

SHOULD THE U.S. ELIMINATE ENTRY BARRIERS TO THE PRACTICE OF LAW?

PERSPECTIVES SHAPED BY INDUSTRY DEREGULATION

Clifford Winston
Brookings Institution

Quentin Karpilow
Yale University

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States' requirements that lawyers obtain a license to practice law and American Bar Association (ABA) regulations of legal practice constitute barriers to entry to the legal profession. Specifically, all but a handful of states require would-be lawyers to graduate from ABA-accredited law schools, and every state except Wisconsin requires them to pass a bar exam.¹ Before the Great Recession, law schools rejected nearly half of all their applicants, and many capable individuals are either unwilling or unable to spend three years in law school and graduate with debts that can easily exceed \$150,000.² Under ABA requirements, firms that sell legal services must be owned and managed by lawyers who are licensed to practice in the United States, meaning that corporations and foreign law firms cannot compete in this market.

According to many in the legal community, the entry barriers ensure a minimum standard of quality, which is necessary because consumers cannot distinguish between competent and incompetent lawyers. Meanwhile, the exclusion of corporations is justified on the ethical grounds that corporate entities have an incentive to represent their shareholders instead of their clients.

In this paper, we argue that, notwithstanding their intended function, entry barriers in legal services have created inefficiencies that parallel those generated by entry regulations of U.S. network industries (i.e., transportation, communications, and energy.) In particular, entry barriers limit competition and raise prices. In the long run, they compound those inefficiencies by impeding operations, innovation, and technological advance. Although network industry regulations were motivated by competitive concerns, rather than ethical considerations, we argue that eliminating entry barriers in legal services would generate benefits that are similar to those

¹ California is the most notable state to have its own law school accreditation process. Wisconsin allows graduates of the state's two major law schools to practice without taking a bar exam.

² The percentage of rejections fell as fewer people applied to law school as the job market for lawyers tightened in the aftermath of the Recession.

resulting from network industry deregulation. Specifically, prices would fall as competition from incumbent firms and new entrants intensifies; in the long run, competitive forces and operating freedom would incentivize firms to produce innovations that significantly benefit consumers and the broader economy. Industry deregulation gained support from experiments that previewed its likely effects. Some initial deregulatory experiments have begun in legal services, although it is too early to conclude they will lead to deregulation.

1. Entry Deregulation's Effect on Competition

State licensing requirements constrain the supply of lawyers, while ABA regulations shield private law firms from additional sources of competition. Their impact on lawyers' earnings is magnified by government policies that generate ever-growing demand for legal services.³ Winston, Crandall, and Maheshri (2011), for example, estimated that earnings premiums for lawyers amounted to \$64 billion in 2004, or \$71,000 per practicing lawyer.⁴ They further found that lawyers at all income levels—not just the highest earners and not just those at the largest law firms—received substantial premiums.

Would entry deregulation reduce legal service prices and eliminate earnings premiums through greater competition? Some have argued that the market for lawyers is fundamentally non-competitive because few people have the human capital to master the complexity of legal matters (Hadfield (2000) p.67). However, network industries were also believed to be fundamentally non-competitive and to require entry regulations, albeit for different reasons (i.e., large scale economies, economies of scope, and significant financial entry requirements). Notably, though, network industry deregulation taught us that (1) theoretical concerns about

³ These policies include economic and social regulations, as well as liability and intellectual property laws.

⁴ Here, earnings premiums equal the portion of lawyers' income exceeding the opportunity cost of their services.

market competitiveness were exaggerated in practice and (2) consumers broadly benefitted when entry barriers were removed (Winston (1998)).

For example, in the deregulated airline industry, Southwest Airlines set the standards for low prices, efficiency, and consistent service that caused other airlines to improve their competitiveness. Schneider National played a similar role among deregulated trucking companies. Competition among incumbent deregulated railroads intensified as (1) the least efficient rail carriers exited the industry through mergers and (2) the remaining efficient carriers used long-term contract rates to compete aggressively for shippers' business. Indeed, even rail duopolists' prices fell because losing a shippers' business meant that the railroad would have to wait several years before it had a chance to regain it. At the same time, some shippers also exploited various forms of competition to negotiate lower rates (Winston (1998)). For example, Alabama utilities that normally received coal shipped from Colorado could receive it from Kentucky (source competition), and utilities that used coal could shift to natural gas or oil if their technology permitted such substitution (product competition).

In a similar vein, entry deregulation of legal services could increase competition and reduce prices. Remyse (2014), for instance, argues that consumers would benefit from new entrants, such as low-cost lawyers, foreign lawyers, and quasi-lawyers.⁵ Moliterno (2013) predicts that deregulation would unleash a new era of competition, as corporations and entrepreneurs force traditional law firms to become more innovative competitors. Sky Analytics, a legal analytics and software company, represents the type of entrepreneurial spirit that deregulation would accelerate by benchmarking how much a firm spends on legal services and how much money it could save if it used different lawyers and law firms (Maheshri and Winston (2014)).

⁵ Quasi-lawyers would have legal training, but would not have graduated from an ABA accredited law school.

2. Entry Deregulation's Long-Run Benefits

Participants in the legal profession would need time to adjust fully to entry deregulation. Such adjustments, however, would reduce the inefficiencies that developed under entry regulation and, more importantly, would result in innovations that significantly increase the benefits of deregulation.

Network Industry Adjustments

By increasing competition in network industries and giving firms greater operating freedom, deregulation spurred innovations in marketing, operations, and technology that improved firms' efficiency, service quality, and responsiveness to consumers' preferences. Many of those innovations were not and probably could not have been anticipated by market participants and students of the industries. Deregulation also led to improvements in corporate governance—namely, better educated and more entrepreneurial managers—that contributed to innovative activity (Winston (1998)). Importantly, the gains from deregulation extended beyond the industries that were deregulated and the consumers of their products and services. For example, by increasing the extent and frequency of air transportation service, airline deregulation spurred the growth of the banking sector in Charlotte, North Carolina, and back-room supporting services in Reno, Nevada and North Dakota (Winston (2013)).

Litan (2014) argued that deregulation was the impetus for revolutionary innovations in operations and products that have generated hundreds of billions of dollars of benefits for the U.S. economy. For example, by improving the efficiency of transportation networks, deregulation increased the speed and reliability of both small shipment deliverers, such as UPS and Federal Express, which spurred the growth of Internet retailers, and carriers of large freight shipments, which enabled manufacturing firms to significantly reduce their inventories.

Litan pointed to large gains from other types of deregulation as well. Decontrol of fossil fuel prices encouraged well owners to combine hydraulic fracturing (“fracking”) with directional drilling, which enabled them to recover vast supplies of oil and natural gas. As a result, energy costs have fallen and energy independence has increased. A measure related to deregulation—the breakup of AT&T—opened telecommunications to competition, allowed new entrants to build fiber optic networks, and accelerated the development of the Internet. In combination, those deregulatory developments have created new American businesses and significantly improved consumers’ quality of life.

Potential Improvements in Legal Services

There are valid reasons to expect, therefore, that deregulation would (1) eliminate the inefficiencies in firms’ operations created by ABA regulations and (2) enable the legal profession to provide greater benefits to consumers. This is not to say that law firms are not trying to innovate. Many law firms, for instance, have created electronic-discovery committees that investigate technological change that might improve firm operations. However, even the keynote speakers at a recent ABA summit on the Future of Legal Services acknowledged that true innovation in the legal industry requires outside views and thinking. In a deregulated environment, those “outside” views and thinking are most likely to come from corporations and from non-lawyers, who are not already in the legal business.⁶ The specific technologies that would emerge in a deregulated environment are difficult to predict; but there is little disagreement that ABA regulations have prevented lawyers from being as technologically advanced and productive as they could be and that unregulated legal service providers have the

⁶ For example, William Henderson, “How to Take Market Share: Lessons for Law Firms,” *American Lawyer*, November 11, 2015 advises law firm leaders to learn from Steve Jobs at Apple Computer on how to compete successfully.

potential to innovate and transform the legal services industry just as other unregulated firms transformed their industries.

Deregulation could also have positive effects on economy-wide productivity. Occupational licensing has distorted the allocation of labor in the legal industry because some lawyers who were attracted to the inflated salaries of the legal profession might have made more economically productive contributions to society by working in a different occupation. At the same time, some people who were unable or unwilling to incur the time and cost of law school could have provided valued legal services if they were allowed to do so. Entry deregulation would reduce those distortions in individuals' choices to become a lawyer by (1) reducing most lawyers' earnings premiums and (2) enabling individuals who are currently barred from practice to provide useful services that require only modest legal training.

Still another important consequence of deregulation is its potential to improve the performance of policymakers. Public-sector lawyers play critical roles in the formulation and implementation of nearly all government policies; thus, government can improve the likelihood that its policies promote social welfare by attracting high-quality lawyers. However, Winston, Karpilow, and Burk (2015) find that, on average, higher quality lawyers, as measured by law school grades and rank, are much more likely to choose private-sector firms over the government, most likely because of the sizeable earnings penalty that government attorneys suffer. The resulting difference in legal talent may have implications for whether the resolution of specific policy disputes between the government and the private sector favors public or private interests. Entry deregulation would more closely align the earnings of private-sector and public-sector lawyers, thereby potentially reducing the disparity in legal talent between the two sectors

and improving the quality of the government's legal representation and advocacy for the public interest.

Finally, deregulation could have a constructive impact on legal education that improves the quality of lawyers and may also improve judicial decision-making. The growing demand for non-lawyers in a deregulated environment who provide legal services at corporations and law firms is likely to expand the types of analytical skills that law schools teach students because they are likely to have more extensive interactions with non-lawyers. Such skills would transform legal education to embrace business and economics and STEM disciplines, and might further encourage decisions based on cost-benefit analysis instead of politics. By inducing firms to recruit a better educated cadre of managers, industry deregulation contributed to a culture of innovation. By enriching legal education, deregulation of the legal profession could encourage practitioners to make more pragmatic policy-based arguments.

Posner (2008) suggests that such a change may even influence the thinking of practitioners who eventually rise to the judiciary, including the Supreme Court. That is, because all judges do not share a commitment to a logical premise for making a decision (such as, cost-benefit analysis), their thinking is often guided by ideology given that it cannot be guided by anything else.⁷ Posner argues that judges should and could make more pragmatic policy-based decisions and that properly-trained lawyers could help them do so. Lawyers who obtain a broader analytical multi-disciplinary education that is spurred by the deregulated environment would be more effective at helping judges appreciate policy-based arguments and more receptive to those arguments when they are judges.

⁷ Winston, Yan, and Karpilow (2015) find strong evidence of growing politicization and polarization on the U.S. Supreme Court.

3. Counter-arguments to Deregulation

The primary argument against entry deregulation is that it would lead to market failure because potential clients would have imperfect information about a lawyer's competence.⁸ Under this line of thinking, regulations are necessary to ensure access to quality attorneys. However, Maheshri and Winston (2014) conclude from a study of the pricing of legal services that consumers are capable of distinguishing between the quality of lawyers, especially infra-marginal—that is, licensed versus unlicensed—lawyers.

Moreover, it is likely that current entry barriers do little to improve lawyer quality in the first place. For example, the standards of lawyer quality represented by the bar examination amount to legal rules that can be looked up in a book, and that once memorized can be easily forgotten after the test is taken.⁹ Meanwhile, state bar associations focus on prosecuting the unauthorized practice of law (UPL) not the incompetent practice of law.¹⁰ And Rhode and Ricca's (2014) summary of complaints of unauthorized practice of law found that very few arose from customer complaints. Instead, the vast majority originated from complaints by lawyers. Moreover, enforcement lawyers rarely identified issues that caused public harm except in cases where undocumented immigrants paid individuals who misrepresented themselves as lawyers and provided no services.

It is also well established that many clients *currently* fail to receive adequate legal services. For instance, Berrey, Hoffman, and Nielson (2012) found that more than half of the

⁸ ABA's rationale for preventing a corporation from competing with private law firms is that a corporation's loyalty to its shareholders would trump its duty to its clients. However, firms in many other industries operate ethically as a public corporation. If there is a valid reason why legal services should be treated differently, regulatory guidelines for corporations could be established so that lawyers maintain their ethical duties to clients.

⁹ The many examples of non-lawyers providing valued legal services include a fifteen-year-old high school student who became the most requested legal expert on the website AskMeHelpDesk.com and a legal secretary who established a successful business preparing and filing the necessary legal papers for people seeking a divorce.

¹⁰ For example, the New York attorney general filed a suit for the unauthorized practice of law in May 2014 against a storefront called Legal Docs By Me, which enabled consumers to handle basic tasks like name changes and uncontested divorces at a fraction of the cost of paying lawyers to do the work.

plaintiffs in employment discrimination cases thought their lawyers were incompetent. Similarly, Gillers (2014) performed a detailed study of lawyer discipline in New York and concluded that the system failed its professed purpose of protecting the public and the administration of justice. Rhode (2004) also argued that the ABA and state bar associations have generally provided weak discipline on lawyers' conduct and the quality of legal services.¹¹

Perhaps more importantly, the emergence of various institutions following industry deregulation illustrates how market forces could protect consumers' interests in the presence of imperfect information (Winston (1998)). In the freight transport industries, third-party logistics firms sprang to life and began providing shippers with the means of identifying the lowest-cost routes and reliable, low-cost carriers. Travel distribution centers and, more recently, online travel companies have provided similar services to airline passengers.

Similar institutions have begun to inform consumers about the quality and reputation of lawyers. For example, a recent survey conducted by FindLaw.com and Thomson Reuters found that a rapidly growing share of respondents, currently approaching 40%, said they would use the Internet first if they wanted legal representation. One source of information that consumers could find on some lawyers' disciplinary records and qualifications is provided online by Avvo. And consumers could benefit from experienced lawyers providing information, which is currently prevented without certification, of their specialties in particular practice areas. Deregulation is likely to increase the available information on lawyers by reducing advertising restrictions and by encouraging legal information services to take off.

Importantly, in a deregulated environment, many providers of legal services would still attend and graduate from a law school, sit for a bar examination, and obtain a certification for a

¹¹ Debra Cassens Weiss reported in the *ABA Journal*, October 27, 2015, that a suspended but not disbarred California lawyer had accumulated more than 1,100 pending bar complaints!

particular specialty. But consumers would no longer have a false sense of security about a lawyer's quality based on those signals. Instead, greater flows of information would determine which signals indicate greater ability and better service, and would reward those accomplishments or ignore them accordingly.

4. Toward Policy Change

Skillful political leadership was essential to passing industry deregulation legislation because it created winners and losers. Deregulation's passage was also aided by evidence from various experiments in response to regulatory-induced inefficiencies that previewed potential benefits of deregulation, including Freddie Laker's pioneering 1977 low-fare trans-Atlantic flights; firms' providing their own low-cost trucking service instead of hiring regulated trucks; and consumers' using MCI and Sprint to make long-distance calls at lower cost compared with AT&T's toll charges that were inflated by state and federal regulations. Policymakers strengthened the case for deregulation with their own experiments (e.g., deregulating intrastate air and truck prices, which economists then compared with higher interstate regulated prices) and with administrative deregulation that gave carriers pricing flexibility that reduced airline fares and railroad rates for certain commodities. As deregulation moved forward, policymakers introduced new legislation to protect air travelers in low-density communities, who might lose service, and rail shippers of bulk commodities, who might be captive to one railroad.

In the legal services industry, some initial deregulatory steps are being taken. For example, Washington State is allowing a new class of legal professionals called "limited license legal technicians," who, after taking a year of classes at a community college and a licensing exam, can help clients prepare court documents and perform legal research. Northwestern University law school is offering a one-year Master of Science degree in law for students with

STEM backgrounds, which, if they are legally allowed to do so, would prepare them to play a significant role in firms that provide legal services. And since 2007, Australia and the United Kingdom have passed laws that allow law firms to be publicly traded. Suggestively, many have proceeded to hire non-lawyers into partnership, set up other types of business, and expand operations.

The motivation for deregulation may also be growing because the ABA's lack of vision is becoming more apparent. Rhode and Ricca (2014) pointed out that over a quarter century ago, the ABA's own commission concluded that lawyers are not the only ones able to advise clients on any matter concerning the law. But the ABA failed to act on that conclusion by allowing individuals to practice law who attended alternative legal education programs that would be less time-consuming and expensive than traditional three-year programs. Today, the ABA is convening task forces on helping law school graduates avoid large debts and is fending off concerns that legal services are so expensive that they are available only to the wealthiest members of society.

It is time for the ABA to abolish its counterproductive regulations on legal practice and to encourage states to eliminate occupational licensing. The legal profession would then be able to begin its adjustment to deregulation which, based on previous industry experience, would produce social benefits that are considerably greater than expected.

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