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# Economic analysis of law, or economically-informed legal research

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'*For the rational study of the law … the man of the future is the man of statistics and the master of economics. It is revolting to have no better reason for a rule of law than that so it was laid down … and the rule simply persists from blind imitation of the past*' ~ Oliver Wendell Holmes, Jr., 'The Path of the Law' (1897) 10 *Harvard Law Review* 457, 469.

In this chapter, I aim to reflect on the topic of 'lay decision-making in the legal system' from the perspective of the *economic analysis of law*. Or, in other words, I attempt to look at the ways in which economic theory and insight can help resolve issues of legal decision-making by providing both a methodology for the analysis of the legal reality to which the decision relates (that is, contributing to the decision-making process by structuring it and helping us focus on relevant factors), and a normative framework and workable criteria to favour some alternatives over others (i.e. providing a decision-making benchmark). Broadly, then, I am concerned with the question of how can economic analysis help us improve legal decision-making generally. After this broad discussion, which is confessedly superficial, and in order to stress the link with the rest of the contributions to this book, I briefly focus on the potential application of some of these theories to research that aims to assess specific issues of lay decision-making in the legal system. Some final thoughts stress the importance of carrying out economically-informed legal research more generally.

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## Introduction

The economic analysis of law (also generally known as *law and economics*)[1] is probably the dominant legal methodology in US scholarship, and one that is slowly growing in importance in Europe,[2] although it is still a far from mainstream methodology in most EU and UK law schools.[3] As aptly put, it 'uses economic theory to analyse the legal world. It examines that world from the standpoint of economic theory and, as a result of that examination, confirms, casts doubt upon, and often seeks reform of legal reality'.[4] Or, in even clearer terms, the 'Economic analysis of law seeks to answer two basic questions about legal rules. Namely, what are the effects of legal rules on the behaviour of relevant actors? And are these effects of legal rules socially desirable?'.[5] Therefore, the economic analysis of law serves two main purposes. First, it helps describe and explain how the law is and what effects it creates or can be expected to create (positive dimension). Second, it provides a framework for critical analysis and an ultimate view of how the law *ought* to be (designed, reformed, interpreted or enforced) for it to achieve specific goals that are socially desirable (normative dimension). Both functions can be controversial, but the normative dimension of the economic analysis of law—which ultimately rests on the pursuit of economic efficiency as a proxy for the maximization of social welfare,[6] as discussed below—has probably been its most debated aspect, and one that has triggered significant resistance and even full-on rejection of this methodology. One extreme line of criticism

[1] In this chapter, I use the expressions *law and economics* and *economic analysis of law* interchangeably. However, distinguished scholars have made important attempts to establish differences between the two; see e.g. G Calabresi, *The Future of Law and Economics: Essays in Reform and Recollection* (Yale University Press, 2016). I do not ignore their work, but the discussion here remains at a level of generality where such distinctions are not needed.
[2] Nuno Garoupa and Thomas S Ulen, 'The Market for Legal Innovation: Law and Economics in Europe and the United States' (2007-2008) 59 *Alabama Law Review* 1555-1633.
[3] For discussion on current developments on legal methodology, see Rob van Gestel, Hans-W. Micklitz and Miguel Poiares Maduro, *Methodology in the New Legal World* (2012) EUI Working Paper LAW 2012/13 available at http://cadmus.eui.eu/bitstream/handle/1814/22016/LAW_2012_13_VanGestelMicklitzMaduro.pdf (last accessed 20 June 2016); and Rob van Gestel and Hans-W. Micklitz, 'Why Methods Matter in European Legal Scholarship' (2014) 20(3) *European Law Journal* 292-316.
[4] Calabresi (n 1) 2. For a distinction with what he calls *law and economics*, see ibid 3-4. As Calabresi explains, this largely matches behavioural law and economics, which is not discussed in detail in this chapter.
[5] Louis Kaplow and Steven Shavell, 'Economic Analysis of Law', in Alan Auerbach and Martin Feldstein (eds), *Handbook of Public Economics*, vol. 3 (Elsevier, 2002) 1661-1784, 1661.
[6] Peter Bohm, *Social Efficiency: A Concise Introduction to Welfare Economics*, 2nd edn (Macmillan, 1987).

has even relied on the claim that law and economics may be immoral.[7] These issues may create a smoke screen allowing critics to dismiss the economic analysis of law too quickly as either a neoliberal market-making endeavour, or a methodology only relevant in very limited aspects of commercial or market-based legal sub-fields. My submission is that this is simply not the case and that the economic analysis of law is a fundamental tool with which to try to ensure that the legal system is both effective in achieving its goals (which are by no means predetermined by the law and economics approach), and efficient in doing so (that is, it achieves those goals in the way that makes most members of society better off, which is what the concept of efficiency as a proxy for social welfare ultimately encapsulates). This submission relies on a number of implicit assumptions, which I will try to unpack later.

It is worth stressing that the economic analysis of law rests on the work of some giants of economic and legal thought,[8] a good number of which were awarded Nobel Prizes in Economics. It is hard to make justice to their work when one tries to strip their theories from technical complication and to present their insights in an accessible way.[9] Thus, I do not aim to present the several technical approaches broadly comprised within the economic analysis of law methodology in a thorough and detailed manner, but I will much rather only try to explain the usefulness of incorporating economic insights into legal analysis and scholarship, in what I like to call *economically-informed legal research*. To push the argument, I am convinced that carrying out legal research without assessing its economic implications and without incorporating the insights of economic theory is ultimately

[7] For discussion, see Robin P Malloy and J Evensky (eds), *Adam Smith and the Philosophy of Law and Economics* (Kluwer, 1994), and Aristides N Hatzis and Nicholas Mercuro (eds), *Law and Economics: Philosophical Issues and Fundamental Questions*, The Economics of Legal Relationships (Routledge, 2015). For an advanced analysis, see Walter J Schultz, *The Moral Conditions of Economic Efficiency*, Cambridge Studies in Philosophy and Law (Cambridge University Press, 2001).

[8] It is impossible to cover even just the seminal contributions to the development of this field in a basic discussion such as the one in this chapter, as the relevant authors include distinguished scholars such as Arrow, Becker, Buchanan, Calabresi, Coase, Friedman, Nash, Posner or Stigler. Any enumeration is however bound to be unfair due to its incompleteness. For clear points of reference in the existing literature, see Richard Posner, *Economic Analysis of Law*, 9th edn (Wolters Kluwer, 2014) and Steven Shavell, *Foundations of Economic Analysis of Law* (Harvard University Press, 2004); as well as the standard handbook by Robert B Cooter Jr and Thomas Ulen, *Law and Economics*, 6th edn (Pearson, 2012). For a simpler introduction, see A Mitchell Polinsky, *An Introduction to Law and Economics*, 4th edn (Aspen, 2011).

[9] For an excellent and successful attempt to provide such accessible introduction, see Emanuel V Towfigh and Niels Petersen (eds), *Economic Methods for Lawyers* (Edward Elgar, 2015). For a thought-provoking introduction, see J Leitzel, *Concepts in Law and Economics. A Guide for the Curious* (Oxford University Press, 2015).

unsatisfactory, just as it is equally faulty not to incorporate the insights derived from political science and other social sciences such as sociology or anthropology, or even beyond, from evolutionary theory and psychology. This is not to say that strict doctrinal legal research has no place in modern academia or that it lacks value,[10] but rather a call for legal scholars to broaden their views and – once their analyses are legally technically sound from a legal perspective – to consider them in their relevant context, in particular from an economic perspective, as a matter of analytical completeness.[11] Law is not, and probably has never been an independent field of study. When it was claimed it was, a deeper analysis would show that law scholars were making philosophical or even theological – dogmatic – analysis of normative statements or social norms settled down in a text.[12] Even further legal studies can hardly be considered free from normative implications.[13] Thus, doctrinal legal research may (simply) differ from other approaches in presenting itself as aseptic and not being explicit about the social and economic normative assumptions that underlie any specific piece of analysis. If that is true, then, it seems preferable to be sincere and avoid masking and passing as 'technical' evaluative issues that are fundamentally normative. I will also try to explain this in more detail later.

I will not cover all aspects of the economic analysis of law and, in particular, I will not discuss in detail its main criticisms and the emergence of *behavioural* law and economics or an *economic analysis of law 2.0*.[14] Focusing strictly on 'classic' economic analysis of law (*law and economics 1.0*,

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[10] This is linked to the discussion on whether 'doctrinal legal research is dead' in which Eric Posner and Richard Posner, amongst others, engaged. For discussion, see the contribution by Hutchinson to this book.

[11] Similarly, Douglas G Baird stressed that 'As long as legal scholars have to worry about the consequences that a new law brings, we shall call upon the tools of law and economics'; in 'The Future of Law and Economics: Essays by Ten Law School Scholars' (2011) *The Record*, available at http://www.law.uchicago.edu/alumni/magazine/fall11/lawandecon-future (last accessed 25 May 2016).

[12] For extended discussion, see Tara Smith, 'Neutrality Isn't Neutral: On the Value-Neutrality of the Rule of Law' (2011) 4(1) *Washington University Jurisprudence Review* 49, available at http://openscholarship.wustl.edu/law_jurisprudence/vol4/iss1/3 (last accessed 20 June 2016).

[13] *Cf*. Andrei Marmor, 'Legal Positivism: Still Descriptive and Morally Neutral' (2006) 26(4) *Oxford Journal of Legal Studies* 683-704. See also Reza Banakar, 'Can Legal Sociology Account for the Normativity of Law?' in M Baier and K Åström (eds), *Social and Legal Norms* (Ashgate, 2012). See also Kenneth M Ehrenberg, 'Defending the Possibility of a Neutral Functional Theory of Law' (2009) 29(1) *Oxford Journal of Legal Studies* 91; and Richard L Abel, 'Redirecting Social Studies of Law' (1980) 14(3) *Law and Society Review* 805.

[14] For discussion, see the special issue of the University of Chicago Law School Alumni Magazine *The Record* in the fall of 2011, available at http://www.law.uchicago.edu/alumni/magazine/fall11/lawandecon2-0 (last accessed 25 May 2016).

or *'primitive' law and economics*)[15] is simply justified by the need to provide a clear account of what this methodological approach can and cannot do, and to avoid any misrepresentation of the very powerful analytical tools it offers, even when the criticisms are considered—or, *discounted*, if you wish. Consequently, all the discussion in this chapter will revolve around the basic understanding of law as an institution aimed at regulating the behaviour of the economic man (or *homo economicus*),[16] without engaging in any level of detail with the theories that challenge this conception or seek to refine it.[17]

### The importance of the *homo economicus* for the economic analysis of law

In very general terms, it can be said that the economic analysis of law focuses on the study of how changes in the law alter the way people behave, which requires a characterisation of human behaviour. Economic analysis is based on rational choice theory, which ultimately rests on the assumption that humans are rational beings who behave accordingly. Thus, the economic analysis of law revolves around the model of the economic man (or *homo economicus*).[18] This means that, for the purposes of predicting or analysing the behaviour that will result from specific legal rules or reforms, the economic analysis of law *assumes* that we make decisions based on our assessment of the utility we can obtain from the different options[19] and that, rationally, we will choose the option that maximises our utility (or, in other words, that we are self-interested). This general assumption leads us to e.g. expect people to have an incentive to breach a contract if they can obtain a benefit from non-compliance (for instance, the seller has incentives to walk away from a contractual commitment and hand over the goods to a higher bidder); or expect them to be more deterred from committing crimes

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[15] Cynthia A Williams, 'A Tale of Two Trajectories' (2006) 75(3) *Fordham Law Review* 1629, 1657, available at http://ir.lawnet.fordham.edu/flr/vol75/iss3/21 (last accessed 20 June 2016).

[16] At this level of generality, the potential connections with socio-legal studies are probably quite apparent, particularly if socio-legal studies are conceptualised in broad terms and the fact that economics is a social science is given proper weight. However, the economic analysis of law is usually not included amongst the garden variety of socio-legal approaches, at least in UK academia.

[17] See Christine Jolls, Cass R Sunstein, and Richard Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50(5) *Stanford Law Review* 1471-1550.

[18] For discussion, see Harold Demsetz, 'Where Economic Man Dwells', in *From Economic Man to Economic System: Essays on Human Behavior and the Institutions of Capitalism* (Cambridge University Press, 2011).

[19] In simple terms, utility is meant to capture the value or the advantage that derives from a given option, which can make it desirable. Or, in other words, it encapsulates 'the capacity of a good or service to satisfy a want, of whatever kind'. For discussion, see R D Collison Black, 'Utility', in John Eatwell, Murray Milgate and Peter Newman (eds), *Utility and Probability* (Palgrave, 1990) 295-302.

the higher the sanction and/or the likelihood of being caught and convicted; or to pursue their own individual interests if the negative consequences of a given behaviour fall upon somebody else's shoulders (such as slacking at work if the employer cannot monitor effort, or reducing the level of precaution when carrying out insured activities if the insurer cannot detect changes in diligence).

This characterisation of human behaviour as rational allows for the formulation of economic models that can explain the behaviour (as a result of the incentive structure that underlies the expressed rational choice) and, more importantly, aim to predict it (especially in view of changes in the structure of incentives). This is particularly relevant because most legal rules aim at preventing types of behaviour that are considered undesirable, either from a social perspective (e.g. criminal activity) or within the framework of private relationships (such as breaching contracts, causing damages to innocent parties or deceiving trustful partners). It is also useful because sometimes the behaviour that can be considered *privately* undesirable may simultaneously be *socially* desirable, or the opposite. A clear example arises in the area of environmental law, where private parties have rational incentives to minimise their costs (for instance, by acquiring goods or services from highly polluting sources if they are cheaper than environmentally-friendly alternatives), despite the fact that this can impose a higher ecological cost on society at large, which is socially undesirable.[20] Conversely, an absolute avoidance of any ecological costs could be socially undesirable if it led to the prevention of economic activity that, overall, could be socially beneficial in terms of generation of employment or the production of necessary goods or services. The economic analysis of law can offer valuable tools that help decision-makers reach a balance of interests that maximizes social welfare in the long-run (or at least tends to it). Furthermore, it is also relevant because sometimes there will be different ways of promoting the same private behaviour, but they will come at different social costs (such as the difference in costs between raising sanctions and increasing investigative capacity, e.g. for the prevention of tax fraud, towards which either option should contribute, as discussed in more detail below).[21] In those

[20] This relates to the concept of externality, which is a key element of analysis linked to market failure in the so called *tragedy of the commons*. See James M Buchanan and William C Stubblebine, 'Externality', in Chennat Gopalakrishnan (ed), *Classic Papers in Natural Resource Economics* (Palgrave, 2000) 138-154; and Elinor Ostrom, 'Tragedy of the commons', in Steven N Durlauf and Lawrence E Blume (eds), *The New Palgrave Dictionary of Economics*, 2nd edn (2008).
[21] George J Stigler, 'The Optimum Enforcement of Laws' (1970) 78(3) *Journal of Political Economy* 526-536.

circumstances, being able to compare options from a social welfare perspective will be important for decision-makers.

As these basic examples show, the main analytical advantage that the economic analysis of law offers is that, by working on the basis of a characterisation of human behaviour *that closely resembles reality* (at least in most settings or in terms of average expected behaviour), it allows for rather accurate predictions of how changes in legal rules can alter that behaviour so as to promote socially desirable outcomes, as well as to allow the design of private relationships in ways that best serve the interests of the parties involved.[22] The models and the examples do not aim to replicate reality in a perfect way (which would not be possible), but rather to create a workable framework for analysis.[23] In the end, this characterisation of behaviour allows us to identify the incentives created by legal rules and, on that basis, to predict the *likely* behaviour of those subjected to the rules. The immediate implication is that, should the expected behaviour not be the desired one, the same economic analysis of law allows us to design counter-incentives and to assess (both theoretically and empirically) if they are superior in promoting the desired behaviour. All of this ultimately rests on the need to determine what behaviour is desirable, which the economic analysis of law answers by clearly indicating that behaviour will be desirable if it fosters social welfare in the long run. This normative bedrock of the economic analysis of law also deserves further discussion.

**Why is this all about efficiency, what about redistribution or fairness?**

The economic analysis of law rests on the position that behaviour will be desirable if it promotes social welfare in the long run. Or, in other words, behaviour will be desirable if it is economically efficient. This proposition triggers two issues. First, how to determine what is economically efficient behaviour and, second, why are alternative goals, such as redistribution of wealth or fairness, not used as the normative benchmark for analysis.

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[22] Gregory Mitchell, 'Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence' (2002) 91 *Georgetown Law Journal* 67.

[23] For discussion, see Muireann Quigley and Elen Stokes, 'Nudging and Evidence-Based Policy in Europe: Problems of Normative Legitimacy and Effectiveness', in Alberto Alemanno and Anne-Lise Sibony (eds), *Nudge and the Law: A European Perspective*, Modern Studies in European Law (Hart, 2015) 61, 75 and ff.

The first question is relatively easier to answer on the basis of the theoretical work of welfare economists. In strict terms, a situation (or legal rule) will be efficient—i.e. will create the highest possible level of social welfare—if it is not possible to modify it in a way that makes some individuals better off without making anyone worse off or, in other words, a situation will only be efficient if it generates advantages to some to the prejudice of none. This strict approach to efficiency is known as Pareto efficiency.[24] The difficulty with this strict approach is that it would make legal reform almost impossible, in particular if changes to legal rules (e.g. increases in taxation) would negatively affect the rights or legal position of any individual (in the example, that is inescapable because someone would bear the burden of the higher taxes). This makes the strict criterion of Pareto efficiency vulnerable to the criticism that it consolidates existing inequalities and that it prevents legal reform that is socially desirable in a broader sense.

To tackle this issue, a refined concept of efficiency was developed by Kaldor and Hicks.[25] Under Kaldor-Hicks efficiency, there is no increase in economic welfare unless, as a result of the implementation of a given rule or policy, those who gain would *in principle* be able to compensate fully those who lose and still be better off themselves—that is, unless there is a net social gain of economic welfare.[26] Using the same example, increases in taxation can be considered efficient under the Kaldor-Hicks criterion even if some members of society are worse off due to the higher taxation, provided that the benefits derived from the increased public revenue by those that are on the receiving end (e.g. recipients of social benefits or users of the public healthcare system) derive a larger advantage, even if there is no actual compensation between these different social groups. This is the concept of social welfare that forms the basis of the (mainstream) economic analysis of law methodology.

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[24] See Vilfredo Pareto, *Manuale di economia politica con una introduzione alla scienza sociale* (Società Editrice Libraria, 1906, repr 1919).

[25] See Nicholas Kaldor, 'Welfare Propositions and Interpersonal Comparisons of Utility' (1939) 49 *The Economic Journal* 549-552, and John R Hicks, 'The Foundations of Welfare Economics' (1939) 49*The Economic Journal* 696-712. The seminal ideas behind this approach were advanced by AC Pigou, *The Economics of Welfare*, 4th edn (London, MacMillan, 1932).

[26] On the desirability of this normative criterion, see Richard Posner, 'Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication' (1980) 8(3) *Hofstra Law Review* 487; and Jules L Coleman, 'Efficiency, Utility and Wealth Maximization' (1980) 8(3) *Hofstra Law Review* 509.

A close look at the criterion of Kaldor-Hicks efficiency makes it clear that the analysis under welfare economics is not concerned with whether compensation or redistribution is *actually* achieved by a given rule or legal reform, but it simply focuses on whether that would be possible in economic terms. It also does not express or indicate any preference about who should benefit from the net economic efficiency derived from the legal situation or reform. In that regard, a legal reform whereby the richest in society benefit sufficiently to potentially compensate the poorest that suffer the detriment derived from that legal reform is as desirable as the opposite development, provided both scenarios create the same absolute amount of social welfare. Thus, inequality and its potential increase is not captured by the Kaldor-Hicks efficiency criterion. This has been another focus of criticism of the economic analysis of law, and critics have raised the stylised argument that legal scholarship should be concerned with redistribution and equality or, more generally, with fairness (or justice).[27] Looking forward, this is a criticism bound to carry some additional weight in view of the increasing discussion about the impact of inequality in terms of economic development.[28] However, it is important to stress that economic analysis of law scholars do not necessarily dismiss those concerns in the abstract or in absolute terms. Rather, the consensus is that equality-oriented interventions should be left to specific areas of law and policy specifically designed around the issue of wealth (re)distribution (such as taxation and welfare law), whereas the rest of the legal system (and in particular private law) should not be driven by redistributive considerations because doing so makes the economic analysis either skewed or impossible.[29] The same applies to arguments of fairness, which are simply impossible to tackle using economic methods.[30] Overall, then, a possible way to conceptualise this is simply to

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[27] Duncan Kennedy, 'Law-and-economics from the perspective of critical legal studies', in John Eatwell, Murray Milgate and Peter Newman (eds), *New Palgrave: A Dictionary of Economics*, 1st edn (1987) 465-474.
[28] See Thomas Piketty, *Capital in the Twenty-First Century* (Harvard University Press, 2014) and the debate it has sparked in economic literature and beyond. See also Angus Deaton, *The Great Escape: Health, Wealth, and the Origins of Inequality* (Princeton University Press, 2013).
[29] For extended discussion, see Louis Kaplow and Steven Shavell, *Welfare versus Fairness* (Harvard University Press, 2002) and David A Weisbach 'Should Legal Rules Be Used to Redistribute Income?' (2003) 70 *University of Chicago Law Review* 439. For a criticism of this line of thought, see C Sanchirico, 'Taxes versus Legal Rules as Instruments for Equity: A More Equitable View' (2000) 29 *Journal of Legal Studies* 797; and ibid, 'Deconstructing the New Efficiency Rationale' (2001) 86 *Cornell Law Review* 1003.
[30] The difficulty of using other evaluative criteria, such as fairness, was stressed by GJ Stigler, 'The Law and Economics of Public Policy: A Plea to the Scholars' (1972) 1 *Journal of Legal Studies* 1.

understand that the economic analysis of law ultimately aims at finding ways of making the pie as large as possible, without concerning itself with (nor being able to determine) how the pie is split.[31]

This on-going discussion and the implicit acceptance of the higher relevance of the economic analysis of law as a powerful methodology where redistribution (or broader *soft* public policy goals) is not the primary concern for legal intervention has had an impact in determining the areas of law where economic analysis has been more developed, which mainly concentrate around commercial law and private law broadly speaking. As clearly summed up,

> Today, economic thinking dominates contract, commercial, bankruptcy, antitrust, corporate, and securities law and related fields. It is also influential if not dominant in tort, criminal, and property law and civil procedure. It has made less progress in the major fields of public law, including constitutional, immigration, administrative, and international law. These areas of law are less closely connected with commercial behavior than most of the others, and so the off-the-shelf economic models do not as clearly apply to them. Economists have produced a large political economy literature, but the models in this literature are more controversial and less usable than models of commercial behavior.[32]

This does not mean that economic analysis of law is necessarily limited to private and commercial law, but it is a fact that these are the fields where its insights may be more powerful and less controversial. Thus, the remainder of the discussion will start by exploring them, and then proceed to other areas of application of the economic analysis of law.

**The origins of law and economics and its focus on transaction costs**

One of the areas where the insights of economic analysis of law are clearly consolidated (and relatively uncontroversial) concerns the analysis surrounding the concept of transaction costs,[33] and the related Coase theorem.[34] Transaction costs are those linked to a given transfer of assets that are

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[31] For discussion and a different view, see Lucian A Bebchuck, 'The Pursuit of a Bigger Pie: Can Everyone Expect a Bigger Slice?' (1980) 8(3) *Hofstra Law Review* 671-709.
[32] Eric A Posner, in Baird (n 11).
[33] Oliver E Williamson and Scott E Masten (eds), *The Economics of Transaction Costs* (Edward Elgar, 1999).
[34] Ronald H Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1-44.

necessary for a legal exchange to take place, such as information costs, negotiation costs, enforcement costs, etc. In simplified terms, the analysis based on transaction costs that leads to the Coase theorem indicates that, in the absence of transaction costs (or where they are sufficiently low) assets will be traded in a way that ensures their optimal final allocation (i.e., regardless of any initial allocation of assets, they will be put to their best possible social use). Conversely, where transaction costs are high, economic transactions that would otherwise be efficient will not take place, which causes a loss of (potential) social welfare.[35]

The classical example to illustrate the Coase theorem concerns situations where allowing party A to carry out an activity damages party B, while preventing damage to party B necessarily causes a detriment to part A. For instance, let's think of a situation where party A runs a private school and party B runs a music studio.[36] The school and the music studio are adjacent, so parties A and B are neighbours. Until now, the music studio was only open in the evenings, while the school finished classes in the early afternoon. Thus, until now, the school and the music studio could both develop their activities unaffected by each other. Imagine that the music studio, in view of increased demand for its services, considers opening all day. If that happens, the school will probably be affected because the noise coming from the studio will distract pupils during their classes.[37] In abstract terms, there are two possible legal rules or models: under option 1, the school is legally responsible to provide a proper (quiet) learning environment to its pupils and, if that is not the case, it must pay the costs to make the situation good or stop its activities altogether. Differently, under option 2, the music studio is responsible for avoiding noise and nuisance to its neighbours, and it is liable to pay damages

[35] This is ultimately linked to the problem of market failure. See Francis M Bator, 'The Anatomy of Market Failure' (1958) 72(3) *Quarterly Journal of Economics* 351-379. Market failure is one of the main justifications for regulatory intervention. However, any such intervention is affected by potential problems of government failure; see Jonathan J Pincus, 'Market Failure and Government Failure' in S King and P Lloyd (eds), *Economic Rationalism: Dead End or Way Forward* (Allen & Unwin, 1993) 261-276.

[36] The qualification that the school is private aims to avoid issues concerning the social value of education, which is certainly difficult to measure. It is generally more accessible (and less controversial) to solely focus on the financial benefits of running a school as a business. This is not intended to pre-empt any other discussion. For some thoughts on the difficulties in measuring the value of public goods, see David S Brookshire and Don L Coursey, 'Measuring the Value of a Public Good: An Empirical Comparison of Elicitation Procedures' (1987) 77(4) *The American Economic Review* 554-566.

[37] The converse example could be constructed assuming the school intends to offer out-of-hours sports activities and the music studio is concerned that the background noise will disturb its clients or diminish the quality of the musical recordings, so the example is not intended to point towards any specific outcome.

if it breaches that obligation. Under rule 1, the school has no possibility to sue the music studio, and its only option to avoid discontinuing its activities due to noise is to invest in soundproofing the school. Under rule 2, the music studio is the one having to invest in soundproofing its premises, least it wants to be open to claims for damages.

An approach to this problem under other research methodologies would probably focus on whether it would be fair for the music studio to take advantage from extended noise hours at the expense of the school, or whether favouring one activity over the other creates the type of social effect that is considered desirable under the relevant normative framework (such as the promotion of regulated school education or the expansion of space for unregulated liberal arts). Differently, under the methodology of economic analysis of law, and in particular under transaction cost analysis, the Coase theorem aims at solving the problem by identifying which solution is more efficient. To understand the insights of this analysis, we need some additional information. Imagine that the private school obtains a profit of £500,000 a year and that it would cost it £100,000 per year to soundproof its premises. In turn, the music studio could increase its annual profit by £250,000 if it extended its opening hours beyond evenings (the current level of turnover of the studio not being relevant), and the cost of soundproofing its premises would be of £200,000 per year. Alternatively, the music studio could risk having to pay damages to the school, which would be of £300,000 a year. Under rule 1, the school would clearly decide to invest in soundproofing rather than closing down altogether (hence keeping a profit of £400,000 per year). Similarly, under rule 2, the music studio would rather soundproof its premises and extend its opening hours than keeping its activity limited to the evenings (thus obtaining an additional benefit of £50,000) or being exposed to damages claims (thus incurring losses of £50,000). Apparently, then, rule 1 is more efficient than rule 2. This derives basically from the fact that the cost of the remedial measure is lower for the school than for the music studio. However, and this is the crucial contribution of the Coase theorem, both rules 1 and 2 are inferior to the solution that parties A and B could reach if they are allowed to cooperate.[38]

[38] We are not concerned here with the analysis of whether cooperation would actually take place, which would be something to assess under game theory, which is briefly discussed below.

In a scenario of possible cooperation (that is, where there are no, or only very low transaction costs), when the music studio considers the possibility of extending its hours, it could ask the school to provide an estimate of its soundproofing costs. When the music studio realised that it was cheaper for the school to take those measures than for itself, it would be rational for the music studio to ask the school to soundproof and to offer to cover the costs, which would allow for a saving of £100,000 per year in soundproofing costs. It would be equally rational for the school to point out that the music studio should compensate the school for its collaboration, so that they should split the savings equally. The end result would then be that the school would take the soundproofing measures and the music studio would pay it £150,000, thus leaving both parties better off (the school would have a total annual profit of £550,000 and the music studio would increase its annual profits by £100,000). The collaborative solution is superior because both parties are better off than under any other solution.

What this indicates is that, where collaboration is possible, the initial allocation of rights (that is, whether rule 1 or rule 2 controls, or whether the music studio has the right to create noise or the school has the right to a quiet environment) is not relevant and an efficient outcome will be achieved regardless. However, this does not resemble reality because transaction costs are far from zero and because the set of circumstances we have depicted are unrealistic. On the contrary, where collaboration is not possible because transaction costs are sufficiently high (e.g., the cost of negotiating a contract between the school and the music studio exceeds the value of the savings derived from collaboration), the initial allocation of rights is very relevant to the possibility of achieving an efficient outcome and any legal rule devised to adjudicate on disputes runs the risk of being inferior to the collaborative solution that could otherwise emerge.

The insights that derive from this type of analysis are plentiful, but the most obvious ones are that, when designing legal rules, a clear focus should be on the minimisation of transaction costs, so as to facilitate collaborative solutions that can increase the efficient use of the resources. Further, that in the design of legal rules, the most efficient solutions can be achieved if costs are imposed on the party that can avoid them more efficiently (cheapest cost avoider), even if it is not the obvious party on which to impose a cost from a different perspective (for instance, under fairness or distributive justice

considerations). Of course, all these insights result in the need to carry out additional (and increasingly complex) analyses (for instance, to determine who is the cheapest cost avoider in a specific situation, or which rule will tend to impose the risk on the class of agents that are generally the cheapest cost avoiders, and so on) and be sure that all relevant circumstances are taken into account (e.g., are there third parties affected by the noise coming from the studio other than the school?).[39] The work of legal researcher thus starts with an examination of the rules applicable to the case (does the school have a right to silence? are the requirements for a claim, e.g. in tort, met? is there a general obligation to minimise losses before claiming compensation, or a duty to cooperate with the tortfeasor in minimising the costs of the activity creating the nuisance? etc), including the way they are interpreted and applied by the courts, and then turns towards a consideration of whether these rules are efficient as a final critical assessment potentially leading to proposals for legal reform.

**The extension of the economic analysis of law beyond private law: crimes and sanctions**

Beyond the area of private law disputes, the economic analysis of law can also provide useful insights in areas such as criminal law or branches of administrative law that deal with sanctions and fines. In these areas, the concept of deterrence is fundamental in order to get the level of sanctions and the amount of effort put into policing crimes and violations right (or, more realistically, to promote legal reforms that tend towards the optimal level of deterrence). Analysis of these issues under other methodologies can often face difficulties such as assuming that all crimes can be deterred (which is not a truly workable assumption, if nothing else, due to the prohibitive costs it would entail in terms of policing), or lacking indications as to the appropriate level of criminal and administrative sanctions in view of the (im)moral nature or general undesirability of specific types of behaviour. The economic analysis of law as applied to this area provides some insights that can be useful on both fronts. On the first aspect, it stresses a certain degree of substitution between investing more resources in deterrence and raising the level of the sanctions. However, it also makes it clear that both issues (in particular increasing the level of sanctions) are subjected to decreasing marginal gains and, consequently, at

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[39] For discussion, see Guido Calabresi and A Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089-1128. Please bear in mind that their contribution has not, however, been uncontroversial.

some point both further investments in deterrence capacity and further increases of the applicable sanctions can be ineffective, or even counter-productive. A useful example can be found in the Singaporean ban on the importation and sale of chewing gum. The punishment for illegal gum trafficking was never corporal, but even for a first offence it can include a fine of up to S$100,000 (£51,000 or €65,000 approx.) and up to two years in prison.[40] Imagine that this measure proved insufficient to completely prevent damages derived from improper chewing gum disposal in the Singapore underground (which was the original goal of the ban) and the Singaporean government decided to attach corporal punishment, or even the death sentence for gum traffickers. Would that be a measure susceptible of creating further deterrence, or would it actually undermine the effectiveness of the ban as a whole? That is the sort of thing that can be assessed under general deterrence theory. On the second issue, concerned with the appropriate level of sanctions, by developing an economic theory of crime, law and economics can also provide some indicators as to how to set the sanctions at a level that is efficient (this can, for instance, be useful in terms of choosing whether a given behaviour should constitute an administrative offence liable to the imposition of a fine, or rather be a criminal offence that can carry an imprisonment sentence or some other sort of non-monetary sanction).

Even if it seems counterintuitive at first sight, the economic analysis of law applied to these areas contributes important insights through a theory of rational crime, whereby the incentives and disincentives for the commission of crimes are treated in a way relatively similar with those for the engagement in preventative or corrective measures discussed above. Under this conceptualisation, it is expected that people will commit crimes whenever they expect to gain from them or, maybe in more accurate terms, when the expected sanction is insufficient to deter them from committing those crimes. A relatively straightforward insight is that the expected sanction for the commission of a given offence is the combined result of the probability of being caught (and convicted) for the offence

[40] See Leo Benedictus, 'Gum control: how Lee Kuan Yew kept chewing gum off Singapore's streets', *The Guardian*, 23 March 2015, available at http://www.theguardian.com/lifeandstyle/shortcuts/2015/mar/23/gum-control-how-lee-kuan-yew-kept-chewing-gum-off-singapores-streets (last accessed 20 June 2016).

and of the level or seriousness of the sanction.[41] Thus, it is possible to establish the pay-off that the potential offender would consider in terms that function as prices.

Examples of this are particularly clear if we consider economic offences that are commonly committed as the result of a rational process, such as tax evasion[42] (although the theory applies equally to other crimes and offences). Under this approach, in order to deter the potential offender, it is necessary for the expected sanction to be larger than the expected gain from committing the offence. Imagine an individual subjected to the highest taxation bracket of 40% currently applicable in the UK, who decides to under-report its income by £10,000. This would lead to an immediate saving of £4,000 in evaded taxes. Imagine that the applicable sanction for that amount of tax evasion was £10,000. The question at this point would be why would she decide to under-report her income, in particular given that the sanction for that behaviour is nominally higher than the amount it plans to evade (in terms of evaded taxes, and equal to the amount of income she plans to under-report). However, maybe counterintuitively, the economic analysis of law demonstrates that this situation would still not ensure deterrence of the under-reporting because not all instances of tax evasion get identified, investigated and successfully sanctioned. Imagine that the tax inspectorate (HMRC) has a probability of sanction of 12% of this type of tax evasion (for instance, because this type of case ranks low in its enforcement priorities, which lead it to concentrate on corporate tax evasion). Then, the expected sanction is the result of multiplying the probability of being sanctioned times the applicable sanction, which means that the expected sanction is actually of £1,200 (that is the amount of the fine £10,000 multiplied by the probability of being caught and sanctioned, which is 12% or 0.12), and falls well below the level needed in deterrence terms. And this is so despite it implying that, in case of being imposed, the £10,000 sanction would represent 2.5 times the evaded taxes (of £4,000) and 100% of the under-reported income (of £10,000), which would ensure that the tax evader keeps no economic advantage whatsoever.

[41] For in-depth discussion, see Gary S Becker, 'Crime and Punishment: An Economic Approach' (1968) 76(2) *Journal of Political Economy* 169-217; and Stigler (n 21).
[42] See Maurice Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1(4) *Journal of Public Economics* 323-338; and in-depth discussion in Joel Slemrod, 'Cheating Ourselves: The Economics of Tax Evasion' (2007) 21(1) *Journal of Economic Perspectives* 25-48.

It is important to note that this is the case because the pay-off of the potential offender would be positive. With a probability of 88% (that is, the reverse of the 12% probability of being sanctioned), she gets to keep the £4,000 in evaded taxes. Taking into account both the benefits of avoiding taxes if not caught and the cost of the fine if caught, this means that her expected pay-off is: 0.88 x £4,000 – 0.12 x £10,000 = £2,320. These calculations still may need to be subjected to adjustments in order to incorporate the potential offender's approach to risk. Risk averse people will tend to over-estimate the probability of being caught (in the example, if she *perceives* the probability of being sanctioned to be any higher than 40%, then she is deterred because at that point her expected pay-off becomes negative), whereas risk prone people will do the opposite.[43] In any case, though, being able to at least assess the risk neutral case already provides interesting insights—since, otherwise, it could have been quite intuitive to assume that a sanction of £10,000 for the evasion of £4,000 in taxes or £10,000 in taxable income was actually sufficient for deterrence purposes.

Beyond this descriptive power, which can help explain difficult issues such as the perceived ineffectiveness of existing sanctions to deter specific types of behaviour that are considered undesirable (such as tax evasion), the economic analysis of law can also help in normative aspects, such as whether to criminalise a given activity that could otherwise be considered a mere administrative offence (which is clearly relevant in terms of the design of public policy around controversial areas such as drug dealing,[44] or prostitution[45]). The approach under this methodology will usually help structure a cost/benefit analysis[46] of the different options available—which is ultimately oriented towards identifying the option that, on the whole or in net terms, creates the largest surplus or the smallest shortfall—and, more often than not, will allow the researcher to

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[43] Developing the example to capture all the complexities that a full formulation of the economic theory of crime has developed would exceed the possibilities of our discussion. The interested reader can follow the discussion in Cooter and Ulen (n 8) chapters 11 and 12, and Shavell (n 8) chapters 20 to 24.

[44] Sylvaine Poret, 'Paradoxical Effects of Law Enforcement Policies: The Case of the Illicit Drug Market' (2002) 22(4) *International Review of Law and Economics* 465-493. For a related analysis of the economics of drug dealing, see Steven D Levitt and Sudhir Alladi Venkatesh, 'An Economic Analysis of a Drug-Selling Gang's Finances' (2000) 115(3) *Quarterly Journal of Economics* 755-789.

[45] Rocio Albert, Fernando Gomez and Yanna Gutierrez Franco, *Regulating Prostitution: A Comparative Law and Economics Approach* (2007) FEDEA Working Papers No 2007-30, available at http://documentos.fedea.net/pubs/dt/2007/dt-2007-30.pdf (last accessed 26 May 2016).

[46] See Sukhamoy Chakravarty, 'Cost–benefit analysis', in John Eatwell, Murray Milgate and Peter Newman (eds), *The New Palgrave: A Dictionary of Economics*, 1st edn (1987) 1889-1897.

question received wisdom about whether society is better off by following a course of action over the other.

**Reaching out to the public law sphere: institutional agency theory and beyond**

Together with criminal law, another area beyond private law where economic analysis can offer interesting insights concerns some aspects of public law.[47] Some specific applications of economic theory are well developed and increasingly used in this realm, such as regulatory capture theory.[48] Specifically, I find *agency theory* particularly useful to inform legal issues such as public governance and the management of public resources.[49] Agency theory conceptualises the relationships that arise when one person or entity (agent) is able to make decisions on behalf of, or that impact, another person or entity (principal).[50] The main insight of agency theory is that agency relationships imply an unavoidable risk of conflict of interest because the agent will (always/sometimes) have an incentive to deviate from the behaviour expected by the principal and further its own self-interest. This creates the need for the principal to monitor the agent (which is costly) and the possibility for both parties to reduce the risk of strategic behaviour through (mutual) commitments (involving signalling and bonding, which are also costly), as well as tailor-made systems of incentives whereby both sets of interests can be aligned. The most well-known application of agency theory is perhaps in the field of corporate law and governance, where agency theory has been used to conceptualise and regulate the relationship between the owners (shareholders) and managers (directors) of commercial firms.[51]

[47] Wolfgang Weigel, 'Why Promote the Economic Analysis of Public Law?' (2006) 23(2) *Homo Oeconomicus* 195-216.
[48] This strand of theory has multiple facets, from some closely linked to agency theory, to others conceptualising the problems in terms of rent extraction. For two excellent examples, one in each line of enquiry, see Jean-Jacques Laffont and Jean Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture' (1991) 106(4) *The Quarterly Journal of Economics* 1089-1127; and Fred S McChesney, *Money for Nothing. Politicians, Rent Extraction and Political Extortion* (Harvard University Press, 1997).
[49] The commonly accepted initial full formulation of the agency theory was by Michael C Jensen and William H Meckling, 'Theory of the firm: Managerial behavior, agency costs and ownership structure' (1976) 3(4) *Journal of Financial Economics* 305-360. In the public law area, institutional agency theory has been significantly influenced by the work of Barry M Mitnick, *The political economy of regulation: Creating, designing, and removing regulatory forms* (Columbia University Press, 1980).
[50] Kathleen M Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14(1) *The Academy of Management Review* 57-74; Joseph E Stiglitz, 'Principal and agent (II)', in Steven N Durlauf and Lawrence E Blume (eds), *The New Palgrave Dictionary of Economics*, 2nd edn (2008).
[51] Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1983) 26(2) *Journal of Law and Economics* 301-325.

Agency theory is also very helpful in understanding and designing rules aimed, for example, at controlling the way in which decisions are adopted by politicians or civil servants. The general theory concerned with these issues is known as public choice,[52] and it is a fundamental area of law and economics, as well as public policy studies.[53] One of its core insights—which has been developed to many areas of political and public administration activity[54]—is that when politicians or civil servants make decisions for which they have received a democratic mandate or been invested with public powers, they will have incentives to act in a way that benefits them (personally) rather than in a way that furthers the public interest. This is clear concerning politicians, who will be tempted to act based on their assessment of the path of action that can lead them to re-election (populism), or that can provide them with more immediate personal gains (such as engaging in outright bribery, or rent-seeking behaviour e.g. by trying to obtain appointments to well-remunerated private positions after they step down from office, thus creating problems of revolving doors). It is also clear regarding civil servants, which may also be tempted by personal gain or decide to engage in policy-making that increases their portfolio of influence or power, or that maximises their budget or the size of their operations within the public sector.[55] All of them may also be tempted to slack and avoid making any decisions that can prove unpopular, which is only going to create further problems down the line. These insights can be usefully exploited under public choice theory and serve the basis of systems of checks and balances, including liability rules, so as to overcome issues derived from the agency problem in the sphere of public governance.

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[52] The seminal work developing the theory is generally understood to be James M Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962), available at http://www.econlib.org/library/Buchanan/buchCv3.html (last accessed 20 June 2016).
[53] See B Guy Peters, *Advanced Introduction to Public Policy* (Edward Elgar, 2015) 39 and ff.
[54] See Dennis C Mueller, *Public Choice III* (Cambridge University Press, 2003); Michael Reksulak, Laura Razzolini and William F Shughart II (eds), *The Elgar Companion to Public Choice*, 2nd edn (Edward Elgar, 2013). See also John Cullis and Philip Jones, *Public Finance and Public Choice. Analytical Perspectives*, 3rd edn (Oxford University Press, 2009).
[55] P Dunleavy, *Democracy, Bureaucracy and Public Choice. Economic Approaches in Political* (Pearson, 1991; repr. Routledge, 2013).

**It's not all fun and games, or is it?**

A discussion on economic analysis of law, however brief and superficial, cannot end without at least having made a reference to *game theory*,[56] which is another of the main areas of study of law from an economic perspective. In simplified terms, game theory aims to formalise (or create mathematical models) to study the interaction between decision-makers and to predict the potential outcomes of situations where the relevant parties need to make decisions on the basis of their expectations or (limited) knowledge of the behaviour of the other party.[57] The most well-known instance of the type of analysis carried out by game theory is the so-called *prisoner's dilemma*, which conceptualises the incentives for two parties that can either cooperate to their mutual advantage or try to cheat each other to obtain a larger individual advantage, with the constraint that engaging in conflict rather than cooperation makes both parties worse off.

In the standard textbook example, two members of a criminal gang are arrested and imprisoned in solitary confinement, with no means of communicating with each other. The prosecutors lack sufficient evidence to convict them for the commission of specific serious crimes (which would carry a sentence of 20 years in prison), but they are confident that they can convict both of them for their membership of the criminal gang (which is a less serious offence and carries a sentence of 1 year in prison). In order to try to obtain additional evidence from the suspects, simultaneously, the prosecutors offer each prisoner the possibility to strike a deal if they betray the other by testifying of the major crimes committed by the other prisoner. The conditions of the offer are as follows: if only one of them betrays the other, the one that confesses will be released, whereas the betrayed prisoner will be convicted for the major crime. However, if both confess, they will be jointly convicted for the more serious crimes, albeit their sentences will be reduced to reflect their cooperation with the investigation, which will result in both of them serving jail sentences of 5 years. If neither of them confesses they will only be convicted for the less serious crime – 1 year. It seems clear that both

[56] John Von Neumann and Oskar Morgenstern, *Theory of Games and Economic Behaviour* (Princeton University Press, 1944).
[57] Or, in more formal terms, game theory is 'the study of mathematical models of conflict and cooperation between intelligent rational decision-makers'; Roger B Myerson, *Game Theory. Analysis of Conflict* (Harvard University Press, 1991) 1.

prisoners have an incentive to cooperate because, if they both remain silent, they are collectively better off.

| | | Prisoner 2 | |
|---|---|---|---|
| | | Confess | Remain silent |
| Prisoner 1 | Confess | 5 , 5 | 0 , 20 |
| | Remain silent | 20 , 0 | 1 , 1 |

However, game theory demonstrates that it would be irrational for both prisoners, acting on individual basis, to remain silent because, by doing so, they risk being cheated by the other prisoner and ending up serving the longer sentence. Thus, not knowing what the other prisoner will do, remaining silent is risky because it leaves one open to being cheated and carries a possibility of serving 20 years in prison. On the contrary, confessing guarantees to the prisoner a maximum sentence of 5 years and the possibility to be let go, which seems a preferable situation. Thus, both prisoners, anticipating that the other one will cheat, will both confess and end up serving a 5 year sentence each. Of course, all of this analysis relies on the impossibility for the prisoners to communicate and cooperate. If cooperation was possible, then we would need to carry out additional assessments concerning the cost of their cooperation, similarly to what we did in the discussion of the Coase theorem above. Where cooperation is structurally impossible or very difficult to operationalise within a legal framework, it is common to refer to the situation as the tragedy of the commons.[58]

Game theory can tackle much more complex situations of interaction in decision-making than the one discussed in the streamlined scenario of the prisoners' dilemma and is very useful in setting up rules that lead to desired behaviour (such as confessions or collaboration with law enforcement bodies, but also in order to design default legal rules that ensure efficient outcomes when the parties cannot cooperate or coordinate behaviour by themselves), or in assessing the complications in the formation

[58] Elinor Ostrom, *Governing the Commons. The Evolution of Institutions for Collective Action* (Cambridge University Press, 1990).

of contracts or the entry into international treaties, amongst a myriad of other uses. Therefore, this is another way in which the economic analysis of law can be useful as an analytical tool.[59]

**Possible applications to research the topic of 'lay decision-making in the legal system'**

After this general discussion of some of the ways in which economic analysis can assist in the analysis of legal institutions and legal decision-making—which are certainly relevant in all areas of law adjudication, regardless of the level of legal training of the decision-maker—it is now time to focus, even if briefly, on the more specific issue of the ways in which this methodology can be applied to the particular topic of 'lay decision-making in the legal system'. For a researcher willing to tackle research questions in this area, this would certainly not be uncharted territory and previous work on juries and their efficiency would necessarily be the point of departure.[60] This line of enquiry under a 'classic' law and economics approach incorporates insights from different more specific methods, such as transaction cost analysis or game theory, and focuses on questions such as the optimal make-up of the jury and its size (which creates trade-offs between the quality of the fact finding and the workability of the arrangement), the economics of the decision whether to seek a jury trial over a bench trial (which can be understood as part of a game ultimately leading the parties to settle out of court, whenever possible),[61] the rule that should apply to jury decision-making (unanimity v majority, or qualified majority, etc), or whether jury duty should be mandatory or not.[62] More recent studies have started to analyse more specific issues, such as the rules allowing lawyers to veto potential jury members.[63] However, this is an area where *behavioural* law and economics is making increasingly relevant strides,[64] and the researcher may be more interested in that perspective due to the closer links with other socio-legal approaches to the study of law decision-making in the legal

[59] Douglas G Baird, Robert H Gertner & Randall C Picker, *Game Theory and the Law* (Harvard University Press, 1998).
[60] See Posner, *Economic Analysis of Law* (n 8) chapters 21 and 22, with further references.
[61] Joni Hersch, 'Demand for a Jury Trial and the Selection of Cases for Trial' (2006) 35(1) *Journal of Legal Studies* 119-142.
[62] Donald L Martin, 'The Economics of Jury Conscription' (1972) 80(4) *Journal of Political Economy* 680-702.
[63] Francis X Flanagan, 'Peremptory Challenges and Jury Selection' (2015) 58(2) *Journal of Law & Economics* 385-416.
[64] For a first approximation to that literature, see Kevin McCabe, Vernon Smith and Terrence Chorvat, 'Lessons from Neuroeconomics for the Law', in Francesco Parisi and Vernon Smith (eds), *The Law and Economics of Irrational Behavior* (Stanford University Press, 2005) 85-86.

system.[65] Given the focus of this chapter on 'classical' economic analysis of law methodology, this issue is not discussed in any further detail.

**Some final thoughts – what do I mean by 'economically-informed' legal research then?**

After this quick overview of some of the main applications of the economic analysis of law, it may be worth stressing its relevance for legal research at a postgraduate or advanced level. As mentioned above, I am convinced that carrying out legal research without assessing its economic implications and without incorporating the insights of economic theory is ultimately unsatisfactory, and that legal research should be economically-informed. What I mean by the need to carry out 'economically-informed' legal research is that researchers, even if they do not directly engage with economic methods and theories as a core component of their projects, should at least incorporate the insights resulting from previous economic analysis in the relevant research area. That incorporation should at least be by way of discussion, if nothing else, to justify the adoption of a different normative framework or of an approach that may challenge the insights offered by the economic analysis of law, or to offer some rationale as to why economic implications can be neglected in the context of a given research project. This is particularly relevant in areas of law with a clear economic component, such as economic regulation, commercial litigation, securities and finance, etc. But it is also relevant in any other area of the law, however apparently remote from economic considerations, such as family law,[66] and even if the main methodology chosen for a specific project is different than law and economics, such as comparative law.[67]

This may be seen as an attempt on my part to support the imperialism of the economic analysis of law.[68] However, I would rather approach this from the opposite perspective and stress the perils of

[65] See the rest of the contributions to this book.
[66] See e.g. Margaret F Brinig (ed), *Economics of Family Law* (Edward Elgar, 2007) and Antony W Dnes and Robert Rowthorn (eds), *The Law and Economics of Marriage and Divorce* (Cambridge University Press, 2010).
[67] See Ugo Mattei, *Comparative Law and Economics* (University of Michigan Press, 1999); Mathias Reimann, 'Comparative Law and Economic Analysis of Law', in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press, 2006) 839-864; and the contributions to Theodore Eisenberg and Giovanni B Ramello (eds), *Comparative Law and Economics*, Research Handbooks in Comparative Law series (Edward Elgar, 2016).
[68] The issue is not at all new. See Robert D Cooter, 'Law and the Imperialism of Economics: An Introduction to the Economic Analysis of Law and a Review of the Major Books' (1982) 29 *UCLA Law Review* 1260-1269

carrying out legal research and engage in legal decision-making in an 'economically-disinformed' manner—not to say, 'economically-ignorant' way. It seems plainly obvious to me that legal decision-making has immediate and unavoidable economic effects,[69] and that failing to understand those effects and incorporate them into the decision-making process and/or the process of legal research is bound to result in faulty outcomes or theories and insights that cannot translate into reality in a desirable way.[70] Therefore, the least that legal research should do from this perspective is to ensure that it is economically-congruous and that its insights can be related to economic reality and economic theory—even if the main purpose of the research is to criticise them, show any shortcomings, or advocate the adoption of a different paradigm. Otherwise, there is a clear risk of pushing for legal reforms or reaching adjudicative decisions that can be detrimental to social welfare in the long-run. To me, this is normatively undesirable. At the risk of accusations of circularity of my arguments, then, I consider all non-economically-informed legal research faulty—which, again, is not to say that all researchers necessarily must follow a law and economics methodology, but to stress that all researchers need to engage in an intellectual dialogue with the economic analysis of law.

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[69] This is clearly recognised in the area of regulatory impact assessment, and should be uncontroversial. See Robert Baldwin, Martin Cave and Martin Lodge, 'Cost-Benefit Analysis and Regulatory Impact Assessment', in ibid, *Understanding Regulation. Theory, Strategy, and Practice*, 2nd edn (Oxford University Press, 2011).
[70] For some additional remarks, see Albert Sanchez-Graells, The Importance of Assessing the Economic Impact of the Case Law of the Court of Justice of the European Union: Some Exploratory Thoughts (2013) SSRN Working Paper, available at http://ssrn.com/abstract=2253346 (last accessed 27 May 2016).