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## What Should Lawyers Know About Economics

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## What Should Lawyers Know About Economics?

Robert Whaples, Andrew P. Morriss, and John C. Moorhouse

Law and Economics is now part of the curriculum at many American law schools; the current AALS directory lists 159 persons teaching at least one course in the area. Because law schools inexplicably do not generally require a background in economics, such courses usually must teach some principles of economic analysis before applying those principles to legal questions. We wondered what law-and-economics scholars and economists thought lawyers should know about economics<sup>1</sup> (as opposed to what they should know about the economic analysis of law). The results are important beyond the circle of law-and-economics scholars. Teachers and students of torts, property, and contracts felt the impact of the first wave of law-and-economics scholarship, but every area of law from admiralty to procedure is increasingly subject to economic reasoning.

Even those legal educators and lawyers who swore off economics after an encounter with an undergraduate principles course are confronting economic reasoning in scholarly work and judicial opinions. Understanding that reasoning requires some familiarity with economics. The optimal number of economics courses may always be one more (at least in our opinions), but those whose consumption of economics education has somehow fallen short may reasonably substitute the works economists—and particularly economists who think about law—think are important for lawyers.

To find out what law-and-economics scholars and economists think lawyers should know about economics, we conducted surveys of random samples of members of the American Law and Economics Association and the American Economic Association.<sup>2</sup> We posed two questions to both groups:

At Wake Forest University, Robert Whaples is Associate Professor of Economics, and John C. Moorhouse is Professor of Economics. Andrew P. Morriss is Associate Professor of Law and Associate Professor of Economics at Case Western Reserve University.

1. Perhaps our next project will be to determine what lawyers think law-and-economics scholars should know about law.
2. Between April and August 1996 we sent 402 surveys to members of the ALEA and 199 surveys to members of the AEA. Fourteen of the ALEA surveys and eight of the AEA surveys were returned as undeliverable. We received 63 usable responses from ALEA members (a 16.2% response rate) and 70 from AEA members (a 36.6% response rate). ALEA members were also asked 42 questions on a number of policy issues and factual propositions, something which may explain their lower response rate. Those results appear in Andrew Morriss et al., *Where Is There Consensus in the Field of Law and Economics?* (unpublished manuscript on file with authors).

What do you think are the five most important economic concepts law students ought to learn in a law-and-economics course?

Law-and-economics courses sometimes include economics articles in their reading lists. If you could choose up to five articles for such a course, what would they be?

Tables 1 and 2 summarize the answers.<sup>3</sup>

*Table 1: Concepts Mentioned*

	Percent Mentioning		
	AEA	ALEA	All
Opportunity cost / diminishing returns	58.6	57.1	57.9
Externalities / Coase Theorem	50.0	51.6	50.8
Marginal analysis	46.4	46.8	46.6
Demand & supply / market equilibrium	22.1	46.8	33.8
Economic efficiency / Pareto optimality	22.1	28.6	25.2
Incentives matters	15.7	11.1	13.5
Comparative advantage	17.1	3.2	12.8
Public choice theory	12.1	13.5	12.8
Economics of property rights	17.9	4.0	11.3
Transactions costs	7.9	15.1	11.3
Present value / discounting	7.1	14.3	10.5
Utility theory / social welfare	7.1	9.5	8.3
Market structure / monopoly	11.4	3.2	7.5
Uncertainty / risk	5.7	9.5	7.5
Competition	9.3	4.8	7.1
Optimization / individual rationality	2.9	11.9	7.1
Government's impact	7.1	6.3	6.8
Game theory concepts	5.7	6.3	6.0
Principal-agent theory	5.7	6.3	6.0
Antitrust	10.0	0.0	5.3
Elasticity	7.1	3.2	5.3
Imperfect information	5.0	4.8	4.9
Market failure	4.3	4.8	4.5
Consumer & producer surplus	6.4	1.6	4.1
Public goods	3.8	4.8	4.1
Moral hazard & adverse selection	1.4	6.3	3.8

As Table 1 shows, four concepts ranked well ahead of the others: opportunity cost, the Coase theorem, marginal analysis, and market equilibrium. Economic efficiency/Pareto optimality also ranked fairly high among the ALEA economists, although not so high among members of the AEA. Four of these five concepts are at the heart of the microeconomic core, and the fifth, the Coase Theorem, is the key to much of law and economics generally.

Missing from the top tier are concepts at the center of modern microeconomics such as principal-agent theory and property rights economics. Macroeconomic topics are also noticeably absent. This suggests that our respondents (correctly, in our opinion) are satisfied with exposing law students to an abbreviated introductory microeconomics course rather than familiarizing them with recent cutting-edge law-and-economics scholarship.

3. Because we asked open-ended questions, we used some judgment in grouping responses. For example, "opportunity cost" includes mention of diminishing marginal utility and scarcity. For reasons of space, we listed only concepts and materials identified by at least two respondents; half-point scores reflect a few respondents' listing two concepts as equally important.

Table 2: Articles Recommended

	Percent Mentioning
R. H. Coase, <i>The Problem of Social Cost</i> , 3 J.L. & ECON. 1 (1960) .....	57.9
*Guido Calabresi & A. Douglas Melamed, <i>Property Rules, Liability Rules and Inalienability: One View of the Cathedral</i> , 85 HARV. L. REV. 1089 (1972) .....	11.3
Ronald H. Coase, <i>The Nature of the Firm</i> , 4 ECONOMICA 386 (1937) .....	8.3
Gary Becker, <i>Crime and Punishment: An Economic Approach</i> , 76 J. POL. ECON. 169 (1968) .....	6.0
Benjamin Klein, Robert G. Crawford & Armen A. Alchian, <i>Vertical Integration, Appropriable Rents, and the Competitive Contracting Process</i> , 21 J.L. & ECON. 297 (1978) .....	5.6
*Harold Demsetz, <i>Toward a Theory of Property Rights</i> , 57 AM. ECON. REV. 347 (1967) .....	5.3
Milton Friedman, <i>The Methodology of Positive Economics</i> , in ESSAYS IN POSITIVE ECONOMICS 3 (1953) .....	4.5
Armen A. Alchian & Harold Demsetz, <i>Production, Information Costs, and Economic Organization</i> , 62 AM. ECON. REV. 777 (1972) .....	4.5
George A. Akerlof, <i>The Market for "Lemons": Qualitative Uncertainty and the Market Mechanism</i> , 84 Q.J. ECON. 488 (1970) .....	4.5
George J. Stigler, <i>The Theory of Economic Regulation</i> , 2 BELL J. ECON. & MGMT. SCI. 3 (1971) .....	3.8
Richard A. Posner, <i>ECONOMIC ANALYSIS OF LAW</i> (1972, 5th ed. 1998) .....	3.8
*Garret Hardin, <i>The Tragedy of the Commons</i> , 162 SCIENCE 1243 (1968) .....	3.4
Richard A. Posner & Andrew M. Rosenfield, <i>Impossibility and Related Doctrines in Contract Law: An Economic Analysis</i> , 6 J. LEGAL STUD. 83 (1977) .....	3.0
Paul H. Rubin, <i>Why Is the Common Law Efficient?</i> 6 J. LEGAL STUD. 51 (1977) .....	3.0
*Steven Shavell, <i>Strict Liability Versus Negligence</i> , 9 J. LEGAL STUD. 1 (1980) .....	3.0
†R. A. Radford, <i>The Economic Organization of a P.O.W. Camp</i> , 12 ECONOMICA 189 (1945) .....	2.3
†Gary Becker, <i>THE ECONOMICS OF DISCRIMINATION</i> (1957, 2d ed. 1971) .....	2.3
*George J. Stigler, <i>The Economics of Information</i> , 69 J. POL. ECON. 213 (1961) .....	2.3
*Oliver E. Williamson, <i>Transaction-Cost Economics: The Governance of Contractual Relations</i> , 22 J.L. & ECON. 233 (1979) .....	2.3
*Michael C. Jensen & William H. Meckling, <i>Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure</i> , 3 J. FIN. ECON. 305 (1976) .....	1.9
†Richard A. Posner, <i>A Theory of Negligence</i> , 1 J. LEGAL STUD. 29 (1972) .....	1.5
†John S. McGee, <i>Predatory Price Cutting: The Standard Oil (N.J.) Case</i> , 1 J.L. & ECON. 137 (1958) .....	1.5
†Harold Demsetz, <i>Industry Structure, Market Rivalry, and Public Policy</i> , 16 J.L. & ECON. 1 (1973) .....	1.5
†Stephen N. S. Cheung, <i>Transaction Costs, Risk Aversion, and the Choice of Contractual Arrangements</i> , 12 J.L. & ECON. 23 (1969) .....	1.5
*Robert Cooter, <i>The Cost of Coase</i> , 11 J. LEGAL STUD. 1 (1982) .....	1.5
*Carl J. Dahlman, <i>The Problem of Externality</i> , 22 J.L. & ECON. 141 (1979) .....	1.5
*Friedrich von Hayek, <i>Competition as Discovery Procedure</i> , in F. A. Hayek, ed., <i>NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS, AND THE HISTORY OF IDEAS</i> 179 (1978) .....	1.5
*William M. Landes & Richard A. Posner, <i>THE ECONOMIC STRUCTURE OF TORT LAW</i> (1987) .....	1.5
*Franco Modigliani & Merton H. Miller, <i>The Cost of Capital, Corporation Finance and the Theory of Investment</i> , 48 AM. ECON. REV. 261 (1958) .....	1.5
*Steven Shavell, <i>ECONOMIC ANALYSIS OF ACCIDENT LAW</i> (1987) .....	1.5

\* mentioned only by ALEA respondents

† mentioned only by AEA respondents

A similar focus is apparent in the suggested readings of Table 2. Respondents in both groups focus heavily on “classic” texts and articles: all but five of the thirty works mentioned were published before 1980.<sup>4</sup> Not surprisingly, the respondents also concentrate heavily on articles from the *Journal of Law and Economics* (7 articles receiving 95.5 mentions) and the *Journal of Legal Studies* (5 articles receiving 16 mentions). Of articles not in law-and-economics journals, only one (Calabresi & Melamed) is from a law journal; the others are from economics journals (10 articles receiving 53.5 mentions) or books (6 books receiving 20 mentions). Since we had asked for “economics” articles a law student should read, the absence of law reviews may seem unsurprising. But there are plenty of articles published in law reviews that contain just as much economics (and certainly as much law and economics) as material published elsewhere. Our results suggest that neither law-and-economics scholars nor economists think of law review materials as “economics” articles.

For the most part, the readings suggested are relatively nontechnical articles comprehensible to most law students; only a few, such as Akerlof’s, might tax most students’ abilities. The desire to choose material within the competence of law students may have led to the selection of older articles—articles written before the mathematization of economics.

The most striking response, although not unexpected, was the top ranking—by a wide margin—of Ronald Coase’s “The Problem of Social Cost.” Clearly this is the key element in the law-and-economics syllabus. More than three-fourths of the respondents gave it a mention; only 15 percent mentioned the second-most-mentioned article. Another Coase article, “The Nature of the Firm,” ranked third.

The major difference between the two groups surveyed was in their treatment of the Calabresi & Melamed article. Many ALEA members listed it, but the AEA members did not mention it at all. Apparently law-and-economics scholars read law reviews, but economists outside the field do not.<sup>5</sup>

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*Table 3: Authors Recommended More than 10 Times*

	<i>Percent Mentioning</i>
Ronald Coase	75.9
Richard Posner	19.5
Harold Demsetz	14.3
Armen Alchian	13.2
*Guido Calabresi	12.8
*A. Douglas Melamed	11.3
George Stigler	10.5
†Gary Becker	8.3
* mentioned only by ALEA respondents	
† mentioned only by AEA respondents	

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4. The AEA and ALEA responses to this question were generally similar, with two exceptions noted below, and so Table 2 combines the results.
5. Another difference lies in the works that relatively few respondents cited: with one exception, every work mentioned by fewer than five persons received mention from members of only one of the two groups.

Another way of interpreting our results is to look for authors mentioned repeatedly. Certainly many law-and-economics scholars have published widely, and some authors' writings lack an obvious focal point like "The Problem of Social Cost." Almost anything by Richard Posner, for example, would be relevant. Table 3 lists authors mentioned ten or more times. Not surprisingly, Coase's name tops the list, although large numbers of respondents mentioned Armen Alchian, Gary Becker, Guido Calabresi, Harold Demsetz, Richard Posner, and George Stigler. Teachers might wish to include in their syllabi works by frequently mentioned authors as representative of the field.

Teachers can use the suggested articles to introduce students to the concepts identified in Table 1. The non-Coase readings come from a variety of areas, from torts to property rights to finance. The wide range of subject areas suggests materials that could be used in substantive courses to provide a law-and-economics perspective, particularly for students who have mastered basic economic principles either in their undergraduate course work or in a law-and-economics course.

There are two major textbooks (Cooter & Ulen<sup>6</sup> and Posner<sup>7</sup>) and two casebooks for law-and-economics courses (Barnes & Stout<sup>8</sup> and Goetz<sup>9</sup>). In addition there are some shorter works that provide an introduction to law and economics (Harrison,<sup>10</sup> Malloy,<sup>11</sup> and Polinsky<sup>12</sup>). All cover the five concepts that our respondents identified as most important, as well as some additional topics. Cooter & Ulen provide the most thorough introduction to economic reasoning and come closest to replicating the experience of an introductory microeconomics course by more formal presentation. Any of the shorter works could also serve as back-up reading for lectures on these concepts.

The textbook format allows for greater topical coverage but at the expense of primary sources. The articles suggested by our respondents offer a source of supplemental readings. The Barnes & Stout casebook includes significant excerpts from Coase; the Goetz casebook does not.

If you wish to take our respondents' collective advice, you might structure your law-and-economics course to include a brief overview of basic microeconomic concepts, discussion of Coase's "The Problem of Social Cost," discussion of Calabresi & Melamed's "Cathedral" article, and selections from one or more of the frequently mentioned writers: Alchian, Becker, Demsetz, Posner, and Stigler.

6. Robert Cooter & Thomas Ulen, *Law and Economics*, 2d ed. (Reading, Mass., 1997).
7. Richard A. Posner, *Economic Analysis of Law*, 5th ed. (New York, 1998).
8. David W. Barnes & Lynn A. Stout, *Cases and Materials on Law and Economics* (St. Paul, 1992). This book is also available as a series of short paperbacks focused on individual subjects for use as supplemental material.
9. Charles J. Goetz, *Cases and Materials on Law and Economics* (St. Paul, 1984).
10. Jeffrey L. Harrison, *Law and Economics in a Nutshell* (St. Paul, 1995).
11. Robin Paul Malloy, *Law and Economics: A Comparative Approach to Theory and Practice* (St. Paul, 1990).
12. A. Mitchell Polinsky, *An Introduction to Law and Economics*, 2d ed. (Boston, 1989).