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The Reform of Legal Aid in England and Wales

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Abstract

Legal aid expenditure has risen dramatically in recent years, prompting attention from successive governments. A prominent theme of past and present government reform proposals has been the shifting of risk away from the taxpayer towards lawyers, clients and insurers by altering the means by which legal aid lawyers are paid. This paper explores this theme by presenting information on legal aid expenditure trends over the last two decades and then considering whether payment mechanisms have contributed to this performance. Finally, it reviews previous and current reform proposals in this area. It concludes that, because risk-shifting also alters incentives, it is essential that reform recognises and monitors these.

JEL classification: K40, L50.

I. INTRODUCTION

The government's plans to reform legal services and the courts, set out in the December 1998 White Paper *Modernising Justice* (Lord Chancellor's Department (LCD), 1998b), represent the culmination of a long period of growing policy concerns about the legal system. Underlying these concerns has been an awareness that use of the legal system may involve high and uncertain levels of cost, which can act as a disincentive to many considering legal action. These disincentive effects raise concerns for economic efficiency: they blunt the deterrent effects of the legal system, and may leave unchecked the unwarranted

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transfer of wealth from 'victims' to 'injurers' which, apart from being inequitable, could hinder the clear definition of property rights in an economy.¹

In many jurisdictions, institutional responses have developed to address these potential problems, particularly by reducing the risks faced by poorly informed clients and placing them with parties who can better bear them. Thus, in the US, lawyers bear much of this risk through contingent fees; in much of continental Europe, insurers accept the risk through legal expenses insurance policies; alternatively, the state might accept such risk itself through a legal aid scheme such as the UK's, which since 1949 has offered '... conditional financial support, provided by the tax payer, for individuals whose financial circumstances would prevent them from taking or defending proceedings without assistance with their legal costs' (LCD, 1991).

Although past and present UK governments have been committed to the continuation of legal aid, it has been increasingly criticised in recent years on grounds of effectiveness and efficiency. First, it has been argued that the services offered by the scheme are mainly legalistic, and do not deliver legal assistance across all areas of need. Second, expenditure on the scheme has grown rapidly and unpredictably, from a net cost of £321 million in 1987–88 to £1,177 million in 1997–98, an annual growth rate of 13.9 per cent compared with annual GDP growth of 6.4 per cent over the same period (Legal Aid Board (LAB), 1998). Simultaneously, the proportion of the population eligible for legal aid has fallen from around 75 per cent to below 50 per cent (Gray, 1994). As the White Paper states, there has been an '... inability to control legal aid, and target it on real legal needs, within a budget the taxpayer can afford' (LCD, 1998b, p. 13).

Successive administrations have sought to tackle these problems through a series of reform proposals, some of which have been implemented and others of which are pending and are summarised in *Modernising Justice*. Attempts to control expenditure have been aimed at the demand for, and supply of, legal aid. On the demand side, there have been alterations to the scope of the scheme, to the criteria governing eligibility for legal aid and to the contribution levels required from assisted parties; and more are proposed (LCD, 1998b, paras 2.42 and 3.24–3.30). On the supply side, a number of attempts have been made to alter incentives so that solicitors become more cost-efficient and 'purchasers' stay within global budgets. Thus retrospective fees for service are gradually being replaced by prospectively fixed ('standard') fees as the basis for remunerating legal aid work. Further, the White Paper proposes to introduce public sector franchising of contracts for legal aid suppliers within an overall fixed budget (LCD, 1998b, paras 3.17–3.23).² In addition to these measures, the

¹Of course, an optimal legal system will also deter the pursuit of 'nuisance' claims and the associated waste of scarce legal resources, and to this end some cost of accessing the system may be appropriate.

²The majority of these changes have been aimed at legal aid in civil cases, as opposed to criminal ones. However, LCD (1998b) includes proposals for reforming the delivery of criminal legal aid. We shall not discuss these in the current paper.

government proposes the removal of some currently legally aided services — in particular, most categories of personal injury litigation — from the scheme. Instead, private insurers and solicitors will be encouraged to provide insurance against legal costs, via insurance policies and conditional fee agreements (LCD, 1998b, paras 2.42–2.44).³ This could be characterised as a form of privatisation, in the sense of transferring the risk associated with a service function (litigation) from the public to the private domain.

It is interesting that each of these supply-side proposals seeks to shift risk from the taxpayer, towards lawyers, insurers and individuals, as occurs in other jurisdictions. Of course, this is only appropriate if sufficient information exists to monitor these parties' responses to the new risk they must bear: in a principal-agent framework with asymmetric information, contracts must provide incentives as well as share risk. This makes it important to understand the incentive effects underlying the legal aid system and how reform might affect these. With this in mind, and given the growing policy interest in this now important area of public spending, this paper examines the recent performance of the legal aid scheme and assesses the supply-side reform proposals that have entered recent policy debate. (See Goriely (1998) for a wider discussion of the legal aid reform debate.)

We begin in Section II by briefly describing the current structure and operation of the legal aid system. Section III provides an empirical account of recent trends in legal aid expenditure, decomposing the growth into programme components and volume and unit-cost effects. This section draws on data from various published sources to provide a quantitative perspective on the performance of the legal aid system. In Section IV, we consider some of the potential causes of rising legal aid expenditure and, in Section V, we examine the major supply-side reforms proposed and enacted in recent years and consider their economic rationale. In particular, we consider standard fees, legal aid contracting and the proposed encouragement of private, as opposed to public, insurance of legal expenses. Section VI offers an assessment of these policy responses, with particular reference to their incentive effects. We argue that a number of these reforms may have provided inappropriate incentives, bearing in mind the monitoring problems generated by information asymmetries inherent in the delivery of legal services. Section VII draws some conclusions and notes other avenues for reform not currently being considered.

³The proposals on contracting and conditional fees build on previous government policy. Thus franchising arrangements — the forerunner to contracting — were introduced in 1993 (see note 12), and LCD (1996) proposed the contracting-out of legal aid services. Similarly, conditional fees were created by the Courts and Legal Services Act 1990 and were first used, though not in place of legal aid, in 1995.

II. THE LEGAL AID SYSTEM

Since the 1988 Legal Aid Act, legal aid in England and Wales has been administered by the Legal Aid Board.⁴ The LAB is organised into 13 areas, each with a Board Area Office (BAO), and these are responsible for determining applicants' eligibility for legal aid, assessing solicitors' claims for payment and administering claims.

Legal aid currently provides assistance under six separate schemes which offer advice and representation in both civil and criminal branches of the law. At the initial stage of a (potential) civil or criminal dispute, legal advice and assistance from a solicitor are generally available for up to two hours (three hours in divorce matters) under the Green Form scheme, which is means-tested. If a civil case is taken further, legal aid is available for all aspects of the proceedings above County Court level, with the exception of defamation cases. For civil cases in Magistrates' Courts and some tribunals, solicitors' costs of preparation and representation can be met through the Assistance By Way Of Representation (ABWOR) scheme. Civil proceedings under the Children Act 1989 are covered at all court levels. In criminal cases, advice is available from the Green Form scheme, but also — under the Duty Solicitor (Police Stations) scheme — to those who have no solicitor themselves and who are detained in a police station. A similar Duty Solicitor scheme operates for the defence of those with no solicitor in Magistrates' Courts. Finally, legal aid is available to defendants in Magistrates' and Crown Courts.

Table 1 provides an indication of the relative importance of these various schemes in 1996–97. (The difference between gross and net expenditure is a

TABLE 1
Gross and Net Expenditure on Legal Aid, by Component, 1996–97

	<i>Gross</i>		<i>Net</i>	
	£m	%	£m	%
Civil	1,111	58	671	45
Criminal, Magistrates' Courts	229	12	226	15
Criminal, higher courts	315	16	313	21
Green Form	153	8	151	10
ABWOR	12	1	12	1
Duty Solicitor schemes	104	5	104	7
<i>Total</i>	<i>1,923</i>	<i>100</i>	<i>1,476</i>	<i>100</i>

Source: Lord Chancellor's Department.

⁴LCD (1998b) contains plans to replace the LAB with a new Legal Services Commission, itself split into the Criminal Defence Service (to supply criminal legal aid) and the Community Legal Service (to supply civil legal aid).

function of contributions by assisted persons, who may have to make a means-tested contribution towards the expenses of a case or to accept assistance conditional on repaying the legal aid contribution if they are successful.) Civil legal aid is by far the largest single category, accounting for 45 per cent of net expenditure. This is followed by criminal legal aid in the higher courts and Magistrates' Courts, together accounting for 36 per cent of net expenditure. The Green Form scheme accounts for 10 per cent, with the other programme areas taking up the remaining 8 per cent.

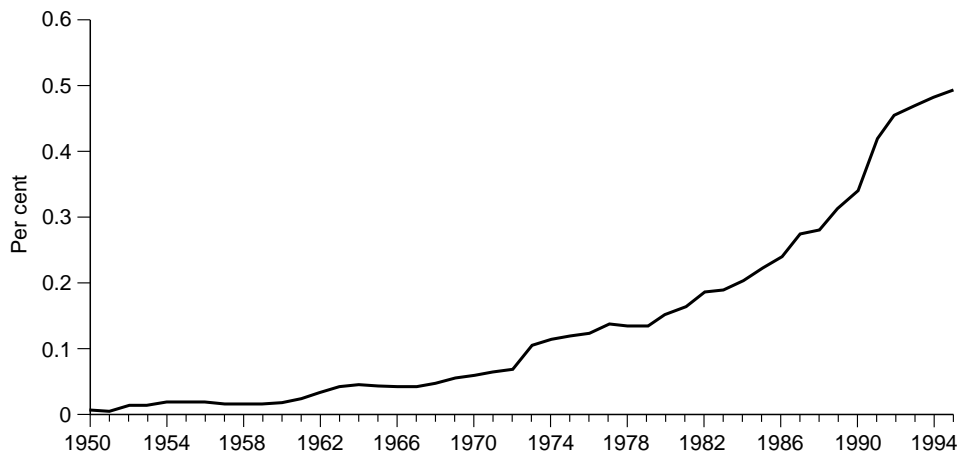
III. RECENT TRENDS IN LEGAL AID EXPENDITURE

Legal aid is still a relatively small part of total government expenditure — 0.5 per cent in 1996 — but, as Figure 1 shows, for most of the 1980s and 1990s, legal aid expenditure grew rapidly, taking a steadily rising share of national income and of total government expenditure.

The unpredictable, unplanned and apparently uncontrollable nature of this increase raises doubts over the LAB's ability to allocate its resources efficiently.⁵ Furthermore, although a raft of reform measures has been introduced, legal aid expenditure is continuing to expand. As Table 2 indicates, the LCD's 1997 Strategic Plan shows planned expenditure rising by a further 25 per cent between 1995–96 and 1998–99. In 1998–99, net expenditure rose by 5.1 per cent compared with retail price inflation of 3.1 per cent.

FIGURE 1

Legal Aid as a Percentage of Total Government Spending



⁵In Barr's (1993, p. 8) terminology, the legal aid system has failed to achieve a degree of 'macro-efficiency', whereby controllable and predictable costs are one important objective.

TABLE 2
Legal Aid Provisional Out-Turn and Planned Net Expenditure

	1995-96 (£m)	1996-97 (£m)	1997-98 (£m)	1998-99 (£m)	Percentage change, 1995-96 to 1998-99
Civil	639	675	730	802	25.5
Criminal, Magistrates' Courts	212	234	246	258	21.7
Criminal, higher courts	286	296	323	350	22.4
Green Form	143	163	183	207	44.7
ABWOR	12	11	10	10	-16.7
Duty Solicitor schemes	95	98	102	106	11.6
<i>Total</i>	<i>1,387</i>	<i>1,477</i>	<i>1,594</i>	<i>1,732</i>	<i>24.9</i>

Source: LCD, 1997.

This increased expenditure becomes even more striking when placed against a background of policy-induced reductions in eligibility for legal aid. Different estimates have been made of the size of this reduction, but the methodology, results and interpretations have been disputed. The normal procedure has been to estimate the proportion of individuals or households who would be eligible on income grounds, based on the current legal aid income limits and the distribution of income (capital holdings are also part of the eligibility criteria, but are normally excluded from eligibility estimates because of lack of information on their distribution). Using this approach, Murphy (1989) estimated that the percentage of households eligible for civil legal aid fell from 81 per cent in 1979 to 51 per cent in 1990, equivalent to around 16 million people in Britain losing their eligibility for civil legal aid.

A necessary starting-point for analysing legal aid expenditure growth is to disaggregate it into its principal components. Only by understanding *how* legal aid expenditure has increased can we begin to assess *why* this has occurred and

TABLE 3
Decomposition of Total Legal Aid Expenditure

	<i>Nominal expenditure growth (%)</i>	<i>Growth in GDP deflator (%)</i>	<i>Population growth (%)</i>	<i>Volume growth (%)</i>	<i>Real expenditure growth per unit (case) (%)</i>
1980-85	17.2	6.7	0.2	11.9	-1.8
1985-90	16.0	5.8	0.3	6.6	2.8
1990-95	15.4	3.6	0.4	7.4	3.8
1980-95	16.2	5.4	0.3	8.6	1.6

Source: See Appendix.

TABLE 4
Decomposition of Legal Aid Expenditure by Programme, 1980–95

	<i>Nominal expenditure growth (%)</i>	<i>Growth in GDP deflator (%)</i>	<i>Population growth (%)</i>	<i>Volume growth (%)</i>	<i>Real expenditure growth per unit (case) (%)</i>
Civil	21.6	5.4	0.3	7.7	7.1
<i>of which:</i>					
matrimonial	19.1	5.4	0.3	6.3	6.4
non-matrimonial	25.3	5.4	0.3	9.6	8.6
Criminal, Magistrates' Courts	11.6	5.4	0.3	3.5	2.4
Criminal, higher courts	13.6	5.4	0.3	2.3	5.4
Green Form	15.1	5.4	0.3	7.2	1.9
ABWOR	11.0	5.4	0.3	-1.0	6.4
Duty Solicitor schemes ^a	37.5	5.4	0.3	34.8	-3.2

^a1985–95.

Source: See Appendix.

to evaluate the reforms on offer. Accordingly, Table 3 presents such expenditure breakdowns across the whole legal aid scheme from 1980 to 1995 (the method for producing these figures is presented in the Appendix). Over this entire period, the nominal growth in net legal aid expenditure averaged 16.2 per cent per annum. The GDP deflator rose at an average of 5.4 per cent per annum, population growth averaged 0.3 per cent per annum and volume growth over the period was 8.6 per cent per annum. Consequently, real expenditure growth per case was 1.6 per cent per annum. Table 3 also shows that, in the early 1980s, volume growth was far more important than real expenditure growth per case (which actually fell slightly during this period), but that rising real unit costs have become more important subsequently.

Similar decompositions for each programme area of legal aid are shown in Table 4 for the entire period 1980–95. Of the major spending programmes, civil cases had the highest rate of nominal expenditure growth (21.6 per cent per annum), a combination of almost equally rapid growth in the volume of cases (7.7 per cent per annum) and real expenditure per case (7.1 per cent per annum). By comparison, the nominal rate of growth in expenditure on criminal cases in Magistrates' Courts was much lower (11.6 per cent per annum), with volume growth less than one-half the rate of increase in civil cases and real unit-cost growth barely one-third of that experienced in civil cases. From these data, it is quite clear that it would be hazardous to generalise across programme areas,

TABLE 5
Volume and Real Unit-Cost Growth Rates by Legal Aid Programme

	Annual percentage change			
	1980–85	1985–90	1990–95	1980–95
<i>Volume of cases</i>				
Civil	8.3	3.1	11.9	7.7
Criminal, Magistrates' Courts	6.2	3.5	0.9	3.5
Criminal, higher courts	4.7	3.2	-0.9	2.3
Green Form	14.3	0.0	7.7	7.2
ABWOR	20.3	0.9	-20.1	-1.0
Duty Solicitor schemes	—	66.4	9.2	34.8 ^a
<i>Real expenditure per case</i>				
Civil	6.2	8.4	6.9	7.1
Criminal, Magistrates' Courts	1.1	6.4	-0.3	2.4
Criminal, higher courts	0.8	6.1	9.6	5.4
Green Form	2.1	1.0	2.8	1.9
ABWOR	4.7	4.0	10.6	6.4
Duty Solicitor schemes	—	-7.9	3.0	-3.2 ^a

^a1985–95.

Source: See Appendix.

which have experienced quite different patterns and rates of growth. Table 5 underlines this point, indicating that the experience of different programme areas has also varied substantially between subperiods.

Non-matrimonial civil work emerges as clearly a crucial ingredient in the overall increase of legal aid expenditure. Matrimonial work, which accounted for over 61 per cent of all cases in 1980, had by 1995 virtually halved in importance, while family work and tort had grown substantially. Using more detailed breakdowns of case types, our analysis indicates that the growth of tort expenditure has been driven primarily by volume, while the growth in family law expenditure is strongly associated with rising unit costs. To illustrate this, in 1980, the average tort case was around 60 per cent more expensive than the average for all civil cases, while the average family law case cost barely two-thirds the average. But, by 1995, the average tort case was close to the average cost for all civil cases, while the average family law case was above the average cost and actually above the average cost per tort case. This might suggest greatly increasing complexity of cases in the family law area.

Within the area of tort, the average increase per annum in the volume of cases between 1980 and 1995 was 14.2 per cent. Even more rapid growth rates can be

identified within this category: in particular, the volume of legally aided medical negligence work grew on average by 27.5 per cent per annum between 1980 and 1995.

In summary, the figures suggest that expenditure on criminal, civil matrimonial and non-matrimonial areas of work have been affected in different ways by changes in volumes and unit costs. Over time, it appears that volume effects have been diminishing and real unit-cost effects have become more important (this pattern may indeed have strengthened since 1995, with some evidence that the volume of civil legal aid is now declining). Bearing these findings in mind, it is now possible to consider the potential reasons why legal aid expenditure has increased and the policies proposed to bring it under control.

IV. CAUSES OF RISING LEGAL AID EXPENDITURE

The variety of patterns in legal aid expenditure described in the previous section suggests that several factors may have contributed to the growth observed in recent years. The possible reasons for this growth fall broadly into three categories. First, there are factors that are external to the legal system, such as demographic changes, changing family structures and fluctuations in economic activity. Some of these, such as demographic changes, have been identified as influences on other areas of welfare expenditure such as health and education, although their influence in the past may have been less than often supposed. (In the OECD between 1960 and 1984, the compound annual rate of growth in health expenditure was 16 per cent, of which 0.3 of a percentage point was attributable to changing population structure and 0.7 of a percentage point to population growth (Culyer, 1990). However, analyses of changes in variables such as household composition could well reveal a stronger link.) Second, there may be factors inside the legal system but not directly within the control of the legal aid system: for example, inefficiencies or capacity constraints in the courts may slow down all legal cases, making legal aid cases more expensive; legislation to raise standards of evidence in criminal cases may make them more costly; the incorporation of Human Rights legislation or extension of specified legal rights to children may create new legal demands; and an increase in the numbers of solicitors or a diminution in their income from other sources may create incentives to expand legal aid work. Third, there may be factors internal to the legal aid system, such as the changes in the scope of legal aid, alterations in eligibility rules and the effects of the payment systems used to remunerate solicitors providing legal aid services. Some of these factors may affect the volume of legal aid cases and others are more likely to influence the unit cost of services — that is, the average cost per case.

These potential explanations for rising legal aid expenditure dictate a lengthy research agenda crossing several disciplines. Here, we focus on the incentive structures faced by lawyers and clients within legal aid, partly because these

have been a key focus for policy debate and reforms, and partly because this area seems particularly amenable to economic analysis. This, however, necessarily leads us to recognise the role of the wider legal system which dictates the opportunity cost of legal aid work. Hence we examine the potential causes of rising legal aid expenditure under two headings: fees and incentives, and litigation behaviour.

1. Fees and Incentives

The principal incentive effects highlighted by policymakers have been due to the existence of moral hazard. By insulating producers and consumers from certain financial consequences of their actions, it is argued that the legal aid system may generate supplier-induced demand, the product of two factors: suppliers' ability to influence uninformed clients' beliefs about their requirements, and clients' inability (through lack of knowledge) or unwillingness (through *de facto* cost insurance) to monitor their supplier's work. The suggested result of these effects is a misallocation of legal aid resources, as a result of an increased supply of legal aid if lawyers face a low opportunity cost for alternative work.

How might incentives to providers within the legal aid scheme have affected its overall cost to the exchequer? A possible explanation lies in the use of hourly rates to pay lawyers performing legal aid work. In the solicitor–client relationship, the solicitor (agent) provides services and information without which the client (principal) would be less effective in using the legal system. When the solicitor is paid by the LAB, a situation of common agency develops (see, for example, Bernheim and Whinston (1985)). For obvious reasons, the client is unlikely to possess expertise for monitoring the solicitor's work. Less obviously, but for reasons relating to administrative facilities and legal expertise, this is also likely to be true of the LAB (Gray, Fenn and Rickman, 1997). However, well-known inefficiencies result from paying agents on the basis of inputs when these cannot be monitored by the principal(s): in particular, fee-for-service payment creates an incentive for oversupply (assuming that the fee is above the opportunity cost of the time spent). This suggests a conceptual basis for a concern that payment by the hour will distort resource allocation, and possibly increase legal aid costs.

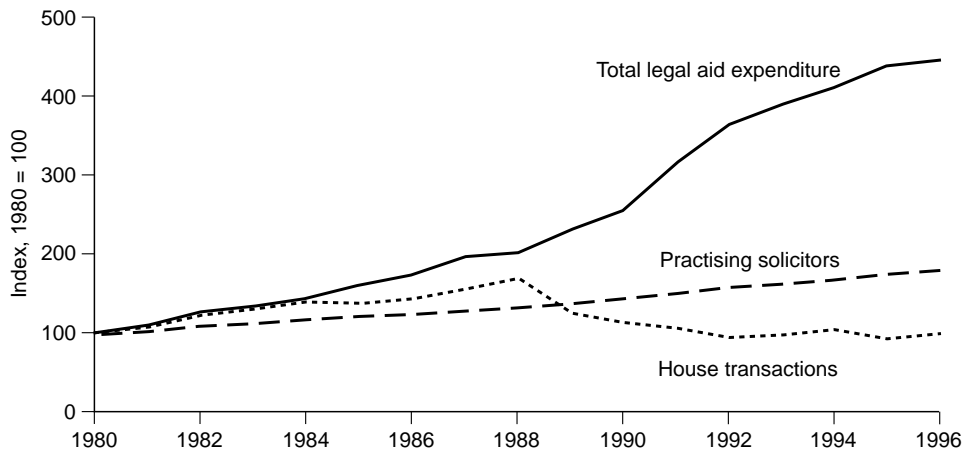
Bevan, Holland and Partington (1994) and Bevan (1996) identify an analogy between this situation and the American provision of health care, where it is often argued that fee-for-service reimbursement by third-party payers (i.e. insurance companies) created moral hazard incentives for physicians to oversupply services to ill-informed, non-cost-bearing patients. Such supplier-induced demand is alleged to have increased health-care costs significantly in the US and, taking the LAB as the third-party payer, to have done the same with legal aid costs in England and Wales. Of course, fee-for-service payment on a third-party retrospective basis is not sufficient for the existence of supplier-

induced demand: as mentioned above, an agent has no incentive to oversupply in such a situation if the fee involved does not cover the opportunity cost of the work, something that solicitors and barristers frequently claim. Thus, for example, Baldwin and Hill's (1988) investigation of Green Form work found little evidence of fraudulent behaviour on the part of solicitors. However, it is feasible that their research pre-dated a sharp drop in the opportunity cost of such work which took place in the late 1980s, the time when legal aid costs began to rise. In that period, solicitors' income from conveyancing was hit by two events: the collapse of the property market and the removal (by Part II of the Administration of Justice Act 1985) of their monopoly on the supply of conveyancing services (see Stephen, Love and Patterson (1994)). This reduction in the opportunity cost of legally aided work as a 'staple' income generator provided at least the conditions in which supplier-induced demand behaviour in legal aid could have occurred.

Unfortunately, a feature of the supplier-induced demand hypothesis is that it is hard to test. Natural difficulties with testing for such micro-level behaviour are compounded in the case of legal aid, however, because the availability of data, about the legal aid system as a whole let alone at the level of individual solicitors' production functions, is so poor. Bearing these problems in mind, Gray, Rickman and Fenn (1999) attempt to test the less ambitious proposition that solicitors' decisions on legally aided cases have been affected by financial incentives. Working with panel data on legally aided criminal and civil cases

FIGURE 2

Changes in Real Legal Aid Expenditure, Numbers of Practising Solicitors and House Transactions, England



Sources: Legal aid expenditure — see Appendix. Practising solicitors — Law Society Annual Reports. House transactions — *Economic Trends* Annual Supplements.

from 1985 to 1992, they find that the volume of mortgages over the period had a negative impact on unit costs and volumes, while the number of practising solicitors (which rose 28 per cent over this period) had a positive impact. Both of these results are consistent with Bevan, Holland and Partington's (1994) analysis (see Figure 2).

It is also interesting to note that some of the patterns of legal aid growth are compatible with incentives playing a key role. In particular, Table 5 reports much smaller increases in criminal volumes between 1980 and 1995 than in civil volumes. This is consistent with the decision to prosecute in criminal cases being largely outside lawyers' control: it is the responsibility of the police and the Crown Prosecution Service instead. Civil cases, in contrast, are pursued partly as a result of the lawyer's advice, and incentives are likely to play some part in this advice, subject of course to the usual professional and ethical constraints.

2. Litigation Behaviour

Although legal aid is not solely available for litigation, related evidence on the role of incentives created by legal aid might be found in the propensity to litigate amongst those eligible for full legal aid and in the duration of legally aided cases relative to those funded by other means: indeed, we saw earlier that tort, a principal area for litigation, has been a growth area within legal aid. The suggestion is that, because third-party retrospective fee-for-service payment saves lawyers and assisted parties from internalising their costs, there is more incentive to bring, and less to settle, a legally aided case. We would therefore expect to see a higher propensity to litigate in assisted cases, and longer case duration.

Once again, data comparing legal aid recipients with non-legally aided litigants are very incomplete. However, some evidence appears to be in line with these predictions. As Table 6 shows, individuals eligible for free civil legal aid are approximately six times more likely to be in receipt of a certificate of assistance from the LAB — that is, to be involved in legally aided non-matrimonial litigation — than are individuals who are eligible for legal aid but are liable for a contribution towards the costs of the litigation. Of course, these figures are dependent on the estimated populations eligible for legal aid, and these estimates are not precise, as noted earlier. However, there does seem to be clear evidence of a significant difference, and this would be consistent with the moral hazard hypothesis.⁶

⁶As we do not know the optimal level of litigation, it is possible that those making contributions to legal aid costs are under-litigating, rather than those making no contributions over-litigating. There may also be interactions between the benefit system, nil contributions and case characteristics. Accordingly, more information would be required before the figures in Table 6 could be confidently identified as being caused by moral hazard behaviour.

TABLE 6
Propensity to Litigate when Receiving Free or Contributory Legal Aid

	1979	1989
No. of non-matrimonial civil legal aid certificates issued		
Free	49,491	104,218
Contribution required	13,796	27,215
No. of adults eligible (thous.)		
Free	10,937	9,443
Contribution required	17,465	15,220
Propensity to litigate (no. of certificates issued per 1,000 eligible)		
Free	4.53	11.0
Contribution required	0.79	1.79
Ratio of free to contributory litigation rate	5.7:1	6.2:1

Source: Constructed from LCD (1991, Table 3).

However, the table also indicates that, while the absolute propensity to litigate increased substantially during the period 1979–89, the ratio between the two groups remained fairly stable. Hence moral hazard might be seen as a factor but not as a primary reason for the underlying growth in litigation.

Regarding the duration of cases, Fenn and Rickman (1999) report a significantly lower conditional probability of settlement amongst legally aided medical negligence cases than amongst non-assisted ones over the period 1990–95.

In summary, there is some evidence for believing that the incentive structure underlying the principal–agent relationships in legal aid has affected the behaviour of assisted parties and their lawyers. In turn, it is plausible that the volume of legally aided cases and their unit costs will have risen, with some of the resulting increases in expenditure that we have seen. While we cannot precisely determine the contribution of these factors to expenditure increases, we have found some information consistent with the presence of these effects. We now consider the policies that have been proposed in order to alter this position.

V. POLICY RESPONSES

In order to bring legal aid expenditure under control, policymakers have embraced a series of reforms to alter incentives within the system. The three main areas of reform have been: first, the introduction of prospective fixed fees per case; second, steps to provide legal aid by a network of suppliers working under contract to the LAB within a fixed legal aid budget (characterised by Bevan (1995) as a ‘quasi-market’ for legal aid); and third, the encouragement of conditional fee agreements in the private legal sector as a means to facilitate the

transfer of a wide range of personal injury actions from the legal aid system into the private market-place for legal services (the 'privatisation' of these services for low-income groups).

1. Standard Fees

If retrospective payment on a fee-for-service basis is perceived to have contributed to increases in legal aid expenditure, a crude alternative is to move to a flat fee, set on a prospective basis, for the whole case. The introduction of 'standard fees' for criminal cases in Magistrates' Courts in 1993 represents precisely this response. Within this mechanism, different standard fees apply in three categories of cases: guilty pleas and other uncontested matters, contested trials and committal proceedings. Given the case's category, its *core cost* can be calculated by applying itemised rates to the amounts of inputs reported by the solicitor as having been provided on the case — namely, time in preparation, advocacy and attendance on client(s) and counsel at court, and number of routine letters and telephone calls. If the core cost falls below a lower limit, the solicitor receives a lower standard fee to cover this work. If the core cost lies between a lower and higher limit, a higher standard fee is paid by the LAB. Finally, if the solicitor can demonstrate core cost in excess of the higher limit, the work done is remunerated on the basis of itemised rates for the recorded amounts of inputs. The standard fee is therefore graduated, with the allowable level depending on the solicitor's report, audited by the LAB, of the work demanded by the case.

Another feature of the system is that the core cost does not cover all of the solicitor's work. In particular, travel and waiting and out-of-pocket disbursements are each reimbursed outside the standard fee by a straightforward application of itemised rates to the recorded volumes of these inputs. The solicitor may additionally claim percentage enhancements to the itemised rates, by demonstrating that the work was done with exceptional competence and dispatch, or that the case had exceptional circumstances.

When introducing standard fees to criminal cases in Magistrates' Courts, the Lord Chancellor suggested that 70 per cent of cases would be captured by the lower standard fee and 20 per cent by the higher standard fee, leaving 10 per cent to be remunerated on a per-item-of-input basis. In fact, in 1997–98, these figures were 80 per cent, 11 per cent and 9 per cent respectively (LAB, 1998).

Standard fees have also been applied to some legally aided criminal cases in the Crown Court (the direct responsibility of the Lord Chancellor's Department rather than the LAB) since 1986. In 1997–98, they were applied to approximately 70 per cent of bills. However, as standard fees apply only to less complex cases, the proportion of expenditure covered by the standard fee system in the Crown Courts is much smaller, at around 25 per cent. There are also plans in place to introduce standard fees in family cases.

2. Contracts for Legal Aid

The radical proposals to reform legal aid that were published by the Conservative government in 1996 are broadly endorsed by *Modernising Justice* (LCD, 1998b). They have at their core the provision of legal aid by a network of suppliers under contract to the LAB (to be replaced by a Legal Services Commission). It is currently proposed that, from January 2000, civil advice and assistance will be delivered exclusively through quality-assured providers contracted to provide services. These contracts specify the number of new cases or 'matter starts' a supplier may start within case categories, and additional new cases that can be started in other categories. Payment is then made for all work reasonably done on the specified number of cases.

A more far-reaching reform aimed at introducing block contracts — fixed legal aid budgets for contracted blocks of work — has also been proposed and piloted in a small number of sites (LCD, 1998b, para. 3.18; Dnes and Rickman, 1998). These would provide a much more direct cost-containment mechanism for legal aid, could encourage tighter monitoring of resource use and could be allocated using as yet undisclosed indicators of relative need, much as NHS resources are allocated according to the RAWP formula. Once the regional level of funding was set, funds could be allocated via contracts with suppliers, on the basis of competitive tenders (LCD, 1998b, paras 3.17–3.23). Tenders would be evaluated on the basis of price (i.e. fixed price per case), quality of suppliers and the degree of service innovation offered in the bid. Thus the tendering mechanism could be used to encourage suppliers providing categories of legal service that currently do not come within the legal aid scheme, such as Citizens' Advice Bureaux, social welfare law and some types of tribunal. The mechanism could also be used to encourage specialisation and concentration in complex areas of legal service such as medical negligence litigation.

At the level of the individual solicitor, fixed-price contracting could raise cost-consciousness by forcing the solicitor to meet the cost of supplying legal aid services from his own budget. Bevan, Holland and Partington (1994) compare this to the position that GP fundholders held within the NHS. However, the details of block contracting have not been finalised and there is currently no timetable for its introduction.

3. Conditional Fees and Legal Expenses Insurance

The third area of reform to the legal aid system relates to the introduction in 1995 of conditional fee agreements (CFAs) for privately financed legal services. These agreements do not require the client to pay (all) the costs of the case if it is lost, although the client will pay the solicitor's hourly fees (plus a mark-up) if the case is successful. This significantly reduces clients' exposure to risk and therefore should price many individuals into the legal market. Accordingly, the government plans to allow 60 per cent of personal injury cases to be removed

from the legal aid scheme and dropped into the private sector, where CFAs will be relied on to ensure access to justice for meritorious cases (LCD, 1998b, paras 2.42–2.44).⁷ It is estimated that this could reduce annual net legal aid expenditure by approximately £300 million.

Clients with CFAs are still liable for some costs. In particular, they have to meet any disbursements (unless the solicitor has agreed to pay these) and the other side's costs (see Napier and Bawdon (1995)). Thus conditional fees do not correspond precisely to a 'no win, no fee' arrangement. In return for placing the fee at risk, however, the solicitor is allowed to charge an uplift, or 'success fee', on top of fee costs, and the client pays this if the case is won (the opponent pays the solicitor's fees and disbursements).⁸ The precise percentage of the uplift will vary from case to case, depending on the likelihood of a successful outcome and on the extent to which the solicitor provides a financial subsidy to the client by meeting disbursements as they arise. There is, however, a statutory limit of 100 per cent on the uplift, and the Law Society has recommended that the client's liability to the solicitor should be capped at 25 per cent of any damages recovered.

Clients can defray the remaining costs they face under CFAs through the purchase of legal expenses insurance (LEI). For a number of years, LEI has been available in England and Wales, but its take-up has been minimal (see Rickman and Gray (1995) and Rickman and Fenn (1998)); this is in contrast to experience in continental Europe, where LEI is the dominant means of defraying legal expense (Prais, 1995). However, it is hoped that CFAs will stimulate the market, and, indeed, new products are emerging (see *Which?*, August 1998). In particular, it is now possible to purchase after-the-event insurance, which, unlike traditional LEI, is purchased after an accident has occurred and generally covers the costs that the client still faces on a conditional fee.⁹

After-the-event policies were pioneered by the Law Society's Accident Line Protect scheme (ALP). This is available through solicitors' firms that are members of the Society's Accident Line scheme, which must therefore have a solicitor on the Law Society's Personal Injury Panel. Further, it is a requirement of the scheme that firms that offer ALP do so to all their qualifying conditional fee cases. In these ways, ALP aims to overcome adverse selection (via compulsory pooling) and problems that might arise via poor-quality solicitors. Both of these are problems that other insurers have expressed concerns about

⁷Original proposals were contained in the consultative document, LCD (1998a). Following concern that some cases, such as medical negligence ones, are too costly to remove from the scheme, a diluted version of the proposals has been suggested.

⁸Although payment of fees is contingent upon case outcome, conditional fees differ from US-style contingent fees by relating the size of the fee to inputs and not outputs: the US fee pays the lawyer a pre-specified fraction of the damages recovered. See Rickman (1994) and Gravelle and Waterson (1993).

⁹Napier and Bawdon (1995, p. 107) describe this as a 'legal morning-after pill'.

and that may hamper the short-term growth of the after-the-event market.¹⁰ In the mean time, ALP prices reflect their bulk market position and the way they address information asymmetries, retailing for a fixed price of £85, compared with alternatives costing £100 more (see Yarrow (1997)).

VI. ASSESSMENT

As we have seen, some of the legal aid reforms outlined in the previous section are still under discussion or are being piloted, while others were implemented a number of years ago. Therefore assessing their impact must take a number of different forms, from empirical investigation to theoretical speculation.

1. Standard Fees

A number of commentators have suggested that standard fees have helped arrest the growth of legal aid expenditure, and it is true that, following their introduction, the unit cost of criminal cases fell from almost £460 in 1992 to £420 by 1994; however, unit costs subsequently resumed an upward course — albeit at a slower rate — reaching £496 per case by 1997 (LAB, 1998), and there are incentive reasons to doubt the potential for success of standard fees.

First, there is some evidence that the introduction of standard fees has changed the way that solicitors define cases, encouraging them to ‘split’ what would previously have been defined as a single case into two or more parts, and then claim more than one standard fee. Following the introduction of standard fees for criminal legal aid, it quickly became apparent that the number of claims being received from solicitors for legal aid work was increasing substantially more rapidly than the volume of cases coming before the courts. This phenomenon was noted in the LAB Annual Report for 1993–94, and further analysis was performed by LAB statisticians. Based on data from 87 courts, this indicated that, prior to the introduction of standard fees, the ratio of bills to number of court cases was between 66:100 and 72:100. With the introduction of standard fees, this ratio rose to between 85:100 and 88:100. Green Form payments (that is, payment for advice given prior to the commencement of the case) rose even more rapidly, from 44 payments per 100 cases in court prior to the introduction of standard fees to 71 per 100 in the period after their introduction. These patterns are consistent with a reduction in the unit cost of cases, and therefore illustrate why caution is needed in interpreting a slowdown in the growth of unit costs as an indicator of the success of standard fees.

The clear evidence of case-splitting following the introduction of standard fees to criminal legal aid demonstrates the difficulties of monitoring supplier behaviour in conditions of information asymmetry, and there is a parallel here

¹⁰See *The Lawyer*, 10 February 1998, p. 2.

with the phenomenon of 'DRG creep' in medical care. Diagnosis Related Groups (DRGs) were introduced to the US Federal Medicaid health-care programme in 1983 as the basis for a move from retrospective reimbursement to prospective payment based on case-severity categories. However, it soon became apparent that health-care providers could respond to the incentives this system created by redefining cases so that they fell into a higher DRG category. A number of studies attempted to quantify the effect of this phenomenon: Carter and Ginsberg (1985) found a substantial short-term effect following the introduction of DRGs, concluding that 6.2 percentage points of the 8.1 per cent increase in the case-mix index between 1981 and 1984 was due to changes in coding and documentation. However, revisiting the issue in 1990, Carter, Newhouse and Relles concluded that, between 1986 and 1987, less than one-third of the change in the case-mix index was due to DRG creep and related coding practices, although this still had significant effects on total expenditure.

Another incentive concern surrounding standard fees is their effects on input mixes. In Gray, Fenn and Rickman (1996), a simple model of (solicitor) labour supply shows that the lower and higher standard fees introduce kinks into the solicitor's budget constraint. Accordingly, it may be predicted that solicitors will reduce their inputs on cases with no prospect of a higher standard fee, but increase their inputs on a case if this pushes the case's core costs high enough to trigger the higher standard fee. Gray, Fenn and Rickman (1999) tested for this effect using data on inputs from 10,000 criminal Magistrates' Court cases over the period 1988–94. Their SURE regression results confirmed that some core cost inputs were reduced following the introduction of standard fees. Non-core inputs' trends were unaffected by standard fees (indeed, there was some evidence of substitution into these inputs).

As we have already mentioned, prospectively fixed fees are a crude way of achieving expenditure control: they provide little incentive to apply costly effort, and their success therefore depends on how well inputs can be monitored. The combination of case-splitting and increased expenditure on non-core inputs means that expenditure on criminal legal aid in Magistrates' Courts neither fell nor was brought under control by standard fees. Further, to the extent that input mixes correlate with the quality of case outputs, it seems that a different 'product' was produced after the introduction of standard fees than before, although we are unable to make a normative comparison between the two.

2. Tendering and Contracting

The proposals outlined above for tendering and contracting of legal aid services distinguished between quality-assured contractors and block contracting. Block contracting envisages bidding on the basis of a cost per case for a fixed number of cases, with the risk of unusually high-cost cases being borne via the LAB by an approved board of solicitors who may be asked to bid for the case. The

welfare effects of such tendering processes are well known, in the context of observable and verifiable output quality. However, the nature of the contract itself becomes important where crucial dimensions of output are not observable. Whilst, as we have just seen, such prospective payment provides sharp incentives for cost-reducing effort, Laffont and Tirole (1993) demonstrate that it may not provide incentives for the production of quality.¹¹ Further, US evidence from public defender schemes suggests that price-based tendering creates moral hazard and adverse selection problems, in the form of shaving on quality and low-quality (inexperienced) tenderers respectively (see Spangenberg (1991)).

The need to assess quality both *ex ante* and *ex post* contract-signing has been recognised by policymakers. In the short term, it is likely that problems of identifying quality *ex ante* will be minimised by awarding contracts to suppliers whose quality is already being monitored by the LAB under its franchising initiative.¹² As Dnes and Rickman (1998) note, to the extent that this restricts the supply of bids, it may create short-term problems for stimulating competition amongst potential bidders. *Ex-post* quality would be audited by a variety of mechanisms. Indicators would include case results, case durations, client satisfaction, appropriate use of legal procedures and services (barristers, experts, etc.) and the accuracy of initial judgements about the cases. Contract holders would be asked to account for any discrepancies between outcomes here and those obtained elsewhere. Again, in the short term, potential problems could arise here since the only data for comparison will be historical and therefore 'biased' by the current system of legal aid. Over time, the potential for valuable bench-marking of performance across firms may develop, however. Provided firms face stiff penalties for breach of contract and/or worry about being awarded future contracts, such quality monitoring may help. Of course, as with all performance indicators, it may also bias firms' efforts in certain directions. This formidable array of difficulties is doubtless one reason why no firm timetable exists for the full introduction of block contracting.

¹¹It is also interesting that Laffont and Tirole's simple model of optimal regulation in the absence of quality problems recommends an element of cost-reimbursement in the contracts (along with lump-sum transfers to induce incentive compatibility), depending on the contracting firm's cost levels.

¹²Since October 1993, the LAB has run a national system of franchising legal firms that perform legal aid work. Firms that obtain a franchise have certain administrative powers devolved to them (for example, approval of Green Form extensions and granting of emergency certificates) and, in return, receive financial benefits such as lump-sum payment on account as soon as legal aid is granted in a case. The franchising system gives the LAB some control over the quality of legally aided services through its power to grant, refuse or withdraw franchises on the basis of audits of firms' management practices and their case-handling methods ('transactions criteria'). As of May 1998, 2,400 franchises had been granted, with a further 600 applications in process; these represented about 28 per cent of all legal aid account holders but accounted for 50 per cent of legal aid expenditure (LAB, 1998, p. 30).

3. Conditional Fees and the Privatisation of Personal Injury Cases

With the reductions in legal aid eligibility highlighted earlier, it is clear that conditional fee agreements (in conjunction with after-the-event legal expenses insurance) could become successful complements to the legal aid system. But, as we have noted, the government intends them to be a substitute instead for a substantial portion of legally aided personal injury cases. The full extent of this transfer from the public to the private sector remains unclear; in particular, medical negligence cases, which constitute a large and rapidly growing area of legal aid expenditure (see the previous volume and unit-cost figures), may not be transferred out of the legal aid system on the grounds that substantial investigation costs are often incurred upfront which neither solicitors nor indigent clients are likely to be able to afford. Nevertheless, this policy could be characterised as a privatisation of legal aid services on a substantial scale.

Being relatively recent, there is little evidence surrounding the operation of CFAs. Yarrow (1997) estimated that over 10,000 such agreements had been entered into within 15 months of their becoming available, but this figure may be an underestimate, as her sample consisted principally of Accident Line firms and excluded sole practitioners; subsequent Law Society figures suggest a higher uptake. Yarrow was particularly concerned about the calculation of success fees, feeling that they were higher than was actuarially fair in more cases than they were actuarially too low.¹³ This is unlikely to reflect an additional mark-up for firms meeting disbursements because clients met these in 75 per cent of her sample. Further, she found that firms often seemed to underestimate the chances of success on cases, perhaps because they did not want to raise clients' hopes or because the firms were unused to calculating success precisely. This raises the issue of whether the market for legal services will be able to withstand the shift of risk associated with conditional fees, an issue questioned by small sample simulation work in Shapland et al. (1998).

It seems unlikely that CFAs and legal aid can be perfect substitutes. We have already seen that CFAs expose the client to some expenditure; this is not true for those poor enough to receive non-contributory legal aid. Thus only for those faced with large legal aid contributions will CFAs be an acceptable alternative. In Yarrow's sample, 10 per cent of CFAs were the result of clients believing them to be cheaper than legal aid; the rest were the result of client preference and/or legal aid being unavailable. Accordingly, it will be important to monitor not only the overall effect of CFAs on the volume and cost of personal injury cases, but also the distributional effects: widening access to justice at one point in the income distribution may be achieved by removing it at another — at the

¹³Thus, although the LCD (1998b, para. 2.42) recognises that most solicitors have agreed not to take more than 25 per cent of damages recovered, Yarrow found a mean uplift of 43 per cent of fees, and a modal range of 41–50 per cent. In fact, LCD (1998b, para. 2.43) suggests that litigants will be able to claim the success fee as *inter partes* costs in future.

bottom. It will also be important to monitor whether an expanded base of suppliers and greater range of cases covered by conditional fee arrangements make insurers more risk-averse.

Finally, little is known about the performance of CFAs relative to other fee schemes: no empirical work has examined them next to a control group of alternative arrangements. For this reason, it is impossible to substantiate the claim in *Modernising Justice* (para. 2.43) that ‘... conditional fees have already greatly extended access to justice’. In theory, we would expect solicitors to be less willing to take on unpredictable or low-prospect claims, which might offset the effect of extra (middle-income) clients being able to afford legal services. In terms of how a case would be handled, we might expect that the fee being payable only in the event of a win will give lawyers an added incentive to seek success relative to hourly fees. However, it might be argued that these incentives would be sharper if the lawyer’s fee were tied to the amount recovered on the case, as happens with US contingent fees. If this is true, CFAs might actually be more appropriate ways of creating incentives in cases without a monetary amount at stake (for example, some contract disputes), rather than restricting them purely to monetary cases as is presently the position.

VII. CONCLUSIONS

Legal aid expenditure has risen dramatically and, despite various reforms, continues to rise. For the first time, we have broken this down by volume and unit cost, and by individual programmes within the legal aid scheme. Our analysis indicates that different areas of the scheme have exhibited different trends, so that it is dangerous to assume that one explanation accounts for all of the rise in expenditure: explanations are likely to involve factors external to the legal aid system as well as factors internal to it. Hopefully, our decompositions will allow others to refine and test other explanations for rising expenditure against the empirical account of trends set out in this paper. However, we have chosen to focus on an area of particular interest to economists — the role played by incentives as an explanation for the performance of legal aid in recent years. We have argued that these appear to have been suboptimal and that a plausible case can be made that they contributed to the expenditure increases we have documented.

The White Paper *Modernising Justice* seeks to contain legal aid expenditure through the introduction of contracting and CFAs and the encouragement of LEI. Each of these alters the payment arrangements for suppliers of legal aid services, thereby shifting risk to the solicitor, insurers and the client and away from the legal aid fund. However, the reallocation of such risk also implies a change of incentives and these are not easily monitored in most legal principal-agent relationships. Yet, as the experience with standard fees shows, we must expect

suppliers to respond to the incentives they face under different payment arrangements.

Recognition of this has two implications: (a) there is a need for caution when embarking on reform, and (b) there is a need for information in order to monitor the effects of such reform. Ideally, this information should start to be collected before reform takes off. Neither standard fees nor CFAs satisfy this observation, and it remains unclear, for example, how replacing legal aid with CFAs will affect access to the legal system and resulting output (although, *ceteris paribus*, a step decrease in legal aid expenditure will occur). However, a combination of piloting and pre-existing franchise arrangements means that more information will be available, in principle, for predicting the effects of contracts.

When assessing proposals for legal aid reform, it is important to recognise that the wider legal landscape is also undergoing reform. In particular, many of Lord Woolf's (1996) proposals for reforming civil procedure will be put into effect in 1999 (see also LCD (1998b, paras 4.3–4.7)). These aim to decrease delay, cost and uncertainty faced by litigants, through the extension of small claims (to case values of £5,000), the introduction of a 'fast track' for case values between £5,000 and £15,000 (with slimline procedure, enhanced judicial case management and fixed legal fees for each stage of the case) and a 'multi-track' procedure for higher-value claims. Once again, there is considerable uncertainty about how these proposals will operate (for example, it is unclear how many 'fast-track' cases there will be). The lack of an information base here, as well, means that our remarks above apply beyond legal aid reform, while adding to the difficulties of evaluating and monitoring the success of legal aid reforms.

Finally, we note that there are many other proposals for reforming the way lawyers are paid to deliver legal aid services. Contingent fees (Rickman, 1994), a contingency legal aid fund (LCD, 1991 and 1998b), legal aid vouchers (Friedman and Schulhofer, 1993; Dnes and Rickman, 1998) and salaried state lawyers (as in public defender systems (Goriely, 1998)) have all entered the debate in recent years. Clearly, there is much work still to be done on the most appropriate way to ensure wide access to cost-effective, good-quality legal services. From the perspective of the current paper, the central message is that all payment systems have incentive effects; the key starting-point in discussing these systems is a clear understanding of how lawyers (and clients) respond to financial incentives, and this in turn needs good theory and good data.

APPENDIX
Method for Disaggregating Volume and Unit-Cost Components of Expenditure

The method we use is analogous but not identical to that used by the OECD for international comparisons of health service expenditure (see Schieber and Poullier (1990)). In our analysis, the level of nominal expenditure in period 0 is defined as $E_0 \equiv P_0 R_0 V_0$, where E represents the level of nominal expenditure on the service, P is an appropriate price index, R is the real expenditure per case (capturing quality and quantity of inputs per case) and V is the number of cases. Adding a population term N , we could then state that $E_0 \equiv P_0 R_0 [V_0 / N_0] N_0$, and rearranging this as $R_0 [V_0 / N_0] = E_0 / P_0 N_0$ would give us the residual defined as volume intensity by the OECD: that is, a combined measure of real cost per case and per capita utilisation. We differ from the OECD's health disaggregations in having a measure of volume (number of legally aided cases); in addition, we are interested in inputs per case because these may be influenced by solicitors' behaviour. Hence we focus on real expenditure per case,

$$R_0 = E_0 / [P_0 (V_0 / N_0) N_0].$$

However, the volume-intensity measure used by the OECD would be useful for looking at the effects of eligibility changes on per capita consumption of legal aid (if such data were available).

Given our interest in legal aid expenditure over time, we introduce growth rates by assuming E , P , R and V grow at rates α , β , γ and δ respectively between periods 0 and 1 (for instance, $E_1 \equiv (1 + \alpha)E_0$). Then, in period 1,

$$\begin{aligned} (1 + \alpha)E_0 &\equiv (1 + \beta)P_0 \times (1 + \gamma)R_0 \times (1 + \delta)V_0 \\ \Rightarrow (1 + \alpha) &= (1 + \beta)(1 + \gamma)(1 + \delta). \end{aligned}$$

This can easily be rearranged to solve for the growth rate of real expenditure per case, so that

$$(1 + \gamma) = (1 + \alpha) / [(1 + \beta)(1 + \delta)].$$

Again adding a population term N with growth rate ε , this can be stated as

$$(1 + \gamma) = (1 + \alpha) / \{(1 + \beta)[(1 + \delta) / (1 + \varepsilon)](1 + \varepsilon)\}.$$

To illustrate, let nominal legal aid expenditure rise by 16.22 per cent over the period in question, population rise by 0.29 per cent, prices by 5.36 per cent and volume by 8.59 per cent. Then annual real expenditure growth per case is

$$1.1622/[1.0536 \times (1.0859/1.0029) \times 1.0029] - 1 = 1.58\%.$$

In order to draw the link between our analysis and that of Schieber and Poullier (1990) for the OECD, we also show how the growth of their volume-intensity measure (a composite of real cost per case and per capita utilisation) can be obtained in our context:

$$1.1622/(1.0536 \times 1.0029) - 1 = 9.98\%.$$

Clearly, the choice of measure to solve for depends on the policy question at hand.

To apply this disaggregation methodology, we have first constructed time-series data on aggregate legal aid volumes and expenditures, using LAB Annual Reports, more detailed breakdowns of cases and expenditure on civil legal aid provided by the LAB, GDP deflator information from the Blue Book and population data from the Office for National Statistics. Our principal time series cover the period from 1980 to 1995. Several features of their construction should be noted. Arguably, the relevant population denominator for legal expenditure is not the total population but the population eligible for aid. By most estimates, this has fallen from around 80 per cent of households in 1979 to less than 50 per cent of households by the 1990s (LCD, 1991 and 1996; Murphy, 1989), equivalent to around 16 million people losing eligibility. However, it is not clear whether these changes in eligibility across the population as a whole can be translated into changes in the demand for legal aid, as demand is not evenly spread across the population but varies by factors such as age-group, income group, and occupational and marital status. Consequently, we have restricted our disaggregation to the effects of total population change but retained population in the disaggregation to facilitate future work with better data.

A further complication when relating expenditure to volume stems from the fact that some legally aided cases may last for several years, with staged payments and possibly considerable delays in final settlements and repayments. The LAB does publish time-series data on the actual cost of completed cases, but these are difficult to reconcile with total expenditures and are not available for all programme areas. We have adopted an alternative approach, in which total legal aid expenditure is defined as net expenditure per annum on all cases in each programme area and volume is defined as number of cases completed per annum in each programme area. Unit costs are then derived from these aggregates. As the duration of most legally aided cases is less than one year, this approach will give a close approximation to actual unit-cost changes while satisfying the requirements of the disaggregation approach set out above.

Finally, we use the GDP deflator as the first approximation of a price index for legal aid services. A specific price index could in principle be constructed, either based on weighted baskets of services provided or input prices (as in various NHS price indices). No such index currently exists for legal aid services, and consequently our measure of real expenditure growth may be an underestimate or overestimate, depending on sector-specific price changes. Drawing a parallel with the health sector, most countries in most periods have experienced health-care prices rising slightly but not dramatically faster than in the economy as a whole.

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