



Bulletin

- Water
- Energy
- Retailing
- Transport
- Financial services
- Healthcare
- Telecoms
- Media
- Post
- Competition policy
- Policy analysis and design
- Regulation
- Strategy
- Contract design and evaluation
- Dispute support services
- Market design and auctions

JULY 2004

The price of justice

GOVERNMENT PROCUREMENT OF LEGAL AID SERVICES

As part of the 2004 spending review, government departments were expected to propose ideas for efficiency savings: that is, find ways to deliver public services at a lower cost. Frontier Economics analysed the legal aid system to help the Department for Constitutional Affairs (DCA) work out whether, and how, changes might generate efficiency savings without compromising the quality of service to defendants and litigants.

For consumers, the search to identify the best "deal" on the market will vary in its complexity, depending on the product. Some searches are highly specific (e.g., for a pint of semi-skimmed milk); others involve complicated assessment of a variety of characteristics (e.g., for a new car). Consumers will typically have a minimum set of requirements, and then search to ensure that they get the best combination of features for their money.

When a government department procures products and services, it shares the same objective as any other consumer: that is, to find the best value. The question is: how? →

While individuals may flick through *What Car?*, ask the opinion of friends and family, and finally make a purchase that leaves them with a warm glow inside, departments must be able to demonstrate to taxpayers (or, anyway to the Treasury) that they are using public funds to good effect, and to better effect than competing bidders for these resources.

Despite successive attempts to cut the cost of legal aid, governments have found this element of public spending hard to control. There are two main categories of legal aid: legal representation by lawyers for those charged with criminal offences; and advice and/or representation for those wishing to take (civil) legal action who could not otherwise afford to do so.

By 2002-03 the annual legal aid bill had risen to £2bn, and the DCA and the Treasury were anxious to find new ways of controlling costs, particularly given inherent limits in the extent to which eligibility for legal aid can be cut; the departments were keen to explore the scope for increasing the efficiency of this expenditure. Frontier Economics was asked by the DCA to analyse the supply of legal aid, and as part of this task to identify potential efficiency savings through the introduction of competition in the procurement of solicitors' services.

PROCUREMENT STRATEGY MATTERS

Government policy has three objectives:

- meeting priority social needs, such as the protection of children;
- ensuring legal aid is available to all those deemed to be eligible, throughout the country; and
- maintaining the quality of services provided as part of legal aid.

Implementing these policies is the responsibility of the Legal Services Commission (LSC), which sets the fees and other conditions for payments to solicitors and barristers.

Lawyers (solicitors and barristers) typically undertake work for both legal-aided and private clients, although the balance of work varies between firms and indeed between individual lawyers. For legal aid work, solicitors are offered a fixed price for every hour of legal advice and representation that they supply to defendants and litigants. Figure 1 provides a simplified representation of this current procurement approach.

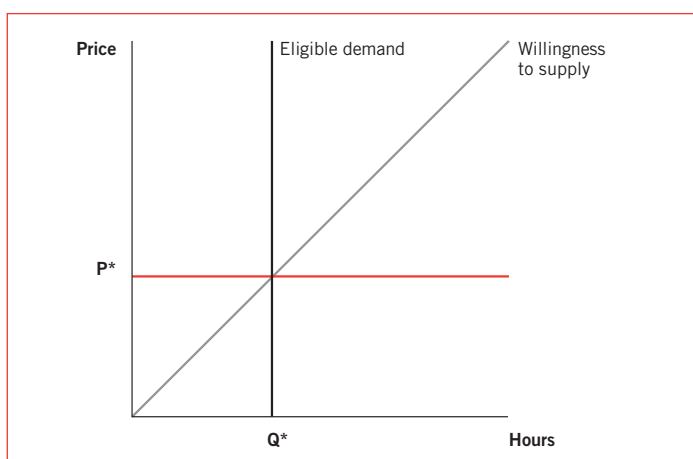


Figure 1: Setting the price for legal aid

Three points emerge clearly from this diagram, which help to explain why a fixed price per hour is unlikely to lead to the most efficient purchasing outcome.

- "Eligible demand" (i.e., the total number of hours of advice demanded by individuals eligible for legal aid) is unrelated to price, because the individual is not picking up the bill.

The price of justice

- "Willingness to supply" (i.e., the hours of advice solicitors in aggregate are prepared to supply) does vary by price. Higher remuneration rates increase willingness to offer hours.
- The point at which the two lines cross defines the lowest price (P^*) that will ensure solicitors offer sufficient hours of advice to meet all eligible demand.

The problem of client indifference to cost is obviously endemic in the provision of any public service free at the point of use. Such lack of constraint on demand may put greater pressure on the costs of legal aid than of (say) dental services, since an hour spent chatting to a solicitor is probably less disagreeable than an hour in the dentist's chair. But it is clearly not the only problem with this procurement approach. To be efficient, the DCA and LSC's procurement strategy requires the accurate prediction of P^* ; that is to say, an ability to forecast the price at which the right quantity of legal services will be supplied. Since this is no easy task, the fixed price is highly likely, in practice, to be set too high or too low.

If the price is set too high, the DCA will spend more than it needs to, and indeed solicitors may seek to induce extra demand, particularly in periods when there is a shortage of other business. If the price is set too low, however, solicitors will be reluctant to supply and not everyone who is eligible will get access to legal aid – a problem which has certainly arisen with respect to dental services. The likelihood that one or other of these outcomes will occur indicates a basic inefficiency in the system.

The next issue relates to quality. Legal aid services are typically consumed infrequently and are relatively complicated. It is hard for consumers to judge the quality of a solicitor's service, before and even after consumption. Nor is it easy for the purchaser – i.e., government – to judge whether the service received was what was actually needed.

Suppliers may react to fixed-price systems not merely by over- or under-supplying but by varying the quality of the service. They may cut costs and therefore increase margins by using less experienced staff. Self-evidently, not all "hours of advice" are the same in terms of the quality of service delivered.

Quality is, at least in theory, maintained by industry self-regulation. However, the problems involved in relying on self-regulatory mechanisms as a control in large and diverse industries are well-documented.

Historically, the DCA and LSC have responded to issues of quantity and quality by regulation: for example, by limiting the number of hours that could be charged for certain kinds of work or by setting qualification requirements. The challenge for Frontier Economics was to weigh up the virtues of the regulatory approach against those of a competitive system, and to ascertain the extent to which the two were compatible.

PLAYING THE NUMBERS GAME

Securing the best deal means getting suppliers to provide services at efficient prices. In the short term, this means prices that reflect the cost of delivering the service. One way to increase efficiency in the delivery of legal aid would therefore be to find out more about the costs of supply at the detailed level, i.e., firm by firm. This is the approach adopted by, for example, the regulators of utilities such as water supply.

However, for legal aid, such an approach would be highly intrusive and administratively costly, given that the number of suppliers is over 3,000. Moreover, utility regulators are forced to adopt such an approach precisely because there are relatively few suppliers and it is difficult to introduce direct competition between them.

A competitive approach is preferable not merely because it involves less detailed intervention and addresses the issue of efficient pricing in the short term; it also tends to lead to greater efficiency in the long term. Setting prices firm by firm might result in

The price of justice

short-term savings, but would tend to fossilise the pattern of provision and reward relative inefficiency. By contrast, the long-term dynamics of competitive markets create incentives for suppliers to keep costs to a minimum. So it is clearly worth looking at ways of developing a market-based approach.

The key problem is to get suppliers to offer their best prices, today and into the future. Creating a market is a delicate operation. The exact approach must depend not only on the nature of the product or service, but also on the nature of supply. But certain general principles can usefully be applied.


- The government department should act as an informed buyer – i.e., should take care to understand exactly what it is trying to procure. If the "product" is not properly defined, it will be very difficult for the buyer to identify the best deal. Where possible, the product should be defined in terms of outcomes (e.g., completed cases) rather than inputs (e.g., hours of advice). This will help to restrain supplier-induced demand and encourage suppliers to use inputs efficiently. The quality specification should be built into the definition of the "product".
- The market should be designed to encourage firms to reveal the minimum price at which they would be willing to supply a given volume of products. If this can be done successfully for each particular product or service specification, it will then be possible to award contracts to the firms that offer the lowest prices.
- The results of competition should be transparent. An important aspect of a competition is the stimulus it provides for dynamic cost reductions triggered by challenge from new low-cost entrants. This stimulus depends on their ability to spot opportunities to under-cut the prices of existing suppliers.

Assuming that the DCA and LSC can specify the services required sufficiently precisely and communicate these to suppliers and organise bidding by a number of potential suppliers, it should be possible to introduce genuine competition. Obvious questions arise as to whether this will be the case for all legal aid services and in all parts of the country. However, the development of online legal services at least raises the question as to whether location will continue to be a limiting factor for the supply of all legal services.

The scale of efficiency savings is an empirical question. There is likely to be a trade-off between the set-up and running costs of any new procurement system on the one hand, and the savings that the new system might generate over time on the other. It would be sensible to test a range of systems (e.g., auctions) by running pilot schemes for different services, in different areas of the country.

CONCLUSION

For government departments providing services to the public, the task of obtaining value for money is complicated by the fact that the ultimate customers are not sensitive to price. However, by taking care to specify the product or service in question carefully, and honing the incentives to suppliers to price efficiently, it may still be possible to develop a market-based mechanism that can improve value for money. The work that Frontier undertook has encouraged the DCA and LSC to consider piloting the introduction of competition into the procurement of legal aid services from solicitors.

SOURCE	<i>"A market analysis of legally aided services provided by solicitors". Frontier Economics 2004.</i>
CONTACT	<p>Rachel Webster rachel.webster@frontier-economics.com</p> <p>Michael Ridge michael.ridge@frontier-economics.com</p> <p>Frontier Economics Ltd 71 High Holborn London WC1V 6DA</p>
	<p>LONDON COLOGNE MELBOURNE SYDNEY</p> <p>www.frontier-economics.com</p>