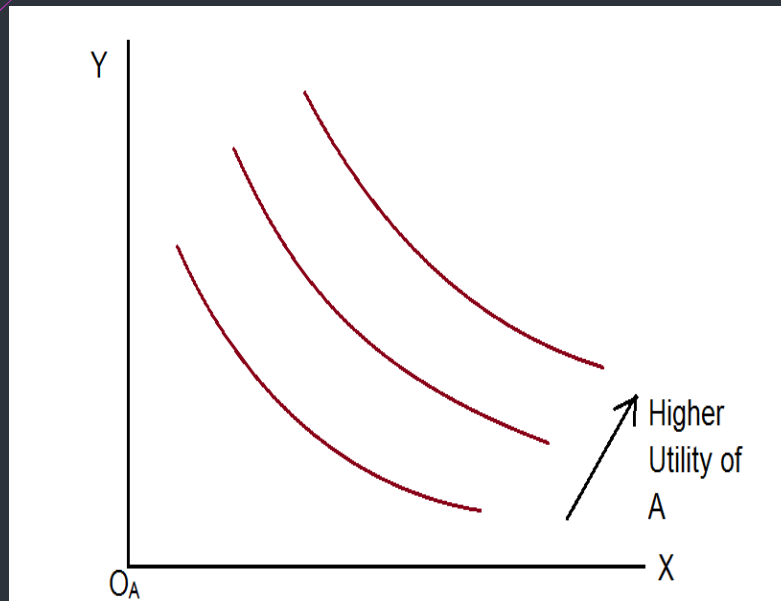
Indifference Curve for B
Two goods – X and Y

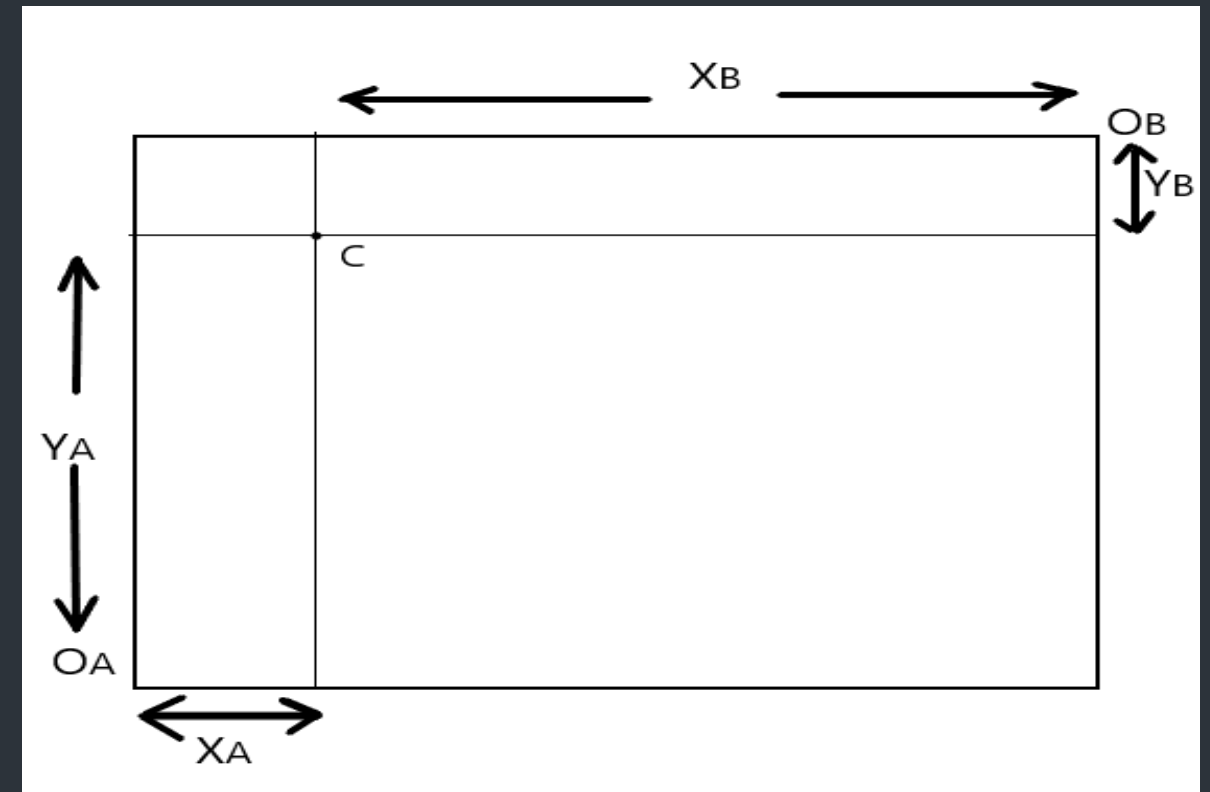# Edgeworth Box- Initial Endowment Allocation

Two individuals – A and B

Two goods – X and Y

Initial Endowment of A (X_A Y_A)

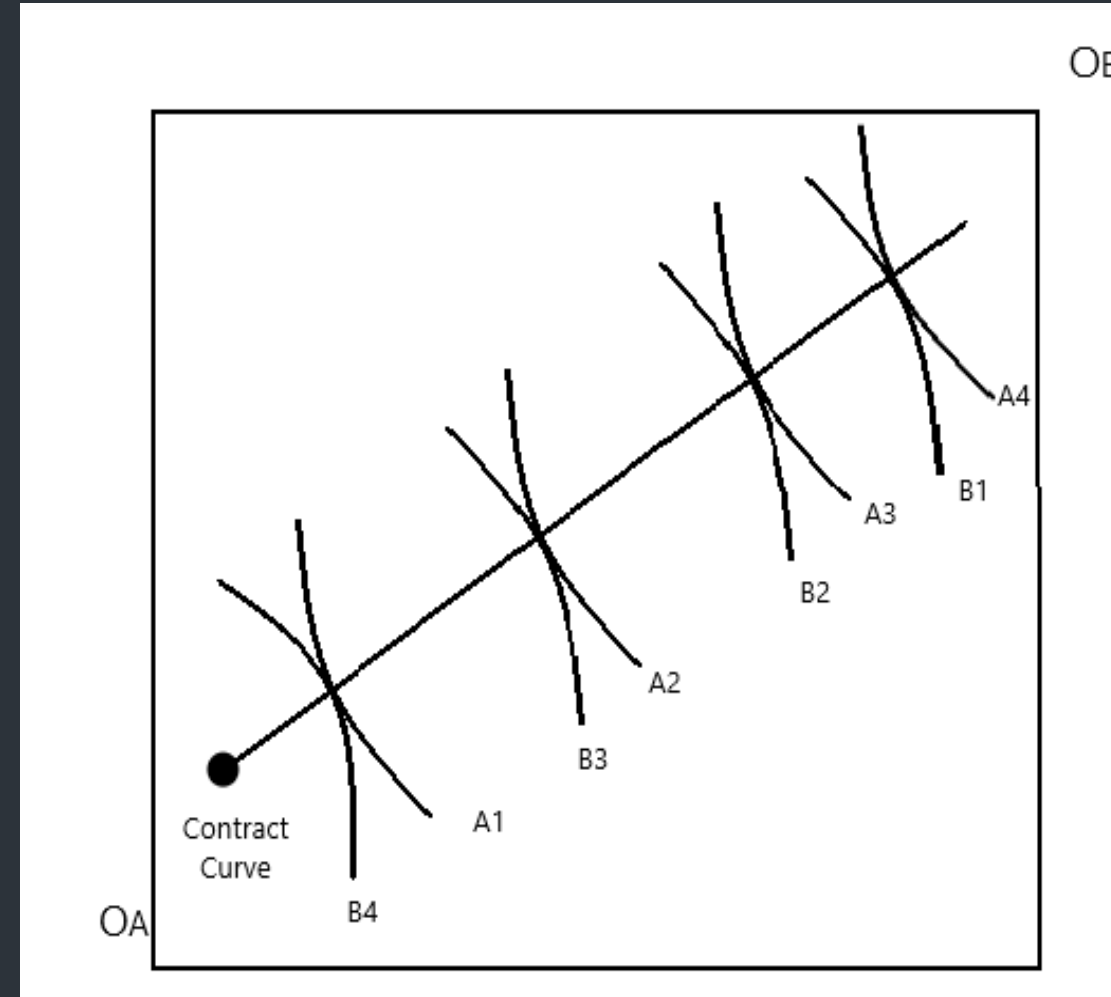Initial Endowment of B (X_B Y_B)

Total quantity of X bar is X   = X_A + X_B

Total quantity of Y bar is Y   = Y_A + Y_B

# Edgeworth Box (Contract Curve)

- Curve Consisting of tangency of the indifference curves for A & B

- All the points on the curve are Equilibrium positions that A and B can reach through exchange

- Any point on contract curve is pareto optimal

Edgeworth Box

- Graphical representation of contractual exchange

- Contract curve – S T – Slopes for both indifference curves are equal.
  Marginal Rate of Substitution (MRS) of A and B are equal

- Contract lens – Any point within the lens C S D T will be pareto superior to both
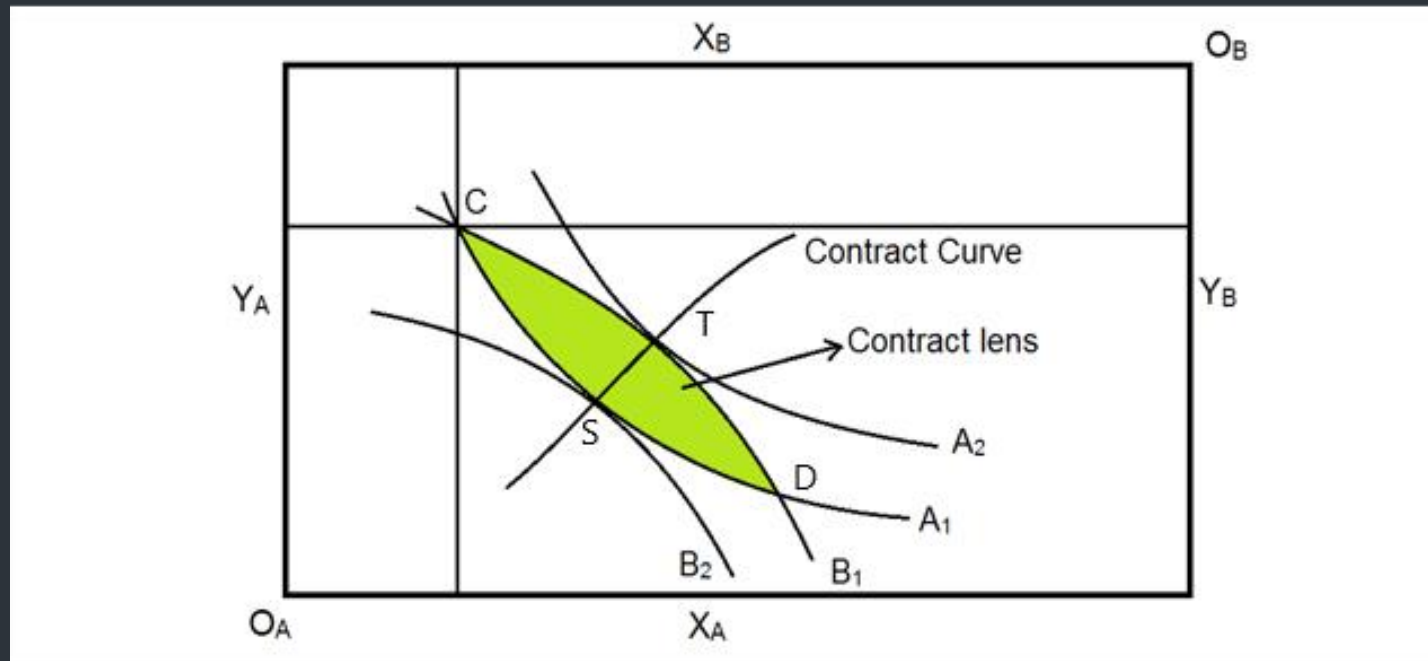
Efficiency

➡ Efficiency aims at increasing utility of wealth i.e. Wealth Maximisation

➡ Types of efficiency

    ➡ Productive efficiency

    ➡ Allocative efficiency

    ➡ Dynamic efficiency

    ➡ Distributive efficiency

Pareto Efficiency

➡ Pareto Superior

relocation when at least one party is better of and no one is worse off

➡ Pareto Inferior

at least one party is worse off

Pareto efficiency

➡ Pareto Optimal

  ➡ resources are allocated in such a way that they can not be reallocated without at least on party feeling worse off

  ➡ Any moment from an allocation would make at least one person worse off

  ➡ Pareto standards involve absolute respect for   autonomy of individual

  ➡ Involve unanimous consent

  ➡ Not for involuntary distributions

Kaldor Hicks Efficiency

➡ Those individuals who are made better off by policy or reallocation would have to be made sufficiently better off that they could compensate those who are made worse off

➡ The compensation is potential, not actual

➡ Responds to weaknesses of pareto by permitting involuntary transfer

➡ Kaldor criterion – winner compensates loser

➡ Hicks criterion – loser compensates/ bribes winner

Contract Formation

Promisor   Promisee

Proposal/ Offer   Acceptance } Promise

                                              +

                                           Consideration

                                              =

                                           Agreement

                                              +

                                           Legal enforceability

                                              =

                                           Contract

Legal Enforceability

➢free consent

➢lawful consideration

➢ lawful object

➢Capacity to contract

Capacity To Contract

➢ Age of majority – 18 years

➢ Sound mind

➢ Not otherwise disqualified – e.g. insolvent

Free consent

➢ Consent – agree upon same thing in same sense

Consensus ad idem

➢ Free Consent – not caused by

    ➢ Coercion – forced by coercive act

    ➢ Undue influence- dominate the other party's free will + unfair advantage

    ➢ Fraud - Deceiving

    ➢ Misrepresentation

    ➢ mistake

Void agreement & Voidable Contracts

➢ Void agreements – not enforceable promise

➢ Voidable contracts – valid if not challenged