

Law and Economics



Avinash S. Ganu,

Advocate

B.Sc. LL.M. (Pune), LL.M. In International Economic Law (Warwick,
U.K.)

Sayali Ganu-Dabake,

Advocate

LL.M. (Business Laws), M.B.L., PGDIPRL, LL.M. (Health & Media Laws)

Coase Theorem



Articles by Ronald Coase

☞ The Federal Communications Commission (1959)

☞ The Problem of Social Cost (1960)

Externality problem

- Actions of business firms with harmful effects on others

Pigouvian Approach



- ❧ Traditional Approach – treatment by Pigou
(The Economics of Welfare, 1932)
- ❧ Pigouvian approach
 - ❧ Taxes (Environmental taxes = pollution damages)
 - ❧ Damages (to Victim)
 - ❧ Subsidies
 - ❧ Regulation (to shift Injurer to other zone)
- ❧ According to Coase –
 - ❧ Approach inappropriate, with undesirable results
 - ❧ Reciprocal nature of the Problem
 - ❧ To avoid harm on B, is to inflict harm on A
 - ❧ Problem is to avoid more serious harm

Coase Theorem



- ✧ Named so by George Stigler (1966)
- ✧ Coase did not state it in the form of theorem

Various versions

- ✧ Stigler

under perfect competition, private and social costs will be equal

- ✧ Calabresi (1968)

if one assumes rationality, no transaction costs & legal impediment to bargaining, all misallocations of resources would be fully cured in the market by bargaining

Coase Theorem



∞ Polinsky (1974)

if transaction costs are zero, the structure of law does not matter because efficiency will result in any case

∞ Cooter & Ulen (1988)

When parties can bargain together and settle their disagreements by co-operation, their behaviour will be efficient, regardless of underlying rule of law

Coase Theorem



∞ Efficiency Hypothesis

Regardless of how rights are initially assigned, the resulting allocation of resources will be efficient.

∞ Invariance Hypothesis

The final allocation of resources will be invariant under alternative assignments of rights

Coase theorem



Strong version

encompasses both the efficiency and invariance hypothesis.

Weak version

encompasses only efficiency hypothesis

Coase Theorem



Various cases considered by Coase

- i) Confectioner & Doctor (Sturges v/s Bridgmen, 1879)
- ii) Rancher and Farmer – straying cattles
- iii) Contamination of stream killing fish in the pond
- iv) Smoke pollution
- v) Railway engine sparks and neighbouring farmers
- vi) Shadow on swimming pool (Florida, 1959)

Coase Theorem



- Assumptions Raised
 - Zero transaction costs
 - Initial allocation and rights specified
 - Free market and bargain

Coase Lesson



- ❧ Law and legal rights certain
- ❧ Institutions of Property rights and Contracts
- ❧ Initial allocation efficient
- ❧ Bargain impediments to be reduced
- ❧ Law to reduce transaction costs
- ❧ Law should be efficient
- ❧ Court approach to promote efficiency