



# Gujarat National Law University

## GNLU PRESS NOTE No. 16/2021

### **Nobel Laureate Prof Oliver Hart at GNLU International Conference on Economic Analysis of Law and Governance**

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**Gandhinagar, March 18, 2021:** Four-day GNLU International Conference on Economic Analysis of Law and Governance was inaugurated at Gujarat National Law University (GNLU).

On the first day, **Nobel Laureate Prof. (Dr.) Oliver Hart** delivered a plenary session, "Exit Vs, Voice." The session was based on the 2017 research paper "Companies should maximise Shareholder Welfare Not Market Value" and the 2020 book "Exit Vs Voice", co-authored by Prof Hart.

Hart said that many people today disagree with famous economist Milton Friedman who argued 50 years ago that corporations have only one social responsibility: To make money for their owners. Prof Hart argued that, after all, shareholders are ordinary people who have social and monetary goals. They may want companies to pursue social goals on their behalf, and they may be willing to sacrifice some profits to achieve these goals.

Applying his theory to the burning issue of Climate Change, Prof Hart said that in an ideal world, national governments would agree on a worldwide carbon tax. Then everyone could go ahead and pursue their own interests. But we do not live in this type of world. There are political failures both at the national and international level. As a result, individual and corporate actions matter. In his view, companies have a comparative advantage in tackling climate change. The same is true of pollution as well.

Prof Hart said shareholders could influence a company to become more environment-friendly in two ways: exit or voice. In the exit strategy, they can divest their holding and hope that the fall in share price will induce a value-maximising company to change its strategy. Consumers and workers can also pursue an exit strategy by boycotting the product of or refusing to work for dirty firms.

In voice strategy, shareholders can use their voice by engaging with management to change company policy. After all, they have the votes.

Based on his research, Hart said that exit (divestment) is less likely to be effective between exit and voice. The reason is that even if a majority of investors are socially responsible, the incentive of purely selfish or mildly responsible investors to buy the shares of those divesting is great, dampening the fall in the share price. Therefore companies will not respond.

Hart argued that well-diversified shareholders (shares held by a large number of people) would vote for the socially efficient outcome even if they are only slightly socially responsible. But this is not true for a large shareholder.



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Hart said his research implies that activists should rethink their strategies. Students at Harvard and elsewhere have pushed their universities to divest (from dirty companies), but it might be better to push them to engage.

Hart concluded by saying that voice should be encouraged much more than it is. However, the voice will not work with majority-owned or private companies; he cautioned.

2016 co-recipient of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, Prof Hart is the Lewis P. and Linda L. Geysler University Professor at Harvard University. He is with Harvard since 1993.

In another plenary, Former Chief Economist of the World Bank Prof (Dr) Kaushik Basu delivered a session on "The Republic of Beliefs: What makes our laws Effective." He said that the neo-classical approach in law and economics have failed to satisfactorily address several conundrums. Why some laws are followed by people, and others are not. Why are laws observed less frequently in some societies than others? Why is corruption more prevalent in some countries and not in others?

Basu said the standard approach assumes the people to be rational actors and argues that law can alter behaviour by changing the payoffs people get from different acts (people change their behaviour to avoid fine, punishments/costs associated with violation of laws). The standard models assume private individuals to be rational and self-seeking who act to maximise their respective payoffs. However, the individuals who act as the law enforcement agents of the state are assumed to be robotic in the sense that they do what the law asks them to do regardless of whether the act is in their private interest or not. Basu said these assumptions are contradictory and, therefore, the standard framework is internally flawed.

According to Basu, in a sense, the law is nothing but "ink on paper". It cannot change the game of life. Force of the law comes not from handcuffs, guns-welding inspectors and jails, but from coordination of beliefs among the individuals concerned. You comply with law because you believe that if you do not, the police will fine you. The police fine you because she believes that her superior will punish her if she doesn't. The superior officer will punish the erring police because she believes that her superior/magistrate will punish her. Thus, the law will be effective if all individuals concerned have a coordination of beliefs. Otherwise, not. The law can achieve the desired outcome only if it an equilibrium of the game of life.

According to Basu, the law works to the extent it does by making an equilibrium a focal point around which the individuals involved can form mutually consistent beliefs about one another's actions. For this purpose, the law needs to be clearly articulated.

Law can create a focal point only if people think that it is meant to be followed. In a society without such beliefs, a law might fail even to generate a signal about the intended outcome and can go completely unnoticed.



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Basu said that corruption is infuriating, but it is a very complex issue. It is intertwined with a legitimate business, which makes it challenging to tackle. Demonetisation by the Indian government is an example of this, he said.

Basu is currently Professor of Economics and the Carl Marks Professor at Cornell University.

Mr Injeti Srinivas, Chairman, International Financial Services Authority, Guest of Honour at the inaugural session, gave an address on "Law and Economics: A behavioural perspective." He said social considerations should outweigh economic considerations while fixing the price of essential medicines. To illustrate his argument, he cited the example of a vaccine for COVID-19. If the vaccine is allowed to be priced high, most people in developing countries may not be able to afford the same and remain un-vaccinated. It would defeat the purpose of achieving herd immunity.

Mr Srinivas said that for any law to succeed, the likely benefit should outweigh the compliance cost.

In his inaugural address, GNLU Director Prof (Dr) S. Shanthakumar said that the interdisciplinary study of law and economics places the study of law on a scientific basis, with coherent theory, precise hypotheses deduced from the theory, and empirical tests of the hypotheses. He said this Conference would provide the participating young researchers and scholars with an excellent opportunity to learn from the stalwarts, including Nobel laureate Prof Oliver Hart. He thanked the distinguished speakers for participating in the Conference and Prof (Dr) Ranita Nagar, Head of GNLU Centre for Law and Economics, for organising the Conference.

Prof Ranita Nagar gave an overview of the activities of the GNLU Centre for Law and Economics.

Dr Hitesh Kumar Thakkar, Assistant Professor of Economics, GNLU and the Convenor of the Conference proposed a vote of thanks.

## **Media Contact:**

Ashok Shah

Email: 9909960240, 8849110049