Law and Economics Exam Spring 2010

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Rules: You have 24 hours from the time you pick up this exam to turn it in, but it must be turned in by noon on May 4 at the latest. This exam consists of two questions and a third element where you choose to either count one of your answers double or to have each of the first two questions count for the same amount toward your final exam grade. You may consult any class notes, as well as any law and economics or economics textbook/treatise, but you may not use internet resources (except Friedman's webbed textbook) or published journal articles in completion of the exam. There are no length guidelines for the answers. Irrelevant but correct material in your answers will neither count in or against your favor. Irrelevant and incorrect material will count against your grade. It is very unlikely that the longest answers will score the highest (if only because an overly wrong answer is more likely to contain incorrect material). I am interested in your law and economics analysis, not your ability to regurgitate classic sources (e.g., Posner). Good luck and have a good summer.

1. One of the concerns in the on-going health insurance reform debate is the claim that insurers have an incentive to deny coverage for cost-justified (i.e., the value to the patient is at least as large as the cost to the insurer) treatments simply as a way to increase profits. The idea is that consumers pay in premiums while they are healthy in return for the promise that the insurer will cover expected costs as they arise, but when those costs actually do arise, insurers can act opportunistically by denying coverage. Presumably, ex ante, no one wants the insurer to commit to covering every cost, no matter how high, since such a practice will increase the price of insurance beyond the value it provides consumers. This makes a "cover everything" policy unworkable. Also, given how quickly medical technology evolves, a fully specified contract which lists everything that is covered in every contingency is also likely to be impractical. Relying on the judgment of regulators and judges may also not be optimal in determining whether something should be covered under the insurance contract or not. One novel solution that has been raised is that an insurer could offer a bundled product that provides both health insurance and life insurance (i.e., a policy that pays a certain amount of money if the consumer dies before a given date; presumably this specific policy would specify a number of dates with declining payout amounts such that the earlier you die, the higher the payout to your beneficiary) together as a long term contract.
    a. Discuss how this bundling might partially offset the concern that insurers will act opportunistically in their coverage decisions.
    b. What problems might such a bundled product create (both in absolute terms and relative to the current unbundled insurance products now offered)?

2. Many jurisdictions ban or limit advertisements for tobacco products. Many of the tobacco manufacturers argue that such bans and limitations do not actually reduce the incidence of smoking or total tobacco sales, and, therefore, should be repealed.
    a. If it were the case that advertising limits do not reduce total tobacco sales, why might tobacco manufacturers advertise in the first place since advertising seemingly does not affect total sales?
    b. Given your response in 2.a, which manufacturers would we expect to lobby against the advertising limits?
    c. Given your responses to 2.a and 2.b, suggest micro-economic mechanisms through which advertising limits might lead to reductions or increases in total tobacco consumption even if it is true that observing advertisements does not directly **cause** people to change their smoking choices (i.e., it is not the case that a non-smoker becomes a smoker because he sees an advertisement or that a light smoker becomes a heavy smoker because she sees a tobacco commercial).

3. Question 1 and question 2 individually have the same total possible point value. Choose to count either question 1 or question 2 double (i.e., your final point total will be equal to the points you earned on the question you did not choose to double plus 2 times the points you earned on the question you choose to double) or choose to diversify such that each of those questions is weighted equally in determining your final grade (i.e., your final point total will be equal to 1.5 times the sum of the points you earned on question 1 and question 2). Make your choice clear, or you will lose 1/3 of the total points available on the exam.