Standard economic analysis of law, dating to the publication of Ronald Coase’s The Problem of Social Cost in 1960, assumes that the initial allocation of legal rights will not affect the final allocation of those rights in the absence of transaction costs. Whether or not this premise is correct turns out to have significant implication for legal policy across substantive fields, from how the state should initially allocate entitlements, whether it should reallocate entitlements, how it should regulate the consensual exchange of entitlements, to how it should protect and vindicate entitlement ownership.

The empirical evidence demonstrates, however, that the context surrounding entitlements can affect their valuation. Research on the "status quo bias" indicates that individuals tend to prefer the present state of the world to alternative states, all other things being equal. The term "endowment effect" stands for the slightly narrower principal that people tend to value entitlements more when they own them than when they do not. And a consequence of the endowment effect is the "offer-asking gap," the phenomenon that people will often demand a higher price to sell an entitlement that they own than they would pay for the same good if they do not own it. For simplicity, in this chapter I will use the term endowment effect to refer generally to these three similar regularities.

The consequence of this evidence for the economic analysis of legal rules blossomed into an important topic of debate in the legal academic literature. Legal scholars have universally grasped the most important positive implication of the endowment effect— that legal entitlements will not change hands as often in the free market as the Coase Theorem assumes. Scholars have also attempted to revisit arguments about normatively appropriate legal policy. This effort has been made with varying levels of success and sophistication, and continued progress on this score is critical for the continued development of the field of behavioral law and economics. This Chapter has two goals. First, it describes the endowment effect, with attention not only to what we know about it, but also what remains unclear about both its scope and its underlying causal mechanism. Second, it demonstrates how the endowment effect is important to a wide-range of substantive legal topics, but that, while its positive implications for law are often straightforward, its normative implications have often proved to be more elusive.