ON THE COST DISEASE AND LEGAL EDUCATION

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CONTENTS

INTRODUCTION

It is a privilege to participate in this symposium on the work of Dean Richard Matasar. His writing on legal education has influenced my thinking and actions as a dean over the last four years, and I owe him a great debt. The most recent example is the Creighton University School of Law "pig" that adorns our administrative suite, a reminder of our fiduciary duties and a call to the better angels of our nature.[1] I am a better dean for engaging his work, and in the words of the standard author's footnote disclaimer, all errors that remain are my own.

Here, I pick up on Dean Matasar's work on the economics of legal education. In a 2004 article in the *New York Law School Law Review*, he provocatively compared a law student's investment in a legal education to buying a car and pushing it off the cliff each year for three years.[2] That image brings home the dramatic rise in the cost of higher education generally and legal education specifically. In this Essay, I address one explanation for those rapidly rising costs—a phenomenon that economists call the "cost disease."

Part I explains the cost disease and how it leads to relatively higher price increases in labor-intensive industries. The discussion concludes by showing how the cost disease arises in elementary and secondary

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1. *See* Richard A. Matasar, *Ya Gotta Pay the Pig*, 37 U. TOL. L. REV. 109, 110 (2005).

2. Richard A. Matasar, *The Rise and Fall of American Legal Education*, 49 N.Y.L. SCH. L. REV. 465, 490 (2004) ("[O]ne would have to wonder how long the Mercedes brand would retain its value if every year the customer borrowed 100% of the price of the car, pushed it off of a cliff, repeated the process for three years, and had nothing to show for it at the end.").

education. Part II then discusses three strategies that might allow colleges and universities to address the cost disease. This Essay closes by suggesting that law schools might undertake limited, controlled pilot projects with these strategies that, if successful, could benefit students and higher education generally.

I. THE COST DISEASE

In a seminal manuscript from 1966, economists William Baumol and William Bowen discussed why costs rise faster in the performing arts than in other industries.[3] They began their analysis with the observation that in certain labor-intensive fields, such as the performing arts, education, and health care, it is exceedingly difficult to achieve gains in productivity. That is, these industries cannot easily increase output per unit of labor. Baumol and Bowen noted the now classic example that it takes the same number of musicians just as long to play a Beethoven quartet today as it did in 1800.[4] The performers' productivity, then, has not increased for over 200 years.

The cost disease arises because labor-intensive, non-productive industries must compete for workers with other industries that make productivity gains. Gains in productivity allow producers to offer increased wages without increasing the price for their goods or services. To take an oversimplified example, if a firm implements a form of technology that allows workers to produce twice as many widgets, the firm can increase its sales (and revenue) without increasing its labor costs. This additional revenue allows the firm to offer higher wages to retain its best employees without increasing price. Increased productivity, then, potentially benefits the producer (increased revenue), employees (increased wages), and consumers (lower prices).

Industries with low or no productivity gains are in a bind because they often compete for labor with firms that can achieve productivity gains. As wages increase in other industries, our quartet members may choose to forgo the arts for a more remunerative field. To prevent loss of its best labor, then, the arts must increase wages despite the lack of increase in productivity. To fund the wage increase, the arts must increase prices, resulting in the cost disease: increases in wages without

3. *See generally* WILLIAM J. BAUMOL & WILLIAM G. BOWEN, PERFORMING ARTS—THE ECONOMIC DILEMMA (1966) [hereinafter BAUMOL & BOWEN]. Baumol's most recent contribution to this discussion is his book *The Cost Disease: Why Computers Get Cheaper and Health Care Doesn't*. *See generally* WILLIAM J. BAUMOL ET AL., THE COST DISEASE: WHY COMPUTERS GET CHEAPER AND HEALTH CARE DOESN'T (2012) [hereinafter THE COST DISEASE].

4. BAUMOL & BOWEN, *supra* note 3, at 164.

offsetting increases in productivity lead to relatively faster increases in prices.[5]

The question, then, is whether labor-intensive industries can find ways to increase productivity that will offset the upward march of labor costs. Without increases in productivity, the cost of labor-intensive goods and services will increase faster than prices in the overall economy, with the threat that such goods and services could someday be priced out of the market.[6] One author has described the situation in elementary and secondary education as follows:

> Over four decades, real K–12 education spending in the United States has more than doubled. If projections prove accurate, over the next six years, system costs will exceed revenues by 9.1 percent. Today's way of schooling won't be sustainable tomorrow.
>
> There are a few obvious ways to address such a gap. We could continue to steadily reduce staff, school days, services, and compensation. We could increase fees for advanced classes and athletics, cut a few ineffective programs, and slash after-school programs and summer school. We could freeze salaries and increase the amount employees must contribute to their benefits.
>
> But we can't take such actions and expect to maintain—much less improve—the quality of our education system. What if instead of killing our education system by a thousand cuts, we found ways to make it more productive, and thus not only more financially sustainable, but also better at producing strong outcomes for students?[7]

5. Alternatively, such industries can attempt to raise revenue in another way, such as when a symphony or university solicits funds through philanthropy, or creates a new product by recording performances for later broadcast or sale.

6. In his most recent work on the cost disease, Baumol has argued that labor-intensive industries that suffer from the cost disease will not be priced out of the market. *See* THE COST DISEASE, *supra* note 3, at 43–44. He rests this argument on the observation that over time, first, incomes will increase, and second, prices in productive industries will fall, remain flat, or rise slowly. *Id.* at 44, 49. The combination of higher incomes and lower prices in productive industries will leave consumers with more income to spend on higher-priced, labor-intensive goods and services. *Id.* at 50. So while consumers may purchase the same bundle of goods over time, a greater portion of their income will be spent on labor-intensive goods and services. *Id.* at 44.

7. Marguerite Roza, *Leveraging Productivity for Progress: An Imperative for States*, THE SEA OF THE FUTURE: PRIORITIZING PRODUCTIVITY, Nov. 2013, at 8, 9, http://www.bscpcenter.org/sea/pdf/SEA_of_the_Future_Vol-2_Prioritizing_Productivity-11-2013.pdf (footnotes omitted). Law schools have seen a similar increase: "From 1992 to 2002, the cost of living in America rose 28%, while the tuition at public law schools increased 134% (for residents) and 100% (for non-residents), and private law school tuition rose 76%." William K.S. Wang, *The Restructuring of Legal Education Along Functional Lines*, 17 J. CONTEMP. LEGAL ISSUES 331, 333 (2008) (footnote omitted).

As has been reported online and in the press, law schools have begun making "a thousand cuts" to respond to the recent dramatic decline in enrollment.[8] Once those cuts have been exhausted, we must answer the author's question—can we find ways to make legal education "more productive"? Part II turns to that question.

II. TREATING THE COST DISEASE

In a white paper on the cost disease in elementary and secondary education, Paul Hill and Marguerite Roza examine eight strategies that have boosted productivity in other labor-intensive service industries.[9] Here, I discuss three of those strategies: deregulation, investments by key beneficiaries, and carefully designed workforce policies.[10] The remainder of Part II discusses each strategy in turn, offering tentative suggestions for how each strategy might apply to legal education.

A. Deregulation

When it comes to deregulation, the most obvious target is the American Bar Association (ABA) and its accreditation standards for United States law schools.[11] The ABA's standards prescribe a wide variety of required functions and restrictions on a law school's program of legal education. And while there has been a recent, welcome deregulatory-trajectory to changes in the standards, many restrictions of uncertain value remain.[12] As Hill and Roza observe, "[e]xternally imposed restrictions on labor use, information exchange, and service delivery models all work to limit productivity."[13]

The ABA standards have examples of both labor-use and required service-delivery models that arguably limit productivity gains. On the labor-use side, the current standards require that full-time faculty

8. *See, e.g.*, Andrew Denney, *Facing Budget Deficit, Pace Law Decides to Trim Faculty Pay*, N.Y. L.J., May 18, 2015, at 1 (Pace University decreases law school faculty salaries by ten percent).

9. *See* PAUL HILL & MARGUERITE ROZA, CURING BAUMOL'S DISEASE: IN SEARCH OF PRODUCTIVITY GAINS IN K–12 SCHOOLING 6–7 (2010), http://www.crpe.org/sites/default/files/whp_crpe1_baumols_jul10_0.pdf.

10. The other strategies discussed by Hill and Roza are information technology, increased efficiency in the supply chain, production process innovations, and organizational change. *Id*.

11. *See generally* STANDARDS AND RULES OF PROCEDURE FOR APPROVAL OF LAW SCH. (AM. BAR ASS'N 2014–2015) [hereinafter ABA STANDARDS].

12. For example, the ABA changed Standard 402 to move from ranges of presumptive student-faculty ratios to a more flexible approach focused on whether the staffing level is adequate to provide the program of legal education. *Id.* Standard 402.

13. HILL & ROZA, *supra* note 9, at 6.

members teach most courses offered in the first year.[14] On the service-delivery side, no more than fifteen credit hours may be earned through distance education.[15] Restrictions like these prevent law schools from experimenting with staffing models and educational methods that might increase productivity.

Even absent deregulation, the ABA Rules of Procedure for Approval of Law Schools allow for variances from accreditation standards for law schools that wish to undertake a thoughtful experiment in their educational program. Rule 33(a) provides:

> (a) A law school applying for a variance has the burden of demonstrating that the variance should be granted. The application should include, at a minimum, the following:
>
> (1) A precise description of the program changes or other actions for which the variance is sought, and identification of the Standard or Standards with which they are or may be inconsistent;
>
> (2) An explanation of the bases and reasons that justify granting the variance; and
>
> (3) Any additional information and factual material needed to sustain the law school's burden of proof and support the granting of the application.[16]

Note that Rule 33 places the burden on the law school to justify the request for a variance with "information and factual material." A law school, then, cannot simply hypothesize or surmise that a variance will promote or improve its program of legal education. It must collect and thoughtfully study relevant "information and factual material," and then tailor its request to that evidence. This is quite sensible—if the standards implicitly set guidelines or best practices for a quality program of legal education, an institution seeking a variance ought to prove that its plans are calculated to achieve the same end. Given the natural institutional inertia in higher education, though, this additional burden, while quite reasonable, may make experimentation impracticable at many institutions.[17] Consequently, the ABA should

14. ABA STANDARDS, *supra* note 11, Standard 403(a) ("The full-time faculty shall teach substantially all of the first one-third of each student's coursework.").

15. *Id.* Standard 306(e) ("A law school shall not grant a student more than a total of 15 credit hours toward the J.D. degree for courses qualifying under this Standard.").

16. *Id.* Rule 33(a).

17. A notable counter-example is William Mitchell School of Law, which was granted a waiver for a hybrid online-residential J.D. program. *ABA Approves Variance Allowing William Mitchell to Offer 'Hybrid' On-Campus/Online J.D. Program*, WM. MITCHELL NEWS (Dec. 17, 2013), http://web.wmitchell.edu/news/2013/12/william-mitchell-to-offer-first-aba-

continue its work to change or abandon accreditation standards that are not essential to a quality legal education.

It has been urged, and ABA officials have expressed support, that the waiver process should be more open, encouraging, and transparent.[18] This would allow law schools to understand the basis of prior waivers, and to learn from the experiments undertaken by other law schools. Transparency, though, may also discourage law schools from innovating. To see this, consider an analogy to the incentive toward research and development conferred by patents. The cost of research and development required to discover a new drug or other innovation may not make financial sense unless a firm can recoup those costs after the innovation goes to market. If competitors could quickly copy and market the innovation without incurring the costs of research and development, they could price the innovator out of the market. Knowing this, a firm may choose to not innovate. To spur innovation, then, the patent laws provide the innovator with a time-limited monopoly on marketing its innovation. During that protected monopoly period, the innovator can charge a higher price that will justify the investment in research and development. The opportunity to benefit financially from innovation, then, encourages experimentation.

The same could be said for innovations in legal education. To seek a variance from the ABA for an innovative method of legal education, a law school will likely incur substantial direct and opportunity costs. For example, a law school could incur direct costs through market research and other financial outlays to assemble the necessary supporting evidence for the variance request, and opportunity costs by diverting faculty and staff hours to work on the request. A law school would likely incur the costs of a variance request only if it believed that the innovation is likely to provide an offsetting benefit, such as attracting additional students to its educational program. This incentive, however, will be lessened if a competing law school could quickly copy the innovation, thereby leveraging all of the work done by the innovating law school. Transparency in the ABA variance process, then, might discourage innovation.

accredited-hybrid-on-campusonline-j-d-program.

18. *See* DENNIS W. ARCHER, TASK FORCE ON THE FIN. OF LEGAL EDUC., AM. BAR ASS'N, THE REPORT OF THE TASK FORCE 7 (2015), http://www.americanbar.org/content/dam/aba/administrative/legal_education_and_admissions_to_the_bar/reports/2015_june_report_of_the_aba_task_force_on_the_financing_of_legal_education.authcheckdam.pdf ("The ABA Section of Legal Education and Admissions to the Bar should strongly encourage schools to seek appropriate variances from the Council/Section when needed and that the Council/Section should give such requests serious and open-minded consideration.").

In sum, while further deregulation by the ABA would free law schools to experiment with lower-cost delivery models, the variance process allows for experimentation if a law school incurs the cost of undertaking the approval process. Given institutional inertia and the costs of seeking a variance, thoughtful deregulation should continue. In responding to the call for greater transparency in the variance process, the ABA should consider whether doing so would encourage or discourage innovation.

B. Investments by Key Beneficiaries

This next strategy ties to the economic concept of externalities. An externality is a cost or benefit of an activity that is not fully-realized by the person or firm engaging in that activity. An external cost is referred to as a negative externality, and an external benefit is referred to as a positive externality. A classic example of a negative externality is a company that employs a manufacturing process that emits pollution. If the pollution is not regulated in some way, the costs of pollution—e.g., harms to property, the environment, and public health—are not borne by the polluter. The name "externality" comes from the fact that the costs of those harms are borne by people and entities outside of, or "external," to the polluting firm.

Externalities are an economic problem because they lead to inefficiently higher or lower levels of production. Consider our polluting manufacturer again. If the firm does not bear the costs of pollution, then its production costs will be lower than the true cost of producing the good, and the firm will increase production.[19] If the firm does bear the costs of pollution, its production costs would be higher and output would be lower. In this case, the negative externality of pollution leads to over-production.

The opposite is true of positive externalities, which lead to under-production. If a firm does not receive all of the benefits of producing a good or service, then its revenue will be lower, and in turn its production level will be lower. Hill and Roza describe how this can work in service industries:

> Professional service organizations, such as hospitals and law firms, also understand that individuals can capture the benefits of new skills; employers adjust pay in light of increased productivity but they often do not subsidize the training. The education supply chain includes

19. The profit-maximizing firm in a competitive market produces to the point where marginal cost equals market price. If production costs are higher, production level typically will be lower.

> many participants who can capture at least some of the benefits of their investments, including students and parents, or industries that rely on graduates. Such investments—say by industries wanting specific skills in their workforce—are not the norm in education.[20]

This point should be familiar to anyone following the recent debate about legal education. Law firms have observed that they can no longer afford to train their entry-level associates because the cost of doing so cannot be passed on to clients.[21] Instead, firms would rather hire an attorney with several years of experience whose work can immediately be billed to the client. Practical training and experience of attorneys creates value that can be captured by an employer through increased billings.

Practical training and experience, then, create a potential positive externality for legal employers. That is, practical training or experience in law school may create a positive externality that can be captured through the billing or reduced training costs. Given these positive externalities, law schools and law students may underinvest in such training because they cannot realize the full benefits. The question is whether law schools, law students, and legal employers can partner to share the returns on practical experience and training in a way that benefits all three parties. This should be fertile ground for further inquiry.

C. Carefully Designed Workforce Policies

Hill and Roza describe this category in a passage that is worth considering in full:

> Many organizations, public and private, consciously manage their workforces in light of the broader labor market. They try to retain individuals who have rare or specialized skills, and anticipate much more rapid turnover among employees with commodity skills. *The resulting pay scale allows for salary differentiation and ensures that the firm has enough highly paid people to do its work, but no more*. In the public sector, the U.S. Foreign Service limits the number of people at the high points on its pay scale via a rigorous "selection up or out" policy. Promotions from lower to higher grades are strictly limited in number so that only a fraction of candidates can be promoted. Moreover, individuals who are passed over for promotion more than

20. HILL & ROZA, *supra* note 9, at 7.

21. Jennifer Smith, *Law Firms Face Fresh Backlash Over Fees*, WALL ST. J. (Oct. 22, 2012), http://www.wsj.com/articles/SB10001424052970203400604578070611725856952 ("[S]ome companies do object to paying for inexperienced junior lawyers, reasoning that the law firms should bear the cost of training first- and second-year associates.").

> twice must leave the Foreign Service. This keeps a lid on salary costs and also guarantees that there are always some slots for excellent junior people to move into. Public schools, with seniority-based pay and lifetime tenure, have avoided such workforce policies.[22]

In short, employment policies should "ensure[] that the firm has enough highly paid people to do its work, but no more."[23] In higher education, these highly paid people will be mostly full-time faculty and administrators with life tenure at an institution. The question is whether colleges and universities can effectively operate with fewer highly paid people than the current tenure system requires.[24]

To answer this question, consider what a foreign-service-like workforce policy might look like at a law school. One possible approach is multiple layers of up-or-out decisions over time, with a progressively smaller cohort of faculty reaching each level. Only a small number of full-time faculty members would reach the upper levels of seniority with the highest levels of compensation. This system has potentially serious pros and cons. On the one hand, it might encourage full-time faculty to maintain a connection to law practice in the event they must leave the academy and re-enter the profession, which could bring a more practical perspective to law teaching. Also, more frequent faculty turnover would infuse new ideas and reduce resistance to change. On the other hand, to maintain a practice connection, faculty members would need to sacrifice part of the service or research duties currently expected of most tenure-track faculty members. In addition, fewer senior faculty members would mean fewer members of the faculty with institutional history and perspective.

Another possible approach is to hire very few full-time faculty members onto tenure-track, with the remaining faculty members either adjuncts who maintain a full-time law practice, professors of practice who maintain a part-time law practice, or some mix of both. Again, a law school would face trade-offs in terms of the service and research expected of the non-tenure-track faculty members. For example, adjunct instructors typically have no research responsibilities or service roles at a law school. Professors of practice likely would not have research responsibilities, given their ongoing part-time law practice, but may play some role in faculty governance and law school service.

22. HILL & ROZA, *supra* note 9, at 7 (emphasis added).

23. *Id.*

24. A regulatory barrier to acting on this question is the current ABA Standard 405, Interpretation 405-1: "A fixed limit on the percent of a law faculty that may hold tenure under any circumstances violates the Standards." ABA STANDARDS, *supra* note 11, Standard 405, Interpretation 405-1.

Changing faculty work rules as described above could lead to less published legal research and fewer full-time faculty members to participate in law school governance and service. The question becomes whether this change fundamentally alters legal education in an unacceptable way. Can a law school have a quality program of legal education if fewer (or none) of its faculty members are expected to publish legal research? If fewer full-time faculty members are available for law school governance and service, would legal education be worse off if full-time administrators played those roles with less faculty participation? To consider this strategy, law schools would first need to address these fundamental questions.

CONCLUSION

Treating the cost disease in higher education will not be easy. Institutions must experiment with different strategies to find effective ways to increase productivity to offset the upward pressure on labor costs. For universities, a law school could be an effective setting in which to pilot possible strategies. With fewer faculty, staff, and students than other academic units, and thus a correspondingly smaller budget, the costs of these experiments would be relatively smaller than if attempted on a broader scale. And when an experiment shows promise, it could be scaled to benefit the entire institution.