

An economics angle on the law

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Abstract

Law and economics tends to focus on ways in which others respond to the law, or on economic input into legal deliberation. There is another dimension that can benefit from an economics perspective. Many people work in law-related occupations. They are delivering a service. In addition, policy is often formulated in terms of legislation or regulation, so the operation and impact of the law is an important aspect of much policy implementation. This paper considers the nature of law as an economic product, identifying characteristics and considering implications. There are parallels with approaches to economics in other areas, land and health being but two. The law has its own defining features, however. These include the nature of legal transactions, with more than one party making the consumption decision, and the importance of rhetoric, or persuasion, for determining outcomes. The nature of costs and benefits, available information, accountability of participants and conflicting objectives are some additional aspects meriting consideration. Several of these are discussed, using economic concepts as tools of analysis where they appear to suit particular circumstances. As such, the discussion illustrates the way that economics may contribute to understanding without requiring assumptions of complete description within a closed analytical system.

¹ Thanks are due to staff of the University of the West of England for helpful comments while visiting on sabbatical.

This is the first of six Bristol Business School Economics Papers by Stuart Birks on Rethinking Economics. The full collection is:

- 1212 [An economics angle on the law](#)
- 1213 [Rethinking economics: theory as rhetoric](#)
- 1214 [Rethinking economics: Downs with traction](#)
- 1215 [Rethinking economics: Economics as a toolkit](#)
- 1216 [Rethinking economics: Logical gaps – theory to empirical](#)
- 1217 [Rethinking economics: Logical gaps – empirical to the real world](#)

Paper 1215 gives a general overview of the “economics as a toolkit” approach. Papers 1212 and 1214 illustrate the application. The approach includes three paths or types of potential error. Papers 1213, 1216 and 1217 cover paths A, B and C respectively.

This paper is based on a very simple premise. People are employed as solicitors, barristers, judges and in numerous other roles in relation to the law. From an economics perspective, they are producing something, which is then being purchased either by the state or by individuals and organisations in the private sector. They are not producing goods, so they are providing services. There are several questions that economists could ask so as to better understand this activity. For example:

- What are the characteristics of the services?
- How can the services be viewed from an economic perspective?
- How do we define this market?
- How are the services developed?
- How well are services delivered?

In part, the motivation to select this topic resulted from some questions that had come to mind over several years’ involvement in policy development and implementation:

- Legislation is a major policy tool for MPs and political parties. How is it that laws can be passed and implemented on the basis of assumptions that are not supported by the information available? Why might there be no response when such anomalies are demonstrated? For example, for many years child support legislation in several countries has failed to recognise the division of costs of caring for children, instead

favouring the parent with whom the children stay for the greater time (Birks, 2011a; Braver & O'Connell, 1998)

- Should lawyers be entrusted with the implementation of policies on such diverse areas as the economy, social problems, and the environment when they are not required to have any training in the issues that the laws address?
- Has enough consideration been given to the financial and time costs that can accrue in the process of legal action, given that these can have significant impacts on behaviour and outcomes?

Law involves deliberation, both in law making and in implementation. Adam Smith (1963) referred to deliberative eloquence and judicial eloquence as branches of rhetoric. The former considers persuasion in the selection of policies (such as laws), and the latter refers to the persuasion of a judge or jury.² This aspect of trials is clearly stated by a legal scholar:

A trial is also a *narrative* competition. Each side tells a story, and tries to convince the jury (or judge) to buy its particular vision and version of fact. In an important sense, neither story line is "true" or "false." The two sides spar with each other before the trier of fact; each embroiders and displays its message with slogans and narrative bits which are thought to be particularly compelling, logical, or attractive. Hence arguments presented in trials are often important clues to what stories count as good, or true, or compelling stories, within a particular culture. (L. M. Friedman, 1989, p. 1595)

Early thinking on rhetoric focused on interactions between individuals. Some more recent approaches do not always use the label "rhetoric", but could be classified as "macro-rhetoric" in that they consider the issue of broadly held perceptions and the factors that can influence these perceptions (Birks, 2008). Parker (2012) illustrates this point in an analysis of the use in legal cases of the term "perfect storm" in attempts to absolve accused of responsibility for events. Macro-rhetoric is a useful classification as it highlights the importance of broader

² Such ideas have a long history. See, for example, Plato (1998, pp. 35, 41), which contains a general discussion of demand for training in rhetoric, especially in the courts, suggesting that rhetoric is more effective as persuasion than is knowledge.

aspects of persuasion and groups together diverse theoretical perspectives with outcomes in common.

A neo-classical economic analysis of aspects of the law assumes not only rationality (Baumol & Blinder, 1991), but also atomism (Lawson, 2003). It is unlikely to be convincing to those in the law, or to those concerned with making the law, or those in other fields to which the law relates (such as politics, sociology, social policy). Rhetoric is to be contrasted with logic in that the former concerns itself with persuasion, whereas the latter relates to proof. This raises two issues. First, mainstream economic theory, with its assumption of rational behaviour, is based on logic and the absence of rhetoric. How can it be used to analyse the making and implementation of laws, for both of which rhetoric is an important factor? Second, is economics so “clean” in its own reasoning, or does it have its own rhetoric?

Much of the existing law and economics literature focuses on the contribution economics can make to improve decision making in law. This can be seen in some key law and economics texts. Hence, “Until the 1960s, economic analysis of law was virtually synonymous with antitrust economics...” (Posner, 2007, p. 23), and, “Until recently, law confined the use of economics to the areas of anti-trust law, regulated industries, tax, and the determination of monetary damages” (Cooter & Ulen, 2008, p. 1). Then, from the early 1960s, “the economic analysis of law expanded into the more traditional areas of the law, such as property, contracts, torts, criminal law and procedure, and constitutional law” (Cooter & Ulen, 2008, p. 2).

This is still a narrow perspective, however. Posner sees law and economics as the analysis of legal doctrine, with “the positive role of economic analysis of law – the attempt to explain **legal rules and outcomes...**” (Posner, 2007, p. 25). A similar position is taken by other writers (D. D. Friedman, 2000; Varuhas, 2005). There is little recognition of the legal sector as a provider of services, with its own products that may have unique characteristics, that are produced at a cost and for which demand may be expressed through markets or in other ways. There are important economic questions as to the nature of the product, methods of production, expressions of demand, and possible (market or other) failures and reasons for intervention.

While generic economic models of production and markets are standard fare in textbooks (Mankiw, 2007; Stiglitz, 1993), specific characteristics are identified in specialist areas such as the economics of health (McGuire, Henderson, & Mooney, 1988), education (Adnett & Davies, 2002; Belfield, 2000; Johnes, 1993) or land (Balchin, Bull, & Kieve, 1995; Barlowe, 1986). The health economics example is useful because some of the characteristics identified there are also relevant for law. It therefore serves as a useful starting point for considering the characteristics of law as a service. This paper considers possible characteristics of the law from the perspective of an individual purchaser or consumer of the service. First, some general characteristics are outlined. Then four specific aspects are discussed in more detail. It is in such discussion that the potential value of economic concepts is observed. While theoretical analysis can be undertaken with specific representations and models, individual concepts can also assist in understanding some aspects of observed (or anticipated) behaviour. A concept on its own, like a theory, is only presenting part of the picture, but it can indicate areas of interest and provide a perspective for analysis.

1. General characteristics

Economists analyse markets and market failure for goods and services by considering aspects of the nature of the products, how they are produced, whether there is competition, how demand is determined, and so on. Mainstream economics textbooks give us a “Claytons theory of the firm”³, presenting the sort of firm we look at when we are not looking at a firm. This sort of simplification may give a neat and tidy structure, but any theoretical approach involves the selection of a limited number of characteristics and the disregard of many others. The aim of this paper is to look at the law in terms of identifying specific characteristics which may be important for an economics perspective on the operation of the law, taking statute law as given.

Workers in the legal system are collectively providing a service. For example we could consider an output of the Family Court as the resolution of a dispute between the parties. Even in criminal cases, there is a service to the state or society and to the accused (imagine if no defence were permitted). The field of law and economics has focused primarily on the use of economics as an input to legal deliberation, but the characteristics of the law as a service

³ Claytons was a non-alcoholic drink promoted in New Zealand and Australia in the 1980s as “the drink you have when you’re not having a drink”.

industry also merit some thought. Several of these characteristics overlap with those of health economics. The following characteristics are well accepted in health economics⁴, and can also be expected to apply to legal services:

1. Consumers are infrequent purchasers of the services of the health or legal sectors and often have limited information about what is being purchased.
2. There are principal-agent issues in that people (principals) are buying the expertise of health or legal professionals (agents) and are not fully informed themselves.
3. When someone initially decides to purchase, it is unclear what the end product will be or what the total cost will be.
4. The benefits of an outlay may not even be clear after purchase, as with "credence goods".⁵

Other characteristics can be identified which apply to both health and law, such as:

5. The government does not have full control over its costs, in that services have to be provided in response to demand decisions of others. With health sector spending, some costs could be "capped". This can result in waiting lists and queuing, and limiting the treatments being funded. Similarly, to some extent public sector legal costs could also be capped, as with provision of judges and courts, and with ceilings on legal aid.

⁴ See, for example, McGuire, Henderson and Mooney (1988), for discussion of points 1-4 in health.

⁵ "Credence qualities are those which, although worthwhile, cannot be evaluated in normal use" (Darby & Karni, 1973, pp. 68-69), so the quality is unknown both before and after purchase. This contrasts with "search" qualities of a good or service, which can be discovered through search prior to purchase, and "experience" qualities, which can be identified after purchase (Nelson, 1970). Darby and Karni analyse repair services as their credence good, although the law could also have served as an example and they published in the *Journal of Law and Economics*. Dulleck and Kerschbamer (2006), writing on credence goods in the *Journal of Economic Literature*, do not cover its relevance to the law. There is an indirect connection, however. They state, "Existing institutions address the informational problems associated with markets for diagnosis and treatment. The problem of undertreatment is most famously controlled for by the Hippocratic Oath of a physician and its counterpart in the law." (Dulleck & Kerschbamer, 2006, p. 8). By that they mean that physicians are subject to a legal counterpart to the oath, but the idea has been raised that lawyers may require a legal equivalent of the Hippocratic Oath (Economides, 2007; Holroyd et al., 2008).

6. Production of the service involves the participation of several service suppliers (such as court staff and opposing counsel) who are independently appointed, some funded privately and some publicly.

There are additional characteristics which are of particular importance to legal services and which do not all apply to health. Several of these arise from the nature of legal services as a mechanism for addressing disputes between parties (one of which may be the state). These include:

7. Participation and production may be on the instructions of two or more parties who may not be very cooperative (indeed, they are frequently on opposite sides in an adversarial contest).
8. The decision to purchase can be determined by one party, then requiring outlays by another.
9. While a party has some choice about his or her own counsel, there is relatively little say afforded in the choice of other professionals involved, including the judge.
10. There is limited scope to insure against the costs of legal services⁶, and limited redress in most cases of "legal misadventure".

There are also broader issues in relation to the delivery of the service and what might then be achieved:

11. The outcome can depend on the process. In particular, time taken can have an important impact on costs and benefits to the parties, as with decisions on care of children, or disputes about forthcoming land or property developments where funds are already locked in. In such situations, decisions reached may depend on timing, and the same decision now or next year may have different values.

⁶ Car insurance and professional indemnity insurance policies are examples of policies which may give some cover in specific areas. As one New Zealand example where this cover may be illusory, McDonald (2009) writes, "Financial advisers are hitting out at insurance firm Lumley for collecting their professional indemnity insurance premiums for years, then refusing to pay up now that angry clients are launching legal claims to recoup their losses". The company is said to cover 75-80 percent of the professional indemnity insurance market.

12. Some issues are ongoing, in which case a decision at one time may not permanently resolve the issue. There are several areas where this may apply, but it is readily apparent with care of children disputes, where circumstances can change as children grow. Moreover, decisions at one time may affect options at a later time (i.e. there may be “path dependence”), as when sole care is given to one parent, thus eroding the relationship with the other parent.
13. If we consider the specification of laws as the governmental implementation of policy via the legal sector, then the government does not have full control over outcomes. A parallel can be drawn with other areas of policy. For example monetary policy depends on the response of the trading banks and others.
14. The “shadow of the law” means that the law can affect people without them directly consuming the service. This is because their decisions are made in the knowledge that the law is available to them or to others, and so legal action is a possibility.
15. People make decisions (career, marriage, asset purchase) with implications for the future, and they can then be subject to law changes that were not anticipated at the time of the decision.
16. Considering the legal sector as a whole, there is limited monitoring and there is little in the way of formal economic evaluation of the legal system.⁷ Monitoring and evaluation should ideally also extend to the broader implications, including enforcement issues and incentive and disincentive effects on others.

Collectively, these points indicate that the theoretical conditions for efficient operation of free markets in legal services, as might be argued to occur with perfect competition⁸, are unlikely to be met. Application of theory which overlooks characteristics such as these is likely not only to result in conclusions that do not match real world circumstances, but also to detract

⁷ A New Zealand attempt to address this problem is Rodney Hide MP’s Regulatory Responsibility Bill, the associated Regulatory Responsibility Task Force (Hide, 2009), and the subsequent Regulatory Standards Bill which had its first reading in 2011. A UK report (Department for Business Innovation and Skills, 2011) specifies principles for regulation, but gives only brief mention of costs and benefits of the regulatory process.

⁸ Note also two questions discussed in Section 2.2.1 of Birks (2011b). First, is perfect competition the right ideal? Second, should the comparison be with an unattainable ideal? A more general concept of “failure” might be that the service may not lead to the logical outcome based on perfect information at lowest cost. Deviations from this outcome or costs over this level may be considered to indicate limitations to the effectiveness of the service delivery.

from or prevent the identification of problems that are occurring. Some specific aspects of particular economic significance will now be considered in more detail.

2. Particular concerns

There are numerous issues which could be addressed in this section. They cannot all be covered, so four have been selected. They have been chosen because they relate to established economic concepts and they raise issues of particular interest and relevance to the operation of law. The four areas of concern discussed here are: the principal-agent relationship; production and game theory – the prisoner's dilemma; objectives of the participants; and the nature of costs.

2.1 The Principal-Agent Relationship

The first specific characteristic or area of concern is the nature of the relationship between a lawyer and a client, which may differ from that generally assumed between a consumer and a supplier of a good. There is a common economic problem that arises when a consumer is paying someone to supply a service based on that person's knowledge. Consider, for example, someone in a dispute that could be resolved through the law. The person decides to buy legal services, becoming a lawyer's client. The purchase is essentially of expertise, which means that the client (the principal) is relying on the lawyer (the agent) for information to guide the purchase decision. For this to work well, there are two dimensions to consider. First, is each participant able to convey the right information to the other, and second, do they face incentives to act in some other way? Both these dimensions are important, although attention has focused on the second. To combine the two dimensions, the problem becomes one of whether, when going to a lawyer, the right advice can be expected.

For the first point, on the one hand the client, not being the legal specialist, does not know what legal information is needed, or even what may be available. On the other hand, the lawyer does not know in any detail what the client's wishes (preferences) are. There is partial ignorance on both sides. The required information will only be exchanged if the necessary questions are asked, but neither may be aware of the correct questions to raise. This is

important because either conventional assumptions will be made, as provided by framing⁹ or by “street-level epistemology” (Hardin, 2002), or a lot of time could be spent in just identifying the issues.

It is the second point that has received most attention in principal-agent literature, however. Will a lawyer always act in the best interest of the client? This depends on both the motivation of the lawyer and the ability of the client to effectively monitor or supervise the lawyer. Laffont and Martimort (2001) discuss three difficulties, moral hazard, adverse selection and non-verifiability.^{10 11} The first two are major problems in the efficiency of insurance coverage, but they also apply here. The third point is potentially highly significant in the law.

Moral hazard is the term used to describe the incentive for people to act inappropriately when they do not face close supervision.¹² People who have insured against accidents may be less concerned about having an accident. This is because many of the costs will be covered by the insurance, but insurance companies cannot closely monitor people’s behaviour and prevent them acting imprudently. Similarly, once a lawyer has been engaged, a client does not know if all the work done is necessary, or if the work is done to a satisfactory standard.

Adverse selection in insurance refers to the greater likelihood that insurance cover will be taken out by those requiring payouts than by those who do not. In giving someone insurance cover, the insurance company is agreeing to pay out when specified conditions are met.

⁹ “A frame can be defined as ‘a central organising idea for news content that supplies a context and suggests what the issue is through the use of **selection, emphasis, exclusion, and elaboration**’” (Severin & Tankard, 1997, p. 320). See also Gajevic (2012, pp. 141-144).

¹⁰ Their focus is principally on management-worker relations (Laffont & Martimort, 2001, p. 29), rather than client-lawyer relations.

¹¹ Some years ago Rodell, Professor of Law at Yale, gave a more sceptical view on monitoring lawyers:

It is this fact more than any other – the fact that lawyers can’t or won’t tell what they are about in ordinary English – that is responsible for the hopelessness of the non-lawyer in trying to cope with or understand the so-called science of law. For the lawyers’ trade is a trade built entirely on words. And so long as the lawyers carefully keep to themselves the key to what those words mean, the only way the average man can find out what is going on is to become a lawyer, or at least to study law, himself. All of which makes it very nice – and very secure – for the lawyers. (Rodell, 1939)

¹² For a discussion of the evolution of the term, see Rowell and Connelly (2012).

Those who never get sick may consider health insurance to be of little benefit, whereas those who are frequently ill will find it far more worthwhile. If the insurance company is unable to distinguish between these groups of people, it cannot charge different premiums according to risk. Consequently, the insured will be predominantly those people who are more likely to make claims. In insurance, the insurance company is paying out on claims by a client. In law, the direction of payment is reversed. A client engages a lawyer, and is then under an obligation to pay resulting fees. It may not be known if that lawyer charges inflated fees or if all the work is necessary.¹³ If such actions are possible, and clients cannot identify them, then those lawyers who use these methods have more options available. They will be able to earn more than those who do not, and are more likely to succeed and prosper.

Non-verifiability refers to the situation where “no third party, and in particular a court of law, can observe [the information]”¹⁴ (Laffont & Martimort, 2001, p. 3). This can cause problems for contract design and enforcement. A client could feel dissatisfied with the service received, but is unable to demonstrate failure and then obtain redress.

In practice, there are factors that limit effective competition in the supply of legal advice.¹⁵ People can choose which lawyer to use. However, purchases of legal services are infrequent and there can be costs involved in transferring from one lawyer to another. There is limited information available about which lawyer would be most suitable.

Some of the available evidence suggests that lawyers may not always try to inform their clients or discover their wishes. For example, some indication of women's experiences with lawyers was provided in a New Zealand Law Commission consultation paper in 1997. Quotes from submissions include:

¹³ Another term in health economics is “supplier-induced demand” (McGuire, et al., 1988, pp. 160-165). This refers to the ability of the agent to recommend, and hence obtain, work that may not be necessary.

¹⁴ The reference to law is worth noting. Frequently courts are required to interpret the information presented, and this can be contentious. Cases may depend on non-verifiable points, and non-verifiable points may be raised and would then prove difficult or impossible to refute. For example, the outcome of a legal case may depend on “non-verifiable” information, such as where motive, intent, or pre-meditation are important.

¹⁵ There may be other professions involved also. Hence in the Family Court there may be input from counsellors, psychologists, accountants, and actuaries, for example. The field of law and economics has been closely linked to the role of economists as expert witnesses. Similar problems could arise there.

...the often condescending attitude of the young lawyer...Many women feel that they are treated as 'simpletons' and their comments and requests are often ignored...many women feel a decision is often reached in the back room and the woman has no input into the outcome. (Morris, 1997, p. 1)

When I went to see a lawyer he kept talking in big words that I couldn't understand. I left his office not even knowing what he had said to me. (Morris, 1997, p. 15)

My solicitor told me that my costs would be between \$600-\$2000 initially, but my final account totalled \$25000. (Morris, 1997, p. 15)

These quotes all relate to legal processes, or the way services are delivered. These are important in shaping perceptions of a service. This might be relevant in two ways, (i) inherent concerns about the way someone is treated, or (ii) the instrumental significance of processes in determining outcomes.¹⁶ In the absence of a reason to expect men's experiences to be systematically different, this sample may reflect the experience of clients in general. There are reasons why lawyers may not act in clients' best interest, and there is evidence in support of this. While principal-agent literature focuses on the principal's limited ability to ensure appropriate behaviour by the agent, there is also the additional problem that each requires information from the other, and their knowledge of the other's requirements may be limited.

2.2 Production and game theory – the prisoner's dilemma

A second characteristic or area of concern relates to the adversarial nature of legal activity. The production of the legal service generally requires more than just a trade between a legal professional and a client. There are generally at least two, and sometimes several participants purchasing the service. The purchase of the entire service (such as a dispute resolution in the Family Court) is a joint purchase with other parties. However the parties are in conflict with each other and so they may well be uncooperative. One game-theoretic example of this sort of scenario is known as the prisoners' dilemma.¹⁷

¹⁶ Note, "process control has an importance not linked directly or indirectly to decision control: people value having the chance to state their case, irrespective of whether their statement influences the decisions made by the authorities" (Tyler, 2006, p. 116).

¹⁷ The use of game theory for analysing behaviour between litigants is discussed in Baird, Gertner and Picker (1998). Xenophon presents a character, Crito, who described his position, "there are a set of fellows threatening

To summarise by means of a simple example, assume that two parties in dispute each have the option of being aggressive (uncooperative) or non-aggressive (cooperative). Assume also that the legally decided outcome of the dispute is the same when both parties act in the same way (aggressive or non-aggressive). The preferable strategy for both would therefore be the non-aggressive one as this gives resolution at lower cost. However, there are gains for one party to be aggressive if the other is not. Similarly, if the other party is aggressive, there are losses incurred by the non-aggressive party. There are therefore incentives to each party to be aggressive. So long as one of the parties cannot be trusted not to be aggressive, the end result would be that both are aggressive.

Unless otherwise constrained, legal professionals may well feel pressured to operate aggressively. By acting in this way, they are safeguarding their clients against possible aggressive behaviour from the other party. If a lawyer tries to reduce a client's costs by proposing a conciliatory strategy, this might give the impression that he/she is unwilling to fight, thus increasing the possible gains of an aggressive strategy by the other party. While it is better if all parties are reasonable, there is an incentive for one to be unreasonable. Given that rational behaviour may be predictable, it can be advantageous in a conflict situation to give at least the impression of potential irrationality. Posturing and other strategies to influence an opponent's perceptions and behaviour are considered in drama theory (Howard, 2004).

At the same time, communication on these matters between the parties to the dispute is often undertaken indirectly through lawyers. This can lead to less understanding, less trust, and less control by the parties. Disputes can therefore escalate. The parties are acting on the advice of lawyers and rely on this advice being appropriate. Lawyers are paid according to the amount of work done, which might in some cases affect their choice of strategy (as with "supplier-induced demand").

The prisoner's dilemma is a simple game and takes preferences as given (unlike drama theory), and there will be many other determinants of behaviour in legal disputes. However, as this discussion indicates, the nature of the service, with parties in conflict, a lack of trust,

me with lawsuits, not because they have any misdemeanour to allege against me, but simply under the conviction that I will sooner pay a sum of money than be troubled further" (Xenophon & Dakyns, 1897, Book II Chapter IX).

and non-cooperative strategies available, may lend itself to strategies and payoffs consistent with the prisoner's dilemma.¹⁸

2.3 Objectives of the participating suppliers

A third characteristic or area of concern is the possible objectives of suppliers of legal services. Their behaviour will be influenced by their environment and their objectives. Considerations such as these were used by Niskanen in his discussion of the behaviour of bureaucrats (Niskanen, 1973). It may be possible to take a similar approach here.

Economic theories about people's behaviour involve specifying their objectives and identifying the constraints they face when trying to meet these objectives. They can consider the available options, selecting the one that performs best in terms of the objectives.

For much of economics, simplifying assumptions are made of profit-maximising firms and utility-maximising consumers. In a competitive market with informed purchasers, economic survival depends on providing value, so such a market with self-interested participants is likely to work quite well. It is a simplified view, however. Few real world markets meet the economic requirements for perfect competition. Objectives can be more complex, and organisations such as firms may not operate in a fully co-ordinated, single-minded fashion. Some economic theories suggest that competitive pressures result in efficiency being widespread in the private sector, and lack of these pressures causes inefficiency in the public sector. However, the two sectors may not be so different, and some of the reasoning may apply in both the public and private sectors.

It would be convenient to be able to assume profit-maximising suppliers competing in a market for homogeneous legal services. However, the market for lawyers' services is not so straight forward. The incentives are more confused and monitoring is difficult, just as in the public sector. In fact, many legal services, such as the operation of the courts, are provided jointly with inputs from both the public and private sectors. Consequently, lawyers may behave in other ways.

¹⁸ Legal disputes may also be seen as a series of strategic moves, rather than a one-off game. Under these circumstances, even within a Prisoner's Dilemma framework more complex strategies could be followed. For example, a non-aggressive strategy could be used until an opponent plays aggressively after which there could be an aggressive response just for one or two rounds as a warning.

We can see some of the possibilities by considering Niskanen's assumptions about the behaviour of bureaucrats. His assumption that they would be budget-maximisers was based on his assessment of their motivation and their environment. He speculated that they may be motivated by "salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau" (Niskanen, 1973, p. 22). Many of these motives could apply equally to lawyers and law practices.¹⁹ Some, such as reputation, power and patronage, could be associated with the size and income of the practice, and these may in turn allow them to charge higher fees to clients.

Considering a contrary position, Niskanen speculated about a bureaucrat trying to operate more efficiently. Such behaviour, he suggested, would result in little reward if successful, and risked penalties if things went wrong. Consequently, budget-maximisation would be a more suitable objective. This was contrasted to the situation for a private sector manager, who would supposedly be well-rewarded for efficiency gains (although this is open to question, see Sheeran, 2005). Where lawyers are paid for their time and where the quality of their work is difficult for clients to measure, as suggested for a bureaucrat, rewards are more likely to come from bringing in a large volume of work. Niskanen is not presenting a purely cynical view. He suggests that bureaucrats who wish to do the best job possible would also aim to do more, rather than less. Similarly, a lawyer wishing to make the best case possible for a client may seek to provide a bigger (and more expensive) service.

Niskanen also gives a "survival argument" for budget maximisation in bureaux. This has two aspects in that it considers employees and funders. He suggests that a bureaucrat can better please subordinates if able to offer them greater rewards such as job security and promotion prospects. Also, the bureau's sponsor, funding body or "collective organisation" (and a law practice's clients) may have expectations of aggressive pursuit of more activities with their associated higher budgets.

The likelihood of this phenomenon in law was illustrated, at least in part, at a "masterclass" for lawyers in Auckland, New Zealand, in 2008. Many of the speakers were presenting ways in which lawyers could use existing legislation to advocate more effectively for their clients. This involved the use of additional arguments and supporting points, all of which would

¹⁹ Posner touches on some of these ideas in relation to the legal sector when he discusses the likelihood of agency costs in administrative agencies (Posner, 2007, pp. 670-672).

increase costs and require opposing counsel to respond. If someone were to be cynical, this could be described as a form of “arms race”, increasing costs to all protagonists.²⁰ For Niskanen, in contrast, bureaux are not providing services in an adversarial environment. Such actions in law could also be seen as a genuine attempt to advocate as effectively as possible for the client, and possibly to pre-empt strategies that might be by their opponents. Niskanen’s points for bureaucrats may well be more significant in law, therefore.

There is another dimension which gives added weight to a suggestion that lawyers may not act in their clients’ best interest. Lawyers are not simply competing against each other in a market place for clients. Their working environment requires regular interaction with other lawyers. Hence their incentives may relate more to their relationship with judges and their fellow lawyers than with clients. They may have one-off interaction with clients, but ongoing working relations with judges and other lawyers.

Clients may come through referral from other lawyers. Work may also depend on decisions by court administrators, as with the appointment of Counsel for the Child, duty solicitors, or allocation of legal aid work, for example. Such work is more likely to arise if a lawyer is on good terms with those making the referrals or decisions. Should a lawyer put a steady source of work at risk in order to better serve a one-off client? In addition, there is professional self-regulation by the Law Society, which may be beneficial or otherwise for clients.

Lawyers have to decide what strategy to advise their clients to follow. Given imperfect information by clients, lawyers have some discretion in this. The issue of "supplier-induced demand" is discussed in literature on health economics, although identification and measurement can be difficult (Labelle, Stoddart, & Rice, 1994), making it difficult to police. The suggestion is that, as the supplier is also the person advising on what should be purchased, there is scope to advise more, or more expensive, actions. Given the added complication with legal services that actions of other parties can also influence the services required, there may well be scope for lawyers to create work for each other while apparently acting to protect their clients.

²⁰ A colleague has suggested that similar pressures apply to those using estimation and diagnostic techniques in econometrics.

With possibilities such as these, issues arise of professional ethics and group culture. There may be codes of ethics or behaviour that provide professional constraints on lawyers' behaviour. If so, the problems described above on principal-agent issues may not be so serious. For doctors, there is the Hippocratic oath, although doctors are not universally required to swear it.²¹ There is not an equivalent for lawyers.

Cotter and Roper (1996) reported on attitudes to ethics held by legal professionals. In the light of the responses, they speculated on whether the legal profession should be considered a profession or a business.²² They see the distinction as one between people bound by professional ethics and people allowed a free hand to make money, with many lawyers subscribing to the latter view. As businesses in any industry can have specifications setting out and regulating the nature of their product, the distinction is perhaps more academic than real. Nevertheless, profit-maximising lawyers have to decide what strategy to advise their clients to follow. If they feel unconstrained in their behaviour, they may be misinterpreting their environment, or the constraints are not effectively enforced.

As a general point, lawyers are part of a profession, or a group of professionals, operating together to deliver an overall service. This can lead to a sense of common interest, common culture, and their own "conventional wisdom".²³ The resulting culture can then be inward looking and self-reinforcing. Beliefs may differ markedly from the equivalents elsewhere in society. There may be feelings of group identity, and expertise and standards are learned and modified within a working environment. Status in that environment may be important for ongoing earnings and possibilities for promotion. Similarly, they have their internal career scales and self-regulation and disciplinary procedures. Their focus for rewards may be only loosely related to the interests of their clients or the operation of the legal system overall.

²¹ A modern version is used by about half of UK medical schools and most of those in the US (Hurwitz & Richardson, 1997). It is not required of doctors in New Zealand (See Dr Richard Worth in the First Reading of the Oaths Modernisation Bill, [17 May 2005, 625, NZPD, 20648-20649]). In the UK there was a debate on the need for a Hippocratic Oath for lawyers, with senior members of the profession as key speakers (Holroyd, et al., 2008).

²² Academics could also question their role, given financial pressures on universities.

²³ See section 3 of Birks (2011b) on groups, and note also Chapter 2 of Galbraith (1999) on conventional wisdom, discussed further below.

2.4 The nature of costs

A fourth characteristic or area of concern relates to the effects of legal action on consumers of the service. The performance of the justice system is sometimes assessed solely on whether the “right” decision is reached in the end. For example, Jonathan Krebs, convener of the New Zealand Law Society’s criminal law committee, said on Radio New Zealand National (emphasis added):

I think that [the Bain case] shows that **the justice system works**. There is a hierarchy of appeal courts...a new trial has resulted in Mr Bain’s acquittal. That is the way that the justice system works, and yes it does take an awfully long time. (Krebs, 2009)

This was a case which had lasted nearly 15 years, for much of which the accused was in prison. He mentions the time, but that is not taken as a failure of the system. Other examples can be found where it is claimed that the law “works” if the end result is considered correct.

According to J K Galbraith, statements such as these should be interpreted with caution if they are made by people in authority. He contends that these people owe their position to a past willingness to expound, and are under an obligation to perpetuate, the “conventional wisdom”:

The high public official is expected, and is indeed to some extent required, to expound the conventional wisdom. His, in many respects, is the purest case. Before assuming office, he ordinarily commands little attention. But on taking up his position, he is immediately assumed to be gifted with deep insights. He does not, except in the rarest instances, write his own speeches or articles; and these are planned, drafted and scrupulously examined to ensure their acceptability. The application of any other test, e.g., their effectiveness as a simple description of the economic or political reality, would be regarded as eccentric in the extreme. (Galbraith, 1999, p. 10)

It would be most unusual for someone in Krebs’ position to say that the law did not work. His comment may be more one of the expected rhetoric rather than a statement of fact. Other examples can be found, including newspaper editorials, emphasising the importance of an

issue being “tested in law”, often with little regard for the impact on individuals of the resulting processes.

When asking if the system is working well, economists would be concerned about the nature of costs and benefits of legal services. A common measure of the cost of a good or service is the price paid. Problems might be expected over time. Although not generally explicitly included, the law fits within the category of personal services for which the “cost disease” has been identified. Economies of scale in manufacturing permit significant growth in productivity per worker. This increases the opportunity cost of labour used in other areas, such as personal service.²⁴ Baumol writes:

...relatively low productivity growth in the personal services is a substantial contributory influence: the services that have been infected by the cost disease are precisely those in which the human touch is crucial, and are thus resistant to labor productivity growth. (Baumol, 1993, p. 19)²⁵

While the direct monetary cost is important, it is not the only type of cost associated with legal action. Other costs include pay foregone due to lawyers' visits and court appearances, and costs of time spent by clients gathering relevant information. These should be noted

²⁴ On the barrier of monetary costs, Dave Smith, former Executive Director of New Zealand’s Legal Services Board, has written:

I realise that this is simplistic analysis, but would suggest that the market splits up into the following very broad categories:

1. Largish, prosperous corporations with healthy litigation and general legal advice budgets ultimately recoupable from their mass market consumers
2. Upper middle class high earner individuals (say \$200,000 p.a. plus)
3. Lower middle class individuals and one-person shareholder/director companies
4. Poorer individuals on slightly less than the average wage
5. People on the higher level benefits
6. Rock bottom benefit (unemployment etc) recipients

In my view, only categories 1, 2 and 6 can usually face extended civil litigation with any degree of equanimity. The very rich can be self-funding while the very poor can access reasonable quantities of legal aid. Categories 3 – 5 may be capable of maintaining litigation for only short periods before having to settle on unsatisfying terms if their lawyer is not prepared to act *pro bono* or on a success/contingency fee basis of some kind. (D. Smith, 2001, p. 2)

²⁵ Baumol sources the concept back to Baumol and Bowen (1966).

because reduced legal fees may be achieved by passing on parts of the work to clients.²⁶ Fees charged will not then fully describe the resource costs incurred.

When evaluating a service, it can be important to know from what perspective the evaluation is being done. For example, costs and benefits to an individual may be different from costs and benefits to the public sector, or to society as a whole. An approach which might be efficient when evaluated from one perspective may not appear so desirable from another, as with the view expressed by Krebs. In some cases individuals have to pay a high price to prove their innocence. Psychological and other costs to individuals arising from stress and uncertainty could also be considered, as can effects on reputation. These can be significant, and have achieved publicity in some recent criminal cases, but they are hard to measure.²⁷ They are related to costs arising from the time required to achieve a resolution, so will be considered here in that context.

British Prime Minister William Gladstone once said (in Parliament on 16 March 1868), “Justice delayed is justice denied”.²⁸ David Blacktop, a competition and regulatory law specialist, describing New Zealand’s Commerce Act 1986 and the operation of the NZ Commerce Commission, wrote:

²⁶ This phenomenon is well recognised in relation to health care, under the label, “cost shifting”. There are parallels also with the distinction between “administrative costs” and “compliance costs” for taxation, with the former being reduced at the expense of the latter (Musgrave & Musgrave, 1982, pp. 302-303; Sandford, 1981). This could be important in legal cases where costs are awarded, as such costs are likely to be based on lawyers’ fees.

²⁷ Matthew Oates was tried for killing an intruder who threatened his girlfriend. His case provides an example where personal costs were high, but his trial was presented as a worthwhile test of the law (i.e. an external benefit). Media reports described the situation, “Mr Oates not only had to endure a night of unimaginable terror but also the agony, embarrassment and expense of a murder trial that ended in a hung jury” (“Self-defence must be tested in the courts,” 1997), and “His life has been in turmoil in the year since the incident, and that is an unfortunate cost of a necessary process as the limits of self defence law were again tested, even if the outcome was confirmation of the status quo.” (“Case that had to go to court,” 1997). He had to carry the cost of his defence, estimated at \$45,000NZ (“Putting a price on the high cost of self defence,” 1997). An editorial in *The Southland Times* concluded, “The present law, as shown in the Oates case, works well enough” (“Sensible result in murder case,” 1997).

²⁸ Traced at http://hansard.millbanksystems.com/commons/1868/mar/16/adjourned-debate#column_1771 following a reference in Shapiro (2009).

The time and costs associated with court proceedings and regulatory investigations are hugely burdensome and go beyond legal costs to the indirect costs that arise from uncertainty and the management time and resource required. Investigations and litigation distract managers from their focus on core responsibilities: creating dynamic and innovative firms that compete strongly. (Blacktop, 2009)

On 1 April 2009 a New Zealand MP, Simon Power, said in a media release on the Disputes Tribunal Bill, “Being tied up in district court dealing with small claims is one of the trouble spots for small businesses - it costs them valuable time and money” (Power, 2009).

Sometimes time costs can work in an individual’s favour, as in this historical English example from the *Poor Law Report of 1834* where the costs would be incurred by those applying the law:

[T]he overseer...has not unfrequently been obliged to give relief to men who...could have procured work if they had exerted themselves; they threaten to appeal to the magistrate; and, as he lives *fifteen* miles off, the overseers are often induced to yield to their demands, on account of the expense of meeting the claim before him. (Checkland & Checkland, 1974, pp. 94-95)

Posner, in his widely-read publication, *Economic analysis of law*, takes a restrictive approach to time delays:

...court delay is a 'figurative' as distinct from a 'literal' queue. Waiting in line for a table at a restaurant is a literal queue; it imposes an opportunity cost measured by the value of the customer's time while waiting. (Posner, 2007, p. 624)

The suggestion is that there are no time costs with figurative queues. This is correct in that time is not taken up by queuing, so there is no opportunity cost in the use of the time, but time delays may not be costless to the parties involved. Posner mentions this, but incompletely. He hints at costs such as those from assets being tied up, restricting options or requiring borrowing in the meantime, or it being harder to plan ahead, given the uncertainty. These costs could be serious, as with foregone investment opportunities or inability to meet

current financial obligations. Delays may even affect the outcome, as with interim custody arrangements affecting final custody decisions.²⁹

In addition, delays may arise beyond simply queuing. For example, they may occur due to the time required to gather evidence and make a case. In New Zealand, the point has been made by the New Zealand Law Commission:

The most crippling effect of delay is not...what goes on in the courthouse. It is the effect on people waiting for court hearings and then decisions. The debilitating and distracting effect of any litigation on the parties and those associated with them cannot be over-estimated. (Robertson, 2002, p. 44)³⁰

As an additional illustration, Auckland criminal defence lawyer Lorraine Smith said in a radio interview:

I hear so often my clients saying, ‘Lorraine, if I defend it, and usually they’ve got a pretty good defence, I’m going to have to come back time and again into court and my boss is getting fed up with me being absent, he’s told me I’m going to lose my job if I have to leave work again, so I may as well bite the bullet and plead guilty even though I didn’t do it.’ (L. Smith, 2009)

These costs can be significant. They may affect people’s willingness to enter into legal proceedings. Moreover, there is another way in which they can be important. There are opposing parties in legal proceedings. While incurring costs, legal action also imposes costs on the other party or parties. Costs may not be evenly spread over all parties, and the importance of the costs may differ. Hence the law can sometimes be used to one party’s advantage even when their position in law is weak. For example, delaying tactics can tie up opponents’ resources or prevent them from acting until the matter is resolved.

²⁹ Even the concept of a final decision in this context could be questioned. A Families Commission report talked of change as, “a day-to-day journey involving the creative management of relationships and behaviours, rather than the achievement of a single point or fixed state that can be predefined and objectively measured” (Handley et al., 2009, p. 34).

³⁰ Australian High Court judge Ian Callinan has also, “pointed to deficiencies in the adversary system, such as cases taking too long and costing too much money” (Mancuso, 2007).

Some issues, such as care of children, are ongoing. Such issues are poorly suited to legal processes designed to address an issue and make a decision based on circumstances at the time of a hearing. Circumstances change with time. Consider a situation where one parent is not seeing the children. In such a case, delays in getting to court can determine the final outcome. It is hard to see how the law could be said to work well in such cases by using solely a criterion that the last decision was “correct”. Time and other costs have an influence on the operation of the law. Their implications should be noted.³¹

2.5 More on Posner and queuing

Posner makes an additional point on queuing when he states, "People queue up to buy litigation but not to buy lobsters because judicial time is not rationed by price and lobsters are." (Posner, 2007, p. 625). This point differs from his distinction between figurative and literal queues, but it is based on a standard representation of the market. Markets for litigation may not be standard, in which a conventional market analysis could be misleading. For standard markets, queues can be largely eliminated if some of those wanting a good or service can offer a higher price, thereby deterring others from effectively demanding the product.³² Rather than price-based rationing, there is time-based rationing through queuing (figurative or literal). Posner is justified in suggesting that, in general, reductions in time delays will increase demand. However, he bases his reasoning on the single purchaser model, whereas litigation involves more than one person. Only one of these people needs to express a demand, and others are then obliged to respond. As time delays may even be advantageous for some people, the magnitude of the deterrent effect of queues on demand is therefore not

³¹ There are a range of costs which may be imposed through legal action, and behaviour may be affected as a result of these costs or attempts to avoid them. An accused may be suspended from work, or face social stigma, whether convicted or not. Ogden (2008) describes an example of legal action being brought with indirect costs being the main factor. The case, which was legally hopeless, nevertheless went to court. Consequently, Justice Harrison imposed costs on Clive Bradbury, the lawyer driving the dispute on behalf of his law firm. According to Justice Harrison, “knowing the proceeding was hopeless, [Bradbury & Muir] used the litigation for the ulterior purpose of attempting to force a financial settlement from Westpac...[Bradbury] was declaring his intention to issue proceedings which would disclose confidential information...to extract a financial windfall from the bank by abusing the process of this Court” (Ogden, 2008, p. 7). This illustrates the way that a threat of legal action may be used in bargaining or negotiation, giving an alternative meaning to bargaining “in the shadow of the law” (see Birks, 2011c).

³² In the sense of effective demand being demand backed by money. Some potential consumers are priced out of the market.

so easy to determine. New Zealand Environment Minister Nick Smith MP has given an example of this, describing the use of the 1991 Resource Management Act (RMA) for anti-competitive behaviour:

“The RMA has been quite badly abused. I'll give the worst example as the battle between Progressives and Foodstuffs on the new supermarket on the North Shore. It took nearly 20 years with the legal battles. What you had was nothing to do with the environment, but the RMA being used by trade competitors, and it doesn't just occur with big business.” (N. Smith, 2009)

It should also be noted that people cannot currently pay for a judge's time. How much would they buy if they could? Would the supply be the same? If demand increases with fewer delays, would this result in a welfare improvement? Would people want legal services to be handled in the current way if there were other options? Currently the supply of judiciary services and the nature of the product provided by the courts are largely set by government, rather than being based on economic factors. There may be good reasons for government involvement, but an economist would suggest that economic aspects must still be considered to determine an appropriate level and form of provision. These aspects might include consideration of externalities (such as the effect of decisions on the actions of others), equity (given people's differing abilities to pay), judicial independence (so no payment from a party would influence outcomes), and state supervision (appointment of judges, etc.), for example.

Given that the government sets the supply of judicial services, the only conclusion that could be drawn from the existence of queues may be that supply is less than demand at designated levels of court fees. If there are other factors to consider, as described above, we cannot determine whether supply is too low or too high.

Posner also states:

“The main response to the growth in demand has been to add judges and supporting judicial personnel. Such a response is unlikely to have a significant effect on court delay other than in the very short run. By increasing the quality of legal redress, at least to those who value prompt justice, an expansion in the number of judges will induce some people to use the courts who previously had been deterred by the delay.” (Posner, 2007, p. 625)

The effect on court delay depends on the extent to which demand increases. It should also be noted that cases are not resolved in zero time, so there can be delays in processing because of time required for specialist reports or other preparation, waiting for availability of witnesses, counsel, or other parties, and so forth. Rather than a simple queuing problem, the issue is more one of complex scheduling. Queues are likely to exist under the best of circumstances.

As a specific Family Court example of the relevance of time as a factor determining outcomes, consider the following quote by New Zealand's Principal Family Court Judge, Patrick D. Mahony:

“Young children need routine. Their sense of security is often built around familiarity of environment, familiarity and consistency of caregiving. Those are very important factors for young children. Their bonding is very closely tied to their sense of security.” (Mahony, 1997)

In practice, the Family Court puts great weight on the status quo when considering custody issues. The emphasis is on continuity of care. This could be interpreted as care by the parent who was the "primary caregiver" before separation, or who has the children for most nights after separation, allowing a judge some discretion. The longer an interim arrangement lasts, the harder it is to achieve any change. Delays in resolving custody matters therefore favour the parent with effective custody.

This also limits options available if a party is not satisfied with an initial decision. While a decision can be appealed, appropriate remedies at that time may not be the same as appropriate decisions in the first instance.

In summary, theory presents an analogy. The discussion on queues in this subsection illustrates how the specific area of application of theory may be important, and the theory should recognise the characteristics relevant in that application. The time requirements and the effects of delays may depend on the nature of the issues under deliberation. Costs and benefits should be assessed in that context.

3. Conclusions

Theoretical approaches do not represent the real world, but they may provide analogies of the real world. The application of a purely theoretical approach is therefore based on assumptions about that approach's relevance for the problem at hand. There may be a lot of information available about the area of application, only a small proportion of which would be incorporated into a theoretical approach. There is therefore a lot of additional investigation that could be undertaken using this additional information to provide insights beyond or in addition to those resulting from pure theory. This has been recognised in several sub-areas of economics, such as economics applied to health, education and land. The result is an identification of specific characteristics that are important in those areas, consideration of which enhances our understanding.

This paper takes a similar approach to the law, giving an initial assessment of the nature of legal services. There are numerous distinguishing characteristics of law, many of which are associated with economic concepts and thereby allow existing knowledge to be brought to bear. Individual components may not be unique to law, with some also being common to health care for example. However, collectively they indicate that basic supply and demand analysis will fail to consider some important aspects of the law, and consequently may present a misleading picture. For example, law as a credence good makes market control of quality very difficult, and individuals seldom use the law, so they have little basis for comparison. The presence of opposing parties creates additional complications. In addition, the limited repeat purchase of services and the institutional allocation of work may affect the focus of those working in the law. Sixteen such characteristics are outlined in Section 1.

There are many areas which could be investigated in more depth, four of which have been covered here. First, the concept of a principal engaging an agent fits the situation where a client uses the services of a lawyer. Consequently, related problems in ensuring appropriate behaviour arise, including those of monitoring and accountability. As was described above, one dimension not commonly addressed is that the relationship between a principal and an agent requires a two-way exchange of information. Neither side may know what information to share, and prior knowledge may be distorted due to prior views as created through means such as macro-rhetoric, including framing and street-level epistemology.

A second area considered the adversarial nature of legal disputes, including those in which one party might be the Crown. This provides a dimension not seen in standard consumption

activities because one party's decision on whether or how to participate affects the situation of other parties. The game theory representation of the prisoner's dilemma may give some insights into the results of such interaction, in which case the result may be a heavier and costlier use of legal services with little or no benefit to the consumers.

A third area considered the nature of the market faced by suppliers of legal services. It was argued that demand may be influenced by interactions with others, including fellow lawyers of court staff, with individual clients sometimes being rare or one-time purchasers of their services. This could affect lawyers' behaviour and resulting service provision, and would mean that a simple supply and demand model might overlook significant aspects of the transactions.

The fourth area considered the nature of costs to consumers. It recognised that costs go beyond fees paid for services provided. The concept of cost-shifting may be relevant, and time may also be significant to a greater or lesser extent depending on the nature of the issues under deliberation. While time delays may be considered as literal or figurative, they do not have to be literal to impose costs. Combining the issue of costs and that of parties in dispute, strategic behaviour is possible, thereby further complicating the representation of a market for legal services. Some of these additional points were discussed in the additional section on queuing.

The discussion of these issues illustrates how economic concepts may serve as tools for application in suitable circumstances. They also show how automatic application of conventional thinking may be misleading if it does not fit the specific nature of the issues being considered. There is scope for much additional investigation along the lines of this paper. Particular areas which could be considered include the nature of legal reasoning, including the type of information provided and how it is used, the incorporation of specialist knowledge through the use of "experts", and mechanisms for ensuring desirable professional behaviour by those working in the legal sector. The material presented here suggests that there are many specific characteristics that can be important, with much potential for "failures" in terms of either increased costs or undesirable or unintended outcomes.

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