

Economic Analysis for Lawyers

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FOURTH EDITION

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To Paige

–H.N.B.

To Ted and Sophie

–J.S.

To Christine

–J.C.

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Preface to the Fourth Edition

Economic Analysis for Lawyers offers a thorough introduction to the tools and methods used in economic analysis of the law. Chapter 2 covers fundamental principles of microeconomics and should be taught first. Chapters 3 through 5 introduce three core areas of law and economics — property rights, externalities, and transaction costs — and should be taught next. Subsequent chapters build on these fundamentals by adding an in-depth analysis in the general areas of risk and torts, crime, antitrust and industrial organization, labor markets, and financial economics. As in prior editions, instructors should feel free to approach this material in whatever order they find most useful.

The Fourth Edition represents a significant revision to the Third Edition, based on experience teaching law and economics both to law students and judges who have attended programs offered by the Law & Economics Center at George Mason University, Antonin Scalia Law School. First, Chapter 1 provides a streamlined introduction to the material. Most significantly, Chapter 2 — which presents fundamental microeconomic theory — has been extensively reworked and expanded to provide a deeper treatment of consumer and producer behavior, including new cases and several new examples. Given the depth of treatment, instructors should not need a supplementary microeconomics text if teaching students without a background in economics. If students have a background in economics, on the other hand, instructors can use this chapter as a refresher. Chapter 3 is new, offering a richer exploration of the role of property rights in market exchange, as well as an examination of the economics of intellectual property. Additionally, Chapter 5 includes a richer discussion of the economics of information. The Fourth Edition also includes new cases and notes throughout.

We thank Bruce Kobayashi, Donald Kochan, and John Yun for helpful comments and suggestions, and feedback on their experience using the Third Edition. Amanda Olsavsky Hu and Matthew Sibery provided excellent editorial suggestions and assistance. We also acknowledge several research assistants who provided invaluable help

in assembling the new material for the Fourth Edition: Lauren Aragon, Sam Bellet, Douglas Boyle, Jacob Frankson, Brandon Gilbert, Christopher Hadsall, Conner Holt, Sean Hong, Cory Jack, Daniel Lynch, Sarah Kratt, Megan Mikeal, Justin Myers, and Andrew West. We also acknowledge the fantastic design work by Donny Truong and Robert Wiley, which has dramatically improved the graphical materials.

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Preface to the Third Edition

This is a microeconomics book that relies on numerous examples from the law and public policy to illustrate practical economic concepts in action. As explained in the prior prefaces, the first three chapters are foundational and should be taught first. The basic narrative is to explain how ideal markets operate, the consequences of interfering with market price adjustments, a consideration of “market failures” as a justification for government intervention in markets, and then the harsh reality that government interventions are often as imperfect as the markets they aspire to correct.

After the first three chapters, subsequent chapters can be taught in whatever order works best. In essence, chapters IV through X are free standing. This third edition includes two new chapters—Chapter VII on Crime and Punishment and Chapter VIII on Labor Markets. These chapters were added in response to suggestions by many of the hundreds of judges who have attended the Economics Institute for Judges offered by the Law & Economics Center at George Mason University School of Law.

We acknowledge the valuable suggestions of professors who adopted the second edition. In particular, Bruce Johnsen and James Cooper have provided detailed suggestions and Cooper helped revise Chapter IX on Market Structure and Antitrust. Several research assistants helped update examples and cases. The George Mason team consisted of Nate Harris, Matt Wheatley, Mark Weiss, Allen Gibby, Sam Banks, Mauro Fiore, Christopher Mufarriage, Jason Greaves, Mark Ericson, and Taylor Hoverman. The Emory team consisted of Robin Caskey, Steve Ferketic, Kasia Hebda, Sarah O'Donohue, Caitlin Pardue, Luka Stanic, and Dimitri Dzagnidze.

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Preface to the Second Edition

This second edition continues to reflect our belief in the value of the building block approach to teaching economics to lawyers and law students, and in the usefulness of cases as a supplement to that approach. Our use of the first edition in class, and the feedback from our students, has reinforced those beliefs. Our goal in preparing this second edition has been to reorganize and streamline the materials in response to comments from professors, law students, and judges, while staying true to the pedagogical approach of the first edition.

The first three chapters remain the core materials and should be covered first. Those chapters cover much of the same ground as in the first edition, but with a somewhat different organization. Chapter 1 introduces the economics approach, examining such topics as the economist's assumptions about human and firm behavior and the fundamental concepts of opportunity cost and property rights. Among the new material in the chapter is a note summarizing some of the recent scholarship on behavioral law and economics. Chapter 2 develops the basic supply-and-demand model in a variety of market and legal settings. Chapter 3 examines the economics of government regulation (and government failure — i.e., public choice economics), and includes a new section on the economics of the court system.

The remaining chapters may be covered in whatever order the instructor prefers. As with the first edition, the organization is by economic concept rather than by substantive legal area. Chapter 4 discusses externalities and legal responses to externalities. Chapter 5 combines two chapters from the first edition (on the economics of information and on organizational economics) into a single chapter dealing with information costs and transaction costs. The remaining three chapters have been updated but largely follow the same structure as their counterparts in the first edition. Chapter 6 discusses risk, Chapter 7 deals with competition and monopoly, and Chapter 8 addresses valuation issues.

By design, this edition is substantially shorter than the first edition. We have accomplished this both by excluding some topics covered in the first edition, and by a careful editing of the cases to focus on the key aspects (both legal and factual) of the

case. The result, we hope, is that reading assignments will be of a more manageable size but without any significant loss of substance. There remains ample material for a one semester course in law and economics.

Thanks to our families for their support and patience with us during this revision. In addition, we very much appreciate the research assistance of Eric Hatchett, Matt Koenigsdorf, and Sean McGivern, and financial support from the University of Kansas School of Law.

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Preface to the First Edition

This casebook is designed to help law students and lawyers learn the principles of microeconomics. A quick review of the table of contents reveals that economics concepts provide the organizational structure of the book. Instead of organizing around substantive areas of the law, it follows the building block approach used in most successful principles of economics textbooks. This proven approach to teaching economics differs from other law-and-economics casebooks that tend to focus on applications of economics to legal issues rather than teaching economics. After fifteen years of teaching economics — often to law students, law school professors, lawyers, and judges — I am convinced of the pedagogical advantages of this approach. For the many law professors who share this view and have been forced to supplement principles of economics textbooks with cases, I believe that this casebook offers a more convenient and coherent alternative.

My involvement with this casebook started as an effort to revise the first edition of *Quantitative Methods for Lawyers* by Professor Steven M. Crafton and Margaret F. Brinig of George Mason University School of Law. Their ambitious effort to create a casebook introduction to economics, finance, accounting, statistics, and econometrics has met with considerable success as judged by adoptions at numerous leading law schools. Nevertheless, my interest in these materials quickly turned to concentrating on a more traditional approach to teaching economics. The result is a very different type of casebook than Crafton and Brinig's initial effort. Keith Sipe, the publisher of Carolina Academic Press, has encouraged me to incorporate some materials from the first edition of *Quantitative Methods for Lawyers* and I have done so in numerous areas of this casebook. It is our hope that many of the materials presented here will be incorporated in the second edition of *Quantitative Methods for Lawyers* by Crafton and Butler. The materials remain a "work in progress." I encourage you to send your comments, criticisms, and suggestions for improvements of subsequent editions.

This casebook is not intended to be an encyclopedic treatise on either the principles of economics or the economic analysis of law. Some topics typically covered in a principles textbook are not found here; similarly, numerous legal issues susceptible to

economic analysis are not covered. Nevertheless, there is plenty of material for a typical one-semester course. I encourage you to work through the first five chapters and then choose chapters according to your interests. Figures are available in PowerPoint. Many of the edited cases presented here are longer than one would expect if they were excerpted in a specialized casebook on their particular area of the law. The pedagogical reason for this is that I was concerned that first or second year law students needed to have more information about the particular substantive law (especially in some regulatory cases) in order to understand the economic issues. I have attempted to ease this pain by minimizing and shortening many case citations in the cases presented.

Numerous individuals have helped me complete this book. I am especially grateful to two individuals. Geoffrey Lysaught, a J.D./Ph.D. in finance student at the University of Kansas, has been involved in every aspect of the project. He was especially helpful on the finance and risk issues covered in Chapters IV, IX, and XI. Christopher Drahozal, a colleague in the School of Law, provided detailed comments and suggestions on the entire manuscript. Geoff and Chris, thank you! I also acknowledge the valuable contributions of research assistants Gary Eastman, Matt Hoy, and Alok Srivastava. The Smith Richardson Foundation provided essential financial support at the start of this project.

I have used earlier drafts of these materials in my Law and Economics classes as well as in the *Economics Institutes for State Judges* offered by the University of Kansas Law and Organizational Economics Center (LOEC). Comments from law students, professors in the *Economics Institutes for State Judges* (Barry Baysinger, Keith Chauvin, and Maurice Joy of Kansas; Terry L. Anderson of PERC and the Hoover Institution; and W. Kip Viscusi of Harvard Law School), and judges have improved the final product. I would like to offer my thanks to three judges — Victor T. Barrera of California, Richard T. Jessen of Minnesota, and Donald S. Owens of Michigan — who took great pride in their ability to spot typos. Accordingly, any remaining typos are their responsibility.

Finally, I wish to express my sincerest gratitude and appreciation to Cathy Lysaught and Missy Amlong at the LOEC for their loyal and tireless assistance. They “hung in there” during the long and tedious process of compiling these materials.

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