

The Republic of Beliefs: A New Approach to Law and Economics

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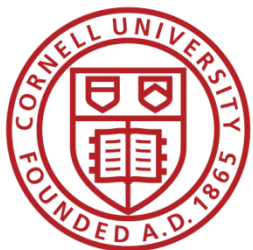
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Encounters with the law

- Antitrust legislation in the United States
- Right to Food Act in India
- Prevention of Corruption Act, 1988, India
- Moscow Airport, 1992



Diversion of PDS Foodgrain in India

| | Rice | Wheat | Foodgrain |
|--------|------|-------|-----------|
| 2004-5 | 41.3 | 70.3 | 54.0 |
| 2006-7 | 39.6 | 61.9 | 46.7 |
| 2007-8 | 37.2 | 57.7 | 43.9 |



The Traditional Approach

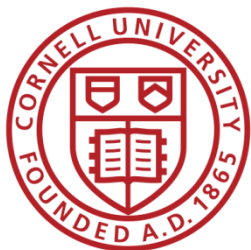
– The Chicago school, the Neoclassical Model

An entrepreneur considers a coal mining venture

- Let the expected revenue from mining be R .
- Let the cost of mining be C .
- The venture is worthwhile if $R - C > 0$

- The project will be rejected if

$$R - C \leq 0$$



The Traditional Approach (cont'd)

- Suppose a new law is enacted, declaring mining illegal
- If caught (probability p), you will be fined F .
- The venture is worthwhile if $R - C - pF > 0$

- The project will be rejected if

$$R - C - pF \leq 0$$

The traditional approach argues that the new law changes behavior by changing the game that people play.

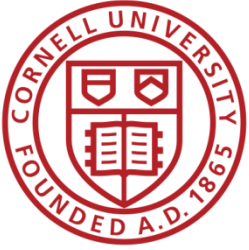
Speed limit laws

It's 1970. German autobahns have no speed limit law. You choose to drive at 120 kms per hour.

It's 1973. The oil crisis prompts Germany to impose a speed limit law of 100 kms per hour. You choose to drive at 100 kms per hour.

Why did your behavior change?

The traditional approach and the 'ink on paper' critique.



Prisoner's Dilemma

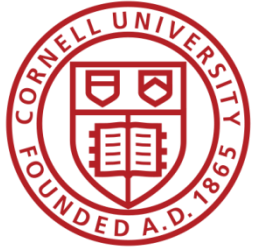
| | | Player 2 | |
|----------|---|----------|------|
| | | A | B |
| Player 1 | A | 7, 7 | 1, 8 |
| | B | 8, 1 | 2, 2 |



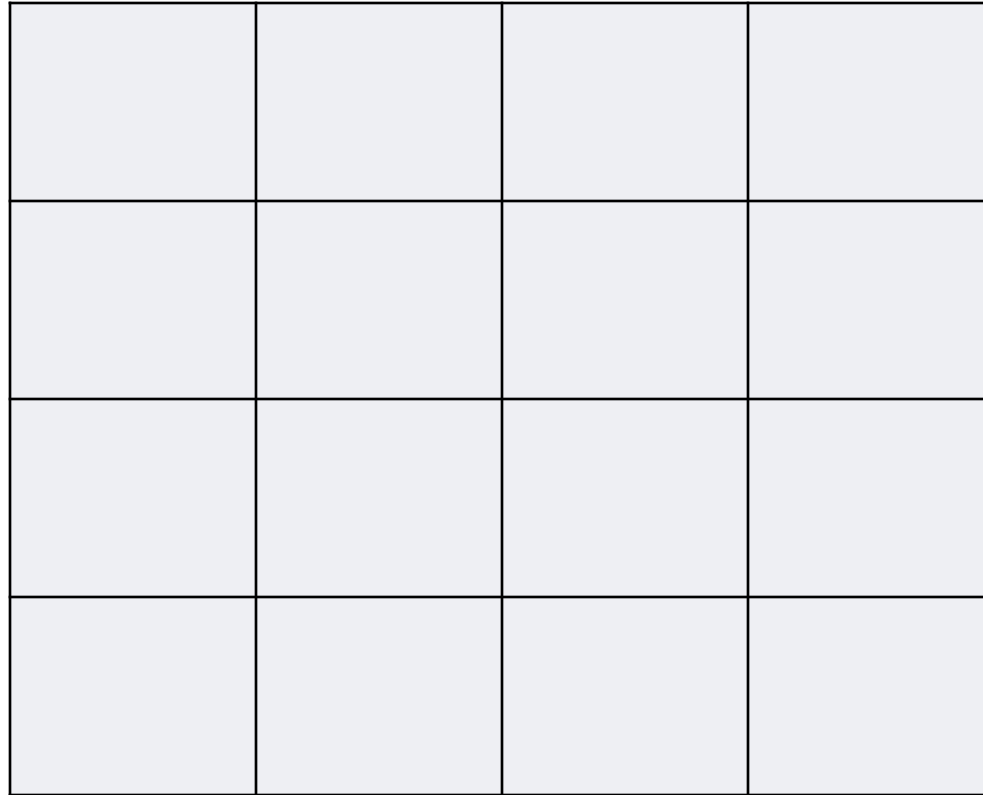
Prisoner's Dilemma with Fine

Player 2

| | | A | B |
|----------|---|------|------|
| | | A | B |
| Player 1 | A | 7, 7 | 1, 6 |
| | B | 6, 1 | 0, 0 |

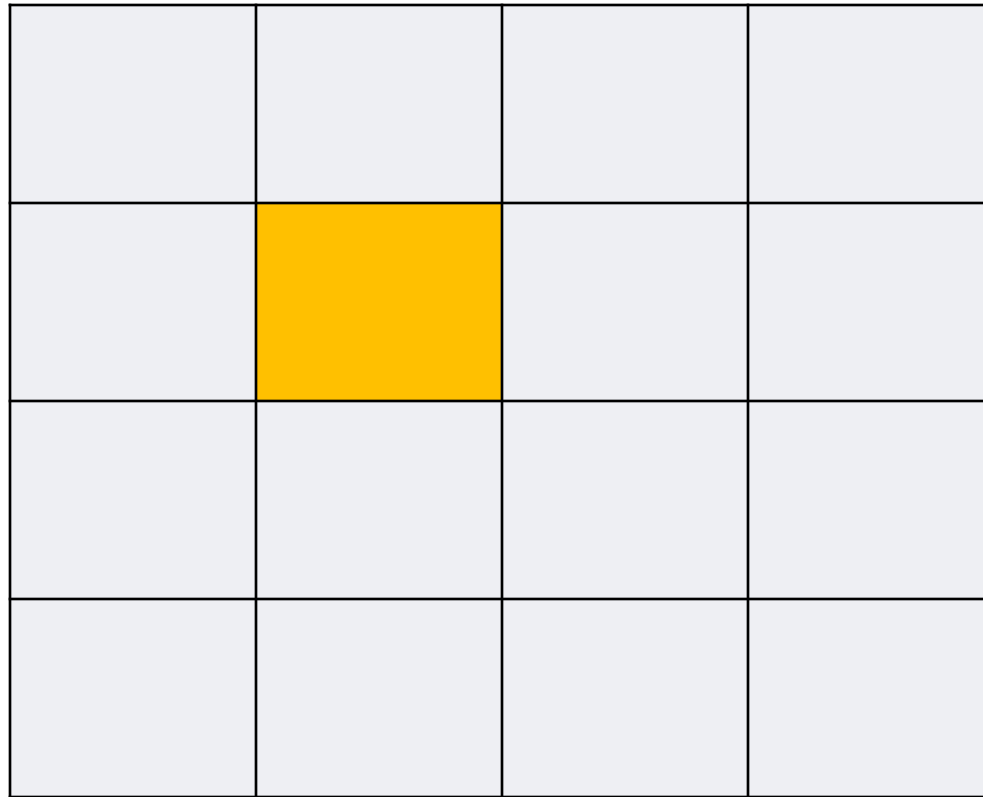


The Squares Game





The Squares Game





Prisoner's Dilemma Game of Life, I

| | A | B |
|---|---------|---------|
| A | 7, 7, 0 | 1, 8, 2 |
| B | 8, 1, 2 | 2, 2, 2 |

L

| | A | B |
|---|---------|---------|
| A | 7, 7, 1 | 1, 6, 1 |
| B | 6, 1, 1 | 0, 0, 1 |

R

Why are laws violated, why are laws followed?

Gordon Brown: “In establishing the rule of law the first five centuries are always the hardest.”

Incentive compatibility

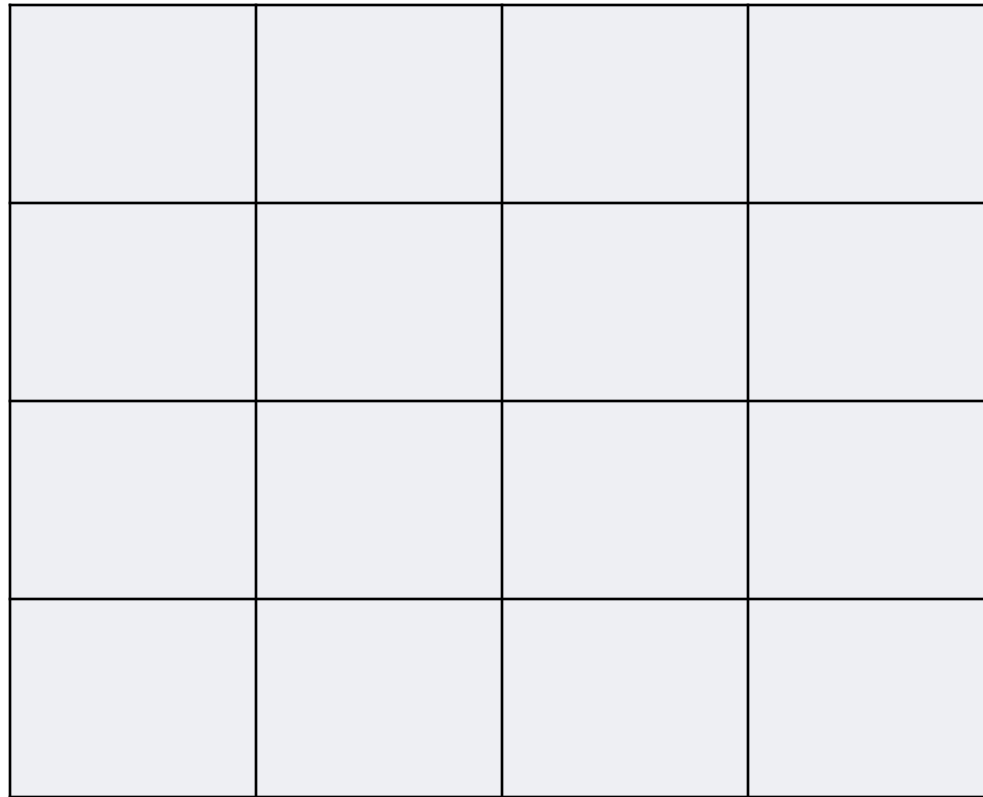
The mystery of focal points (Hume/Havel/dictatorships)

Multiple focal points

Beyond economics: psychology and culture

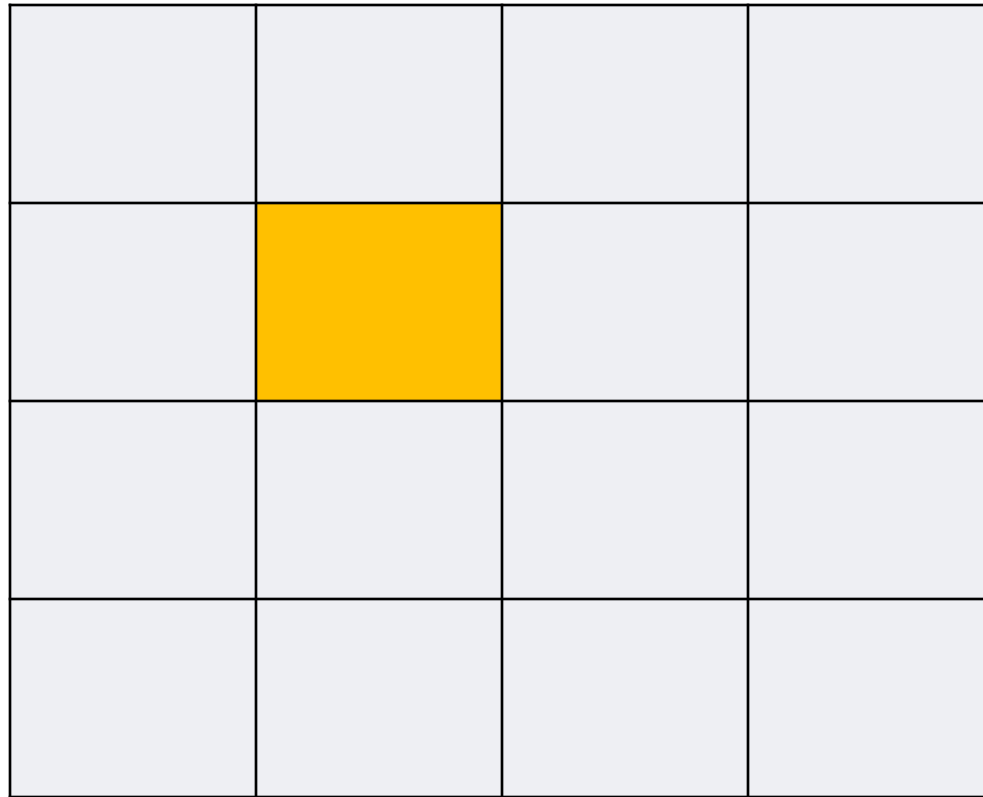


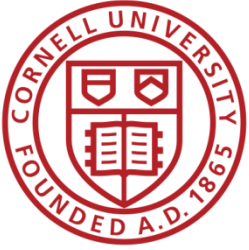
The Squares Game



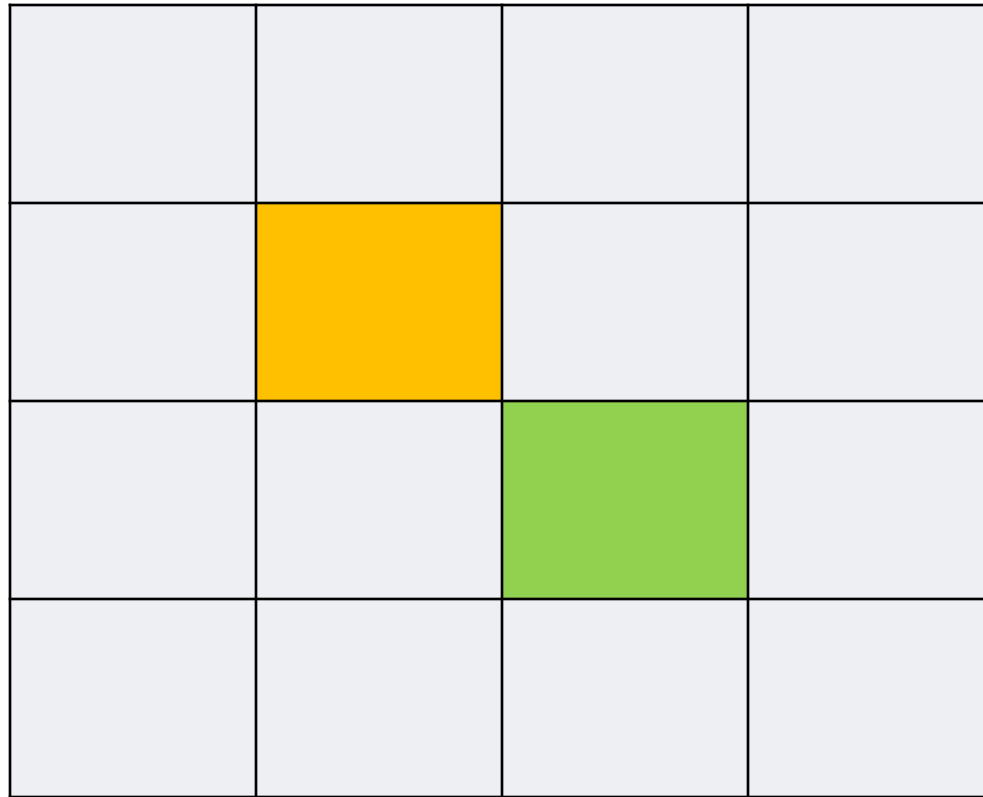


The Squares Game





The Squares Game





Game of Punctuality

- Punctual: at 8 a.m. for sure
- Unpunctual: at 8 a.m. with probability p (<1)
- If both punctual, the meeting starts on time, and the benefit is B
- Individual cost of punctuality is C



Game of Punctuality

| | | Other | |
|------|---|-------|--------|
| | | P | U |
| Self | P | $B-C$ | $pB-C$ |
| | U | pB | p^2B |

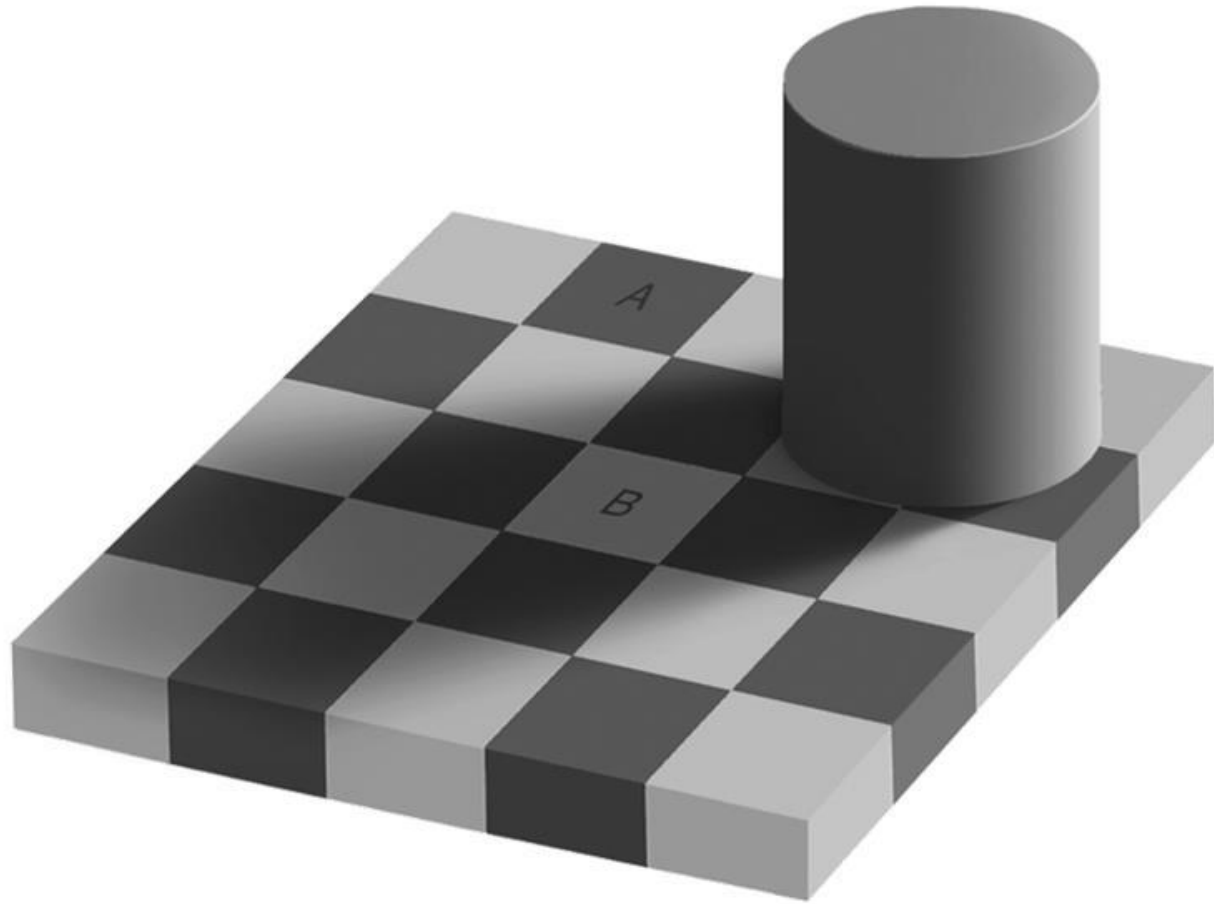
- Assume:

$$B - C > pB \quad (1)$$

$$p^2B > pB - C \quad (2)$$

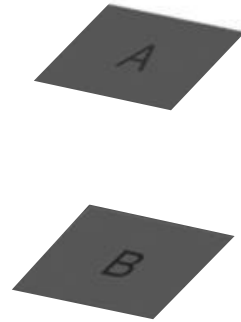
$$B(1 - p) > C > pB(1 - p) \quad (3)$$

Social Norms and Development



Here is one example of a frame.

Social Norms and Development



Here is one example of a frame.

Created targets

- Football
- The desire to kick the ball through an artificial gateway.
- The desire to see Manchester United win and the desire to see Trump win