



Stockholm  
University

Department of Economics

**Course name:** Law & Economics 1  
**Course code:** EC2105  
**Type of exam:** Retake exam  
**Examiner:** Lars Vahtrik  
**Number of credits:** 7,5 credits  
**Date of exam:** Sunday 2 April 2017  
**Examination time:** 3 hours (9:00- 12:00)

**Write your identification number on each answer sheet (the number stated in the upper right hand corner on your exam cover).**

Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked.

**No aids are allowed.**

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The exam consists of 4 questions. Each question is worth 25 points, 100 points in total. For the grade E 45 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Question 4 is a credit question. If you have handed in assignments during the course you may choose to answer this question anyway if you aim at a higher score. Note that in this case only the score on the exam will be counted regardless of your score on the assignments!

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Your results will be made available on your "My Studies" account ([www.mitt.su.se](http://www.mitt.su.se)) on Thursday 27 April at the latest.

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**Good luck!**

### Question 1

- a) A thief (B) has stolen a bike from a student (A). B later sells the bike to a person (C) who has no knowledge of that it is stolen. A later sees C riding the bike and calls the police who arrests C. C explains that C has bought the bike from B and even shows a receipt, although B's name is false. Please discuss from an economic perspective whether the law should protect A or C in the current situation. **(10 p)**
- b) C has also been in an accident with the very famous football player D. In the accident D was injured and he could not play football for the rest of the season. Now D claims that C should pay him damages for among other things loss of income. Please discuss under which circumstances C should be responsible to pay damages to D (based on the assumption that the legal system is economically efficient). **(15 p)**

### Question 2

An investor can invest in high reliance or low reliance upon the agent's future performance. The extra investment in high reliance is made outside of the contractual agreement with the agent. The payoffs for the investor and the agent with no enforceable contract are given by

		Agent	
		Perform	Breach
Investor	Invest & low reliance	0.5 0.5	-1.0 1.0
	Invest & high reliance	0.6 0.5	- 2.0 1.0

The agent can appropriate the original investment but not the additional investment. As shown in the matrix the additional investment in high reliance costs 1. Calculate and explain the meaning of the "tipping point" or critical value of  $p$  (the probability that the agent performs). Show and explain why and when simple (or naive) expectation damages may cause an inefficient outcome. Suggest a solution that guarantees an efficient outcome of the contract. **(25p)**

### Question 3

Consider Hart and More's example with the chef, the skipper and the tycoon. Explain the setup in the example and discuss the consequences of different allocations of ownership of the yacht for the incentives to make relation specific investments that increase the value of the cruise. **(25p)**

### Question 4 ( Credit Question)

- a) Explain why it may not be a good idea to let the punishment for embezzlement be the maximum punishment possible (fine and imprisonment) even if this is required to deter all embezzlement in society. **(8p)**
- b) Explain why very harsh punishment combined with a low detection probability may not be an efficient deterrent for young first time offenders. Suggest a more appropriate deterrence policy for this category of offenders. **(8p)**
- c) Try to explain why a successful attempt to reduce the supply of drugs, by increasing the expected punishment for suppliers, may not be an efficient policy in the short run if your aim is to reduce drug related crimes like violent crimes, robbery and property crimes. Include the response from suppliers, drug addicts and non-addicts to the new policy in your analysis. Is there any reason to believe that the policy could be more effective in the long run? **(9p)**