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Rodney H. Mabry
Clemson University

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A NOTE ON THE ELASTICITY OF DEMAND FOR LEGAL SERVICES¹

Rodney H. Mabry

It has recently been suggested² that lawyer associations in the United States are using minimum fee schedules to fix prices and raise profits. These "suggested, advisory or minimum" fee schedules set the fees which should be collected by the lawyer for the usual services provided in particular kinds of legal cases.

While it is undoubtedly true that the intent of these schedules is to raise the income of lawyers, it is less certain that these tactics are successful for the industry as a whole. The purpose of this note is to suggest theoretical reasons why the legal profession may underestimate the true elasticity of demand for their services, leading to the development and enforcement of minimum fee schedules which may reduce total legal income.

For the minimum fee schedules to meet their objective of raising the total income of lawyers, the price of legal services must be raised above its market equilibrium and the market demand curve must be relatively inelastic. With elastic demand, total legal income will fall as price is raised above equilibrium.

The relevant question, then, is whether there is any reason to believe that the demand for legal services might be elastic. An application of Leibenstein's bandwagon effect³ to the legal service market provides interesting support for an affirmative answer.

Given prices, the demand for any product or service is determined by its utility-satisfying characteristics. The utility of some commodities, however, is dependent not only on inherent qualities in the commodity but also on the amount of that commodity which is currently being consumed by others. In Leibenstein's words⁴, this bandwagon effect refers "to the extent to which the demand for a commodity is **increased** due to the fact that others are also consuming the same commodity."

Many legal services have the interesting characteristic that they are subject to a bandwagon effect. To simplify the analysis, suppose that all legal services may be dichotomized into offensive and defensive categories. An increase in consumption of offensive legal services will certainly increase the marginal utility of defensive legal services in both civil and criminal litigation.

Thus, in new cases about to begin one might expect a one-for-one increase in the demand for defensive legal services. For cases already in progress, the use of additional offensive

or defensive legal services (e. g. calling in a second prosecutor or defense lawyer) will increase the opposition's demand for legal services.

This phenomenon in the legal service market can easily be shown with the aid of figure 1 which is adapted from Leibenstein⁵. The inelastic market demand curve, D^a , is drawn to reflect real preferences for legal services at various prices, given that quantity Oa of legal services is being consumed at prices OP_1 .

If the price falls to OP_2 the quantity of legal services demanded increases by the amount ax to quantity Ox based solely on the income and substitution effects of the price decline.

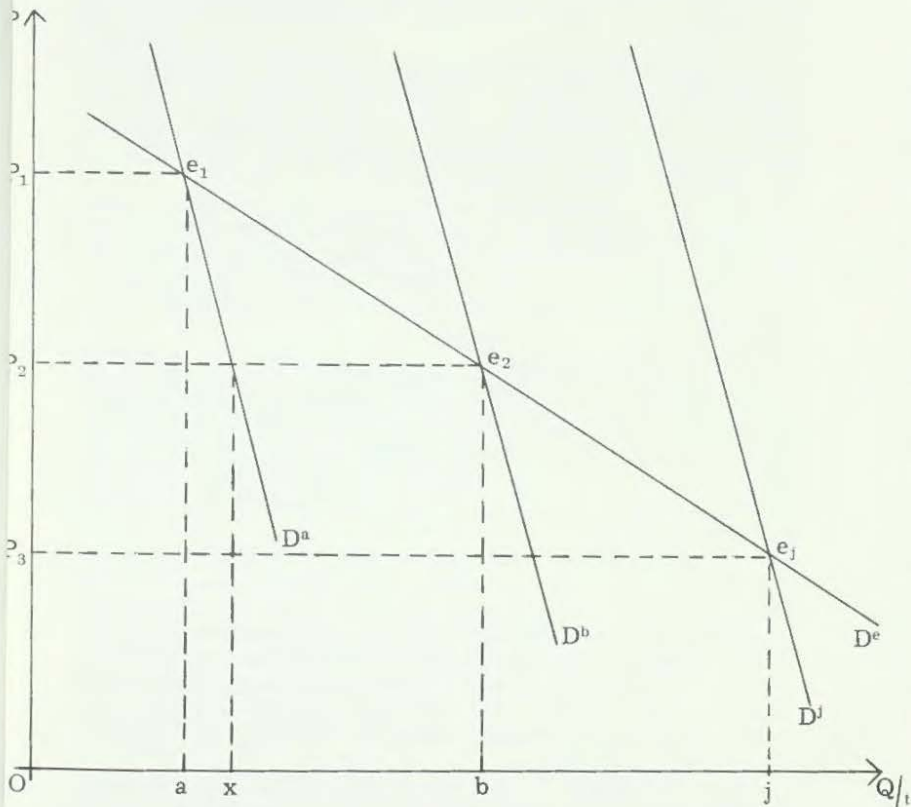


Fig. 1

Ox quantity demanded is not the prevailing quantity, however, because some consumers, who are not affected by the price decline, now increase their demand in response to the increased quantity of the legal services being consumed by those adversaries affected by the drop in price.

Thus, the demand curve shifts rightward, becoming D^b , where O_b is the total quantity of legal services demanded at the lower price. In other words, as the quantity demanded of both offensive and defensive legal services rises due to a price decrease, there is an autonomous increase in the demand for legal services to the degree that new demand for opposing legal services is generated. Hence, only one point on each of these demand curves will represent the actual quantity demanded in the market and it will be determined by the prevailing price.

The equilibrium points e_1, e_2, \dots, e_j have been connected to represent the effective demand curve, D^e , that exists in the legal services market. The elasticity of this effective demand curve is necessarily greater than that of the perceived demand curve since the latter does not account for what may be called the ratchet demand effect.

Whether or not the demand curve is actually elastic over the relevant range is an empirical question and will depend upon (1) the elasticity of the perceived demand curve, and (2) the magnitude of the ratchet demand effect associated with initial changes in quantity demanded resulting from price changes.

In the first case, the elasticity of perceived demand will be strongly affected by the availability of substitute goods or services. The availability of substitutes for legal services depends on the nature of the situation or event calling for legal services. In the case of federal criminal action, for instance, the defendant is required to employ legal counsel, but the amount and quality of legal service he in fact obtains is quite open.

In "legal advice" situations involving tax law, property and contract law, for example, many substitutes for legal services exist in the form of full service banks, brokerage firms, real estate brokers, certified public accountants, marriage counselors, and even public libraries containing information on how to make a will. Indeed, many legal services of the past have evolved over time into regular business services, one dramatic example being the preparation of federal and state tax returns.

An explanation of the persistent support by the legal profession for minimum fee schedules may be that individual lawyers consider only the direct decrease in quantity demanded which results from an increase in their own prices. As individuals, they may justifiably conclude that the revenue

lost on forgone sales is exceeded by revenue gained on units still sold.

Thus, by ignoring the negative external effects on the demand for other lawyers' services, each lawyer may overestimate the value to himself of a general increase in the price of legal services. Taking the ratchet demand effect into account might very well lead to the removal of minimum fee schedules in this profession.

In conclusion, we have attempted to explore the area of legal services to the purpose of stimulating thought and research in a much neglected field. We have suggested that there may be theoretical reasons to expect a much more elastic demand for legal services than may be generally believed and that minimum fee schedules may reduce total legal income. Specifically, more empirical work is needed to determine

- (a) what the elasticity of the perceived demand curve for various categories of legal services actually is,
- (b) the nature and extent of the ratchet demand effect,
- (c) the history of the legal profession with regard to changes in the composition of output and the rise of substitutes for legal services, and
- (d) the direct effect of changes in minimum fee schedules in various states on the quantity of output and the net income of lawyers.

FOOTNOTES

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²Arnould, Richard J. "Pricing Professional Services: A Case Study of the Legal Service Industry," *Southern Economic Journal*, April 1972, p. 495.

³Leibenstein, Harvey, "Bandwagon, Snob, and Veblen Effects in the Theory of Consumers' Demand," *Quarterly Journal of Economics*, May 1950, pp. 183-207, reprinted in W. Breit and H. M. Hochman, eds. *Readings in Microeconomics* (New York: Holt, Rinehart, and Winston, Inc., 1968) pp. 123-139.

⁴*Ibid.*, p. 127.

⁵*Ibid.*, p 132.

Rodney H. Mabry is an Assistant Professor of Economics in the Department of Economics, Clemson University, Clemson, South Carolina.