



ECONOMIC VALUE OF THE LEGAL SERVICES SECTOR

MARCH 2016

FOREWORD

A HEALTHY LEGAL SECTOR SUPPORTS A HEALTHY ECONOMY

Growth in legal services significantly contributes to the wider economy, boosting investment and jobs. Solicitors advise individuals and businesses in the UK and internationally. They work in law firms from small local businesses to global practices, they also work in alternative business models and in-house.

An estimated 370,000 people are employed in legal services in the UK. 63% of these are solicitors or employed by solicitor firms.

The total value of legal services to the economy is £25.7 billion* and in 2014-15 the sector grew by £1.9 billion. This is a phenomenal success story which we should celebrate. The legal sector has grown by 3.3% per year over the last 10 years, compared to real growth in the UK economy as a whole of 1.2% per year over the same period.

By 2014 net exports of the sector had increased by 73.2% in real terms since 2004. This is equivalent to 5.6% real growth per year on average. The legal services sector is a net exporter, helping to offset the UK's overall balance of payments deficit. The legal services sector net exports more than five times as much as accounting, auditing, book-keeping and tax consulting. English and Welsh law is the choice of law internationally and England and Wales is the jurisdiction of choice.

Our research shows that 8,000 new jobs are created and £379 million is added to the economy when the UK legal services sector grows by 1%. This is the first time the wider economic contribution of the legal services sector has been measured. As the sector grew by 8% in 2014-15, this is good news for the economy.

Each £1 of extra turnover in the legal sector stimulates £1.39 in the rest of the economy, according to an independent analysis undertaken for the Law Society by Cambridge Econometrics. This model, which estimates the income generated plus the value of goods and services purchased by the legal sector, also shows that every 100 extra jobs in legal services supports a further 67 jobs in the wider economy.

The provision of expert legal services is fundamental to the success of business and commerce and underpins the very fabric of our society.

The legal profession is proud to make an important and measurable contribution to the wider UK economy. That contribution is even greater when the very important benefits solicitors provide are taken into account such as completing business and commercial transactions, resolving disputes, facilitating investment and innovation and advising people every day on issues which affect their lives.

However, like many sectors, legal services operate in a complex and fragile ecosystem. It is important that any changes to the regulatory and legislative environment for the legal services sector are fully considered to avoid any unintended consequences of change, which could put our position as the jurisdiction of choice at risk and so jeopardise future success. We will continue to represent the interests of the public, buyers of legal services and solicitors to support a vibrant legal profession which delivers for its clients and contributes to growth in the wider economy.



Catherine Dixon
Law Society chief executive

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The report is based on analysis undertaken by Cambridge Econometrics, Oxford Economics and the Law Society's Research Unit.

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1. INTRODUCTION

This report provides fresh perspectives on the value of legal services at a time of significant change for the UK legal services market.

The direct contribution that legal businesses make to the UK economy, estimated by the Office for National Statistics (ONS), was £25.7 billion in 2015, or 1.6% of total value added, and in 2013 legal businesses provided 314,000 jobs. Including solicitors, barristers and others working in non-legal businesses (commerce and industry, government and the not-for-profit sector), the figure is estimated by the Society's Research Unit to be approximately 370,000².

The wider economic contribution of the sector, however, has not previously been estimated. This report addresses that gap, in part, by providing the findings from two different approaches quantifying value. For these purposes value has been defined as the amount of activity that legal services supports in the economy. The data underpinning these analyses are from the 2010 ONS Input-Output Analytical Tables (IOATs), which are published every five years with a substantial lag – the next iteration, due in 2019, will relate to 2015.

The advantage provided by what might otherwise be a limitation of the data, is that the analysis provides a baseline of evidence about value before radical changes were introduced to the legal services market by the Legal Services Act 2007 and the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPOA). Similar analysis of the next set of ONS IOATs will enable assessment of change between 2010 and 2015.

Since 2010, as a result of the Legal Services Act almost 500 Alternative Business Structures (ABSs) have been licensed, and 465 firms are, at the time of writing, operating as ABSs, according to the latest Solicitors Regulation Authority (SRA) register. LASPOA brought about significant reductions to the scope and funding of legal aid provision. Furthermore, in 2015, the SRA signalled a substantive change in approach to regulating education and training for solicitors.

The combined approaches taken in the report provide a unique evidence base about the value of the UK Legal services sector and, by inference, the role that solicitors, as the largest group of providers within the sector, and other lawyers play in supporting wider economic activities in the UK.

The following section (Section Two) summarises available ONS figures and new analysis that describes the size and nature of the Legal services sector's direct contribution to the UK economy. The findings of the new analysis commissioned and undertaken by the the UK economy are detailed in Section Three. Section Four provides further insight into the make-up of the sector's contribution to the UK economy through its supply chain and main areas of demand.



² This figure is based on figures obtained for the number of solicitors and barristers working in organisations outside of legal business. This is then pro-rated up based on an estimate of the ratio of solicitors/barristers to other staff given by a question asked in a previous Law Society Firms Survey.

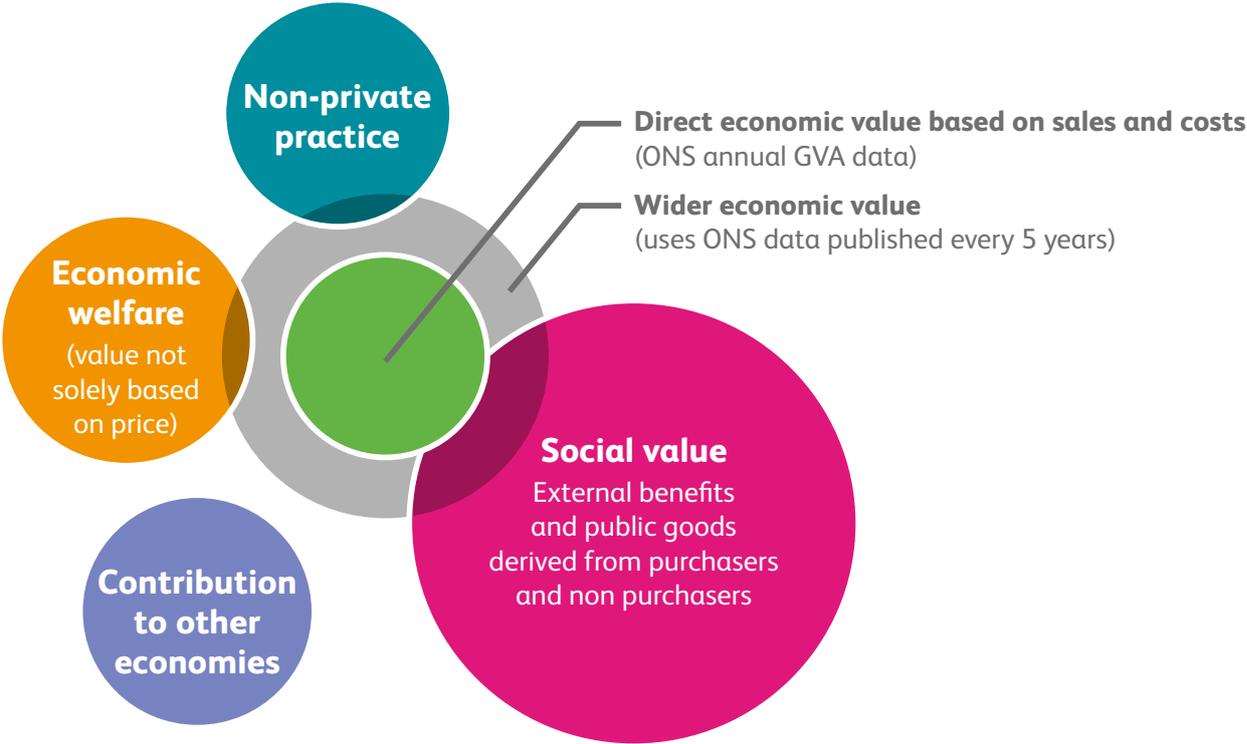
Data availability has restricted analysis to a narrow definition of value which cannot account for all benefits generated by legal services.

The estimates provided for direct contribution through Gross Value Added (GVA) and wider value supported through jobs and market value created in other economic sectors are only a portion of the true social and economic value generated by the Legal services sector. Figure 1 suggests how these concepts of value overlap the direct and wider measures that

are the subject of this report, in terms of consumers and businesses to which benefits accrue, and indicates an order or magnitude for the various sources of value.³

International comparisons between legal sectors, to put the estimates in context, were not possible because most countries likely to be relevant for the purposes of comparison do not collect economic data specifically at the level of the Legal sector.

Figure 1: Concepts of value of legal services, including potential overlaps and indicative scale of value



³ The size of the circles are not empirically based – they simply represent a preliminary suggestion by the authors regarding the comparative scale of various sources of value.

2. DIRECT ECONOMIC CONTRIBUTION OF LEGAL SERVICES

Gross Value Added from legal businesses was £25.7 billion in 2015, with total employment of 314,000 (in 2013).

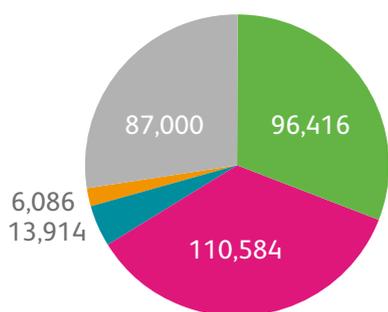
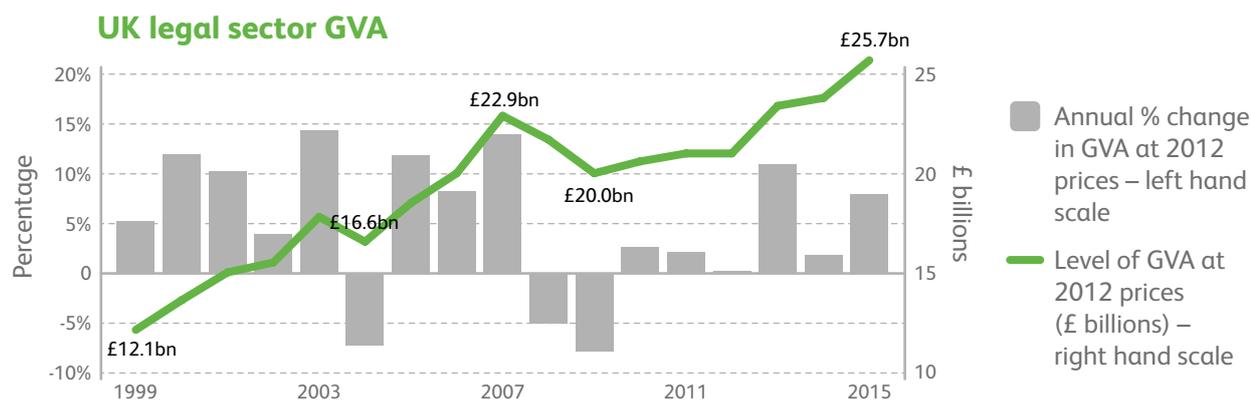
The direct contribution of the Legal sector to the economy is captured by the ONS through estimates of its GVA, which is, roughly, total turnover less non-labour inputs or costs. The latest ONS estimate of GVA of the Legal services sector was £25.7 billion for 2015 (in constant 2012 prices). This estimate includes all types of activity in legal businesses, but excludes in-house activity of solicitors not in private practice. A glossary of terms used by the ONS relating to these figures is provided in Appendix A.

The GVA measure is broadly consistent with Gross Domestic Product (GDP) data reported for the

UK, and represents returns to the production of legal services in terms of income earned by labour (employee compensation) and capital ('gross operating surplus', sometimes taken as a broad measure of profits). Alternative approaches include counting total sales of legal services or employment of legally qualified professionals and others working in the sector.

Figure 2 summarises information on the direct economic contribution of legal businesses, showing GVA over time, and a breakdown of the latest employment data (2013). Those employed in legal businesses include practising solicitors and barristers along with large numbers of support staff. Legal businesses also make a positive contribution to the UK's balance of payments. Net exports (exports minus imports) of legal services were £3.4 billion in 2013, more than double since 2000 in real terms.

Figure 2: Direct economic impact of the legal services sector



Employment in the UK's legal sector firms 2013

- Private practice solicitors
- Other solicitor firm employees
- Private practice barristers
- Other barrister firm employees
- All others in legal sector firms

Source: ONS, Law Society Group, Bar Standards Board

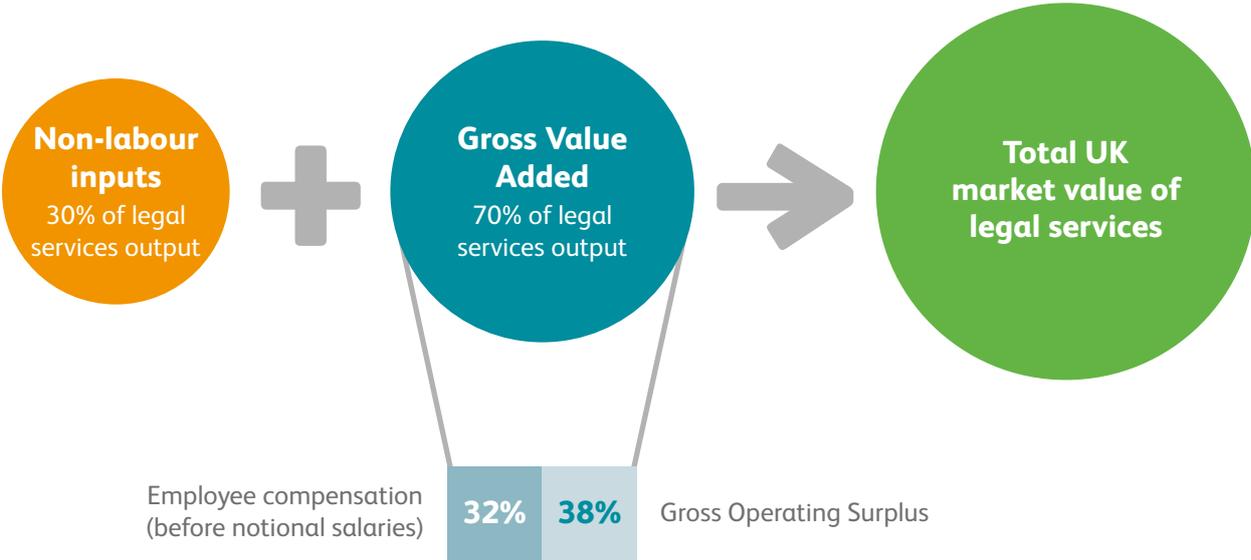
The majority of legal services' market value is derived from the labour of its staff and profits, rather than inputs from suppliers.

The breakdown of total UK output of legal services between GVA and other inputs used by legal service providers is depicted in Figure 3. The percentages shown in the figure are derived from the 2010 Input-Output Table data consistent with the market value, employment multipliers and further supply chain and demand analysis detailed in the following sections. In theory, the 2010 input-output data relates to the Legal sector as a whole and not just legal businesses.

Figure 3 shows that the majority (70%) of total UK output of the Legal services sector is generated as GVA within the sector itself, in the form of wages and gross operating surplus – a broad measure of profits. The proportion of total market value represented by profits (38%) contains the profits received by equity partners within law firms that in other sectors would normally be paid as wages (employee compensation). The traditional partnership structure within law firms thus partly explains a profits proportion that is relatively high compared with other sectors.

Section Four provides further detail on the non-labour inputs shown in the figure along with the sources of demand that collectively account for the total UK market value of legal services.

Figure 3: Total UK output of legal services, 2010 (2010 prices)



Source: ONS 2010 Input-Output Table. The ONS terminology in the Figure is explained in Appendix A

3. WIDER ECONOMIC VALUE

Two approaches were used to provide a starting estimate for wider economic value (as opposed to direct contribution).

Static input-output analysis assisted by **Cambridge Econometrics**

- Standard use of ONS IOATs for 2010, applied by other sectors, to demonstrate the support of a sector to other economic activity.
- These data capture the value of certain products, including legal services, used to produce others (for 127 product groups) along with labour inputs. The data enables analysis of the supply chain, and demand for legal services, and the extent to which the sector supports activity in other economic sectors. Labour market statistics are used to estimate the effects arising from income changes of those employed in the sector, and the full potential impact on jobs.
- The analysis is static in that it provides quantification for a point in time (latest data relate to 2010). It is not intended to illustrate long-term effects from a change in the size of the sector, or competition for resources with other sectors.

Dynamic modelling undertaken by **Oxford Economics**

- Dynamic modelling, as well as forecasting a future trend, accounts for changes in relationships between sectors over time as a result of a particular sector's expansion or contraction and constraints on resources.
- Oxford Economics' proprietary Global Economic Model was augmented with a purpose-built extension to factor in the Legal sector, in order to analyse the scale of the long run versus short run effects of a change in the size of the Legal sector on the economy as a whole.
- The starting point is a hypothetical 'shock' the effect of which, on the wider economy, can be modelled over time.
- The extended model was also used by the Society's Research Unit to test the economic implications of potential withdrawal from the EU, published at <http://www.lawsociety.org.uk/news/stories/the-uk-legal-services-sector-and-the-eu/>

Every £1 increase in final demand for legal services in 2010 would have supported £2.39 in spending across the entire UK economy.

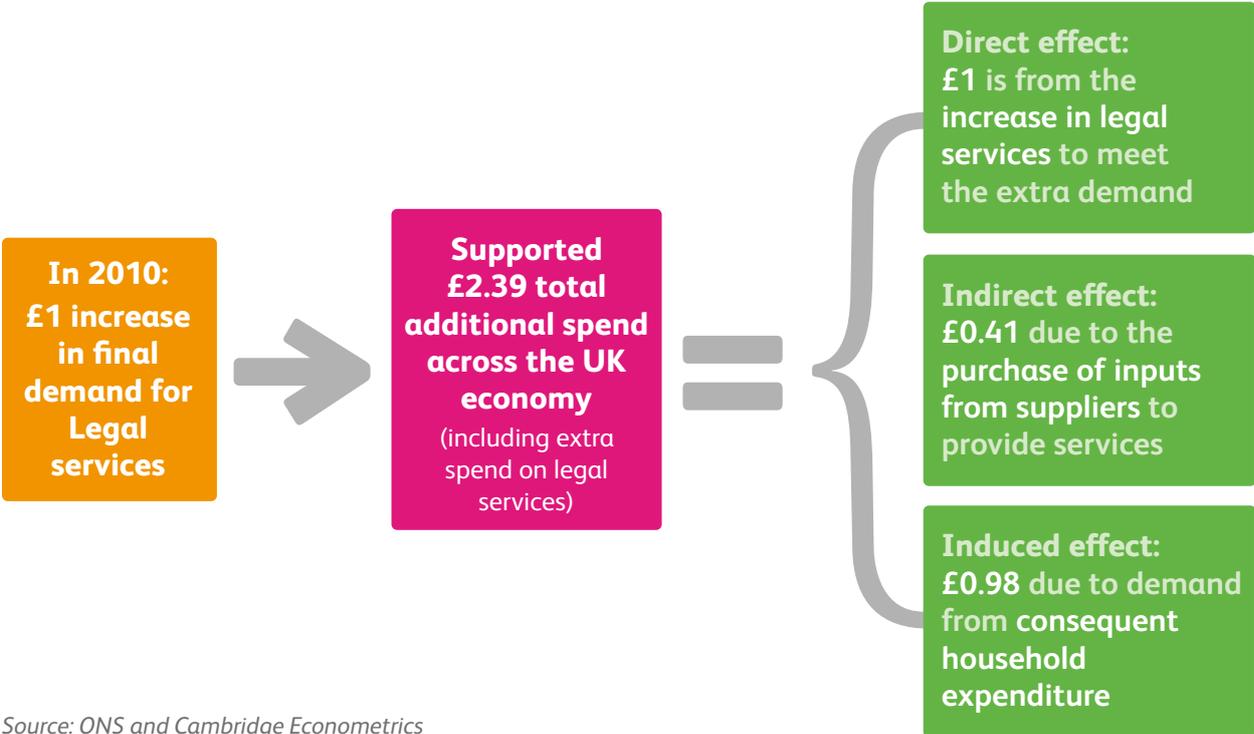
Separate from the direct economic contribution, the standard, static input-output analysis shows that a £1 increase in final demand for legal services in 2010 would have supported £2.39 in spending across the entire UK economy, including the extra £1 spent on legal services. The figure of 2.39 is known as the output multiplier.

The value generated outside of the Legal services sector would have included £0.41 due to the activity of suppliers providing extra resources for legal services providers to meet additional demand, and

£0.98 from increased household expenditure due to increases in the incomes of people employed in suppliers and people employed in the Legal services sector. This wider value supported complements the direct economic contribution from legal services which in 2010 was £18.8 billion measured in current prices or 1.4% of UK GVA (see Section Two for further detail).

A number of caveats that apply to the multipliers are explained in full in Appendix B. Critically, the static nature of the analysis ignores the possibility of limited availability of workers and supplies, price responses, and purchasers altering their buying behaviour.

Figure 4: Breakdown of wider spending supported by an increase in demand for legal services



Source: ONS and Cambridge Econometrics

The output multipliers for the Legal services sector are similar to other professional services sectors, but generally lower than those for non-service sectors.

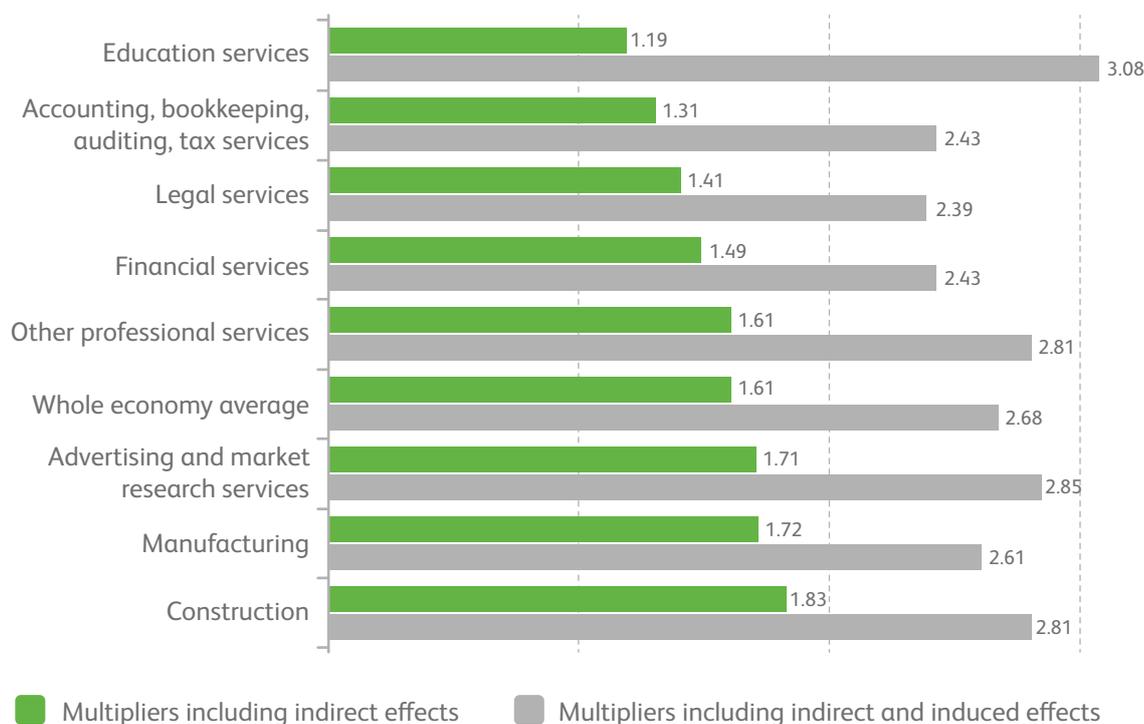
The increases in spending following a notional £1 rise in demand for legal services due to activity at suppliers, and wider household expenditure, are known as the indirect and induced effects respectively in the standard input-output analysis.

Figure 5 compares the multipliers for legal services with those for other economic sectors, based on indirect effects only, and both indirect and induced effects. The multipliers for legal services are similar to some other professional services sectors.

The Legal services sector has been relatively self sufficient in that it is labour intensive and does not rely heavily on resources purchased from other sectors in order to produce its activity. Sectors with short supply chains of this nature tend to have lower multipliers than those with longer supply chains, such as Construction and Manufacturing sectors, which rely on a host of primary industries to supply inputs to the production process.

However, it is important to emphasise the fact that input-output analysis only provides a starting point for considering the full value of the Legal sector because it quantifies the impact due to purchases from other sectors but does not address the full range of perspectives on value outlined in the introduction. Legal services are unique because of the fundamental role they play in society, democracy and the economy through delivery of the rule of law.

Figure 5: Sector output multipliers



Source: ONS and Cambridge Econometrics

For every 100 extra jobs created in the sector by an increase in final demand in 2010, 167 jobs across the entire UK economy would have been supported.

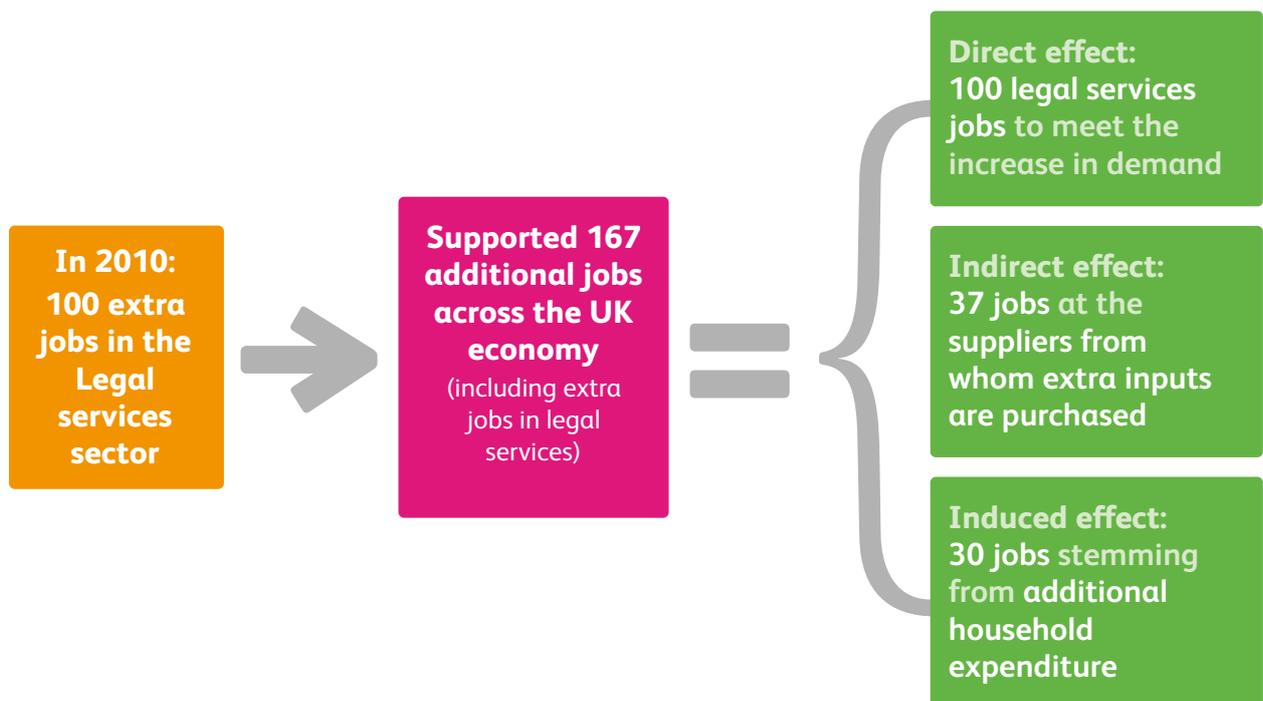
Analogous results for employment show that an increase in final demand for legal services in 2010 producing 100 extra jobs in the sector would have supported 167 jobs across the entire UK economy. Of this number, the wider value comprises 30 jobs supported in suppliers to the Legal services sector and a further 37 jobs supported by related household expenditure.

Section Two provides full details of the total number of jobs directly involved in the provision of legal services in the UK.

The sum of all jobs in the Legal services sector depends on the definition of workers (qualified legal professionals are counted along with other support staff) but counting all staff the total was 335,000 in 2010.

The ratio of total jobs supported (167) to the initial boost (100 jobs) is the employment multiplier of 1.67. This multiplier relies on productivity measures that were particularly variable over the period 2005 to 2010. As a result, the employment multiplier should be treated with some caution.

Figure 6: Breakdown of wider jobs supported by an increase in demand for legal services



Source: ONS and Cambridge Econometrics

The boost to UK GVA as a result of a 1% positive shock to legal services market value would extend to the medium term, but would be maximised at £379 million, and 8,000 extra jobs, one year later.

The starting point for dynamic analysis is a hypothetical 'shock', the effect of which can be modelled over time. Unlike static analysis, dynamic modelling accounts for the likelihood that any shock will have a diminishing impact over the long term, partly reflecting the different constraints on resources that apply in an economy as one sector expands at the expense of others. Further information about dynamic modelling is set out in Appendix C.

The initial change in legal services GVA (similar to GDP) was arbitrarily set as a 1% increase and decrease on the total GVA of the sector in 2015, and on forecast GVA in future years up to and including 2022.

In 2015, 1% amounted to a £242 million increase in the GVA of the Legal services sector. We do not explicitly specify where the hypothetical shock may come from, although to put the shock into context the average annual growth rate of the sector was 4.0% over the period 1990-2014. Moreover, the £242 million step change in 2015 is approximately equivalent to annual GVA generated by the sixth largest solicitor firm in the UK based on turnover, or the annual savings in the legal aid budget that government targeted in 2013. This suggests that the 1% change modelled is plausible and possibly conservative.

Separate charts on Figure 7 show the impacts on UK output and employment from an annual 1% increase and a 1% decrease respectively in legal services GVA (described on page 13).

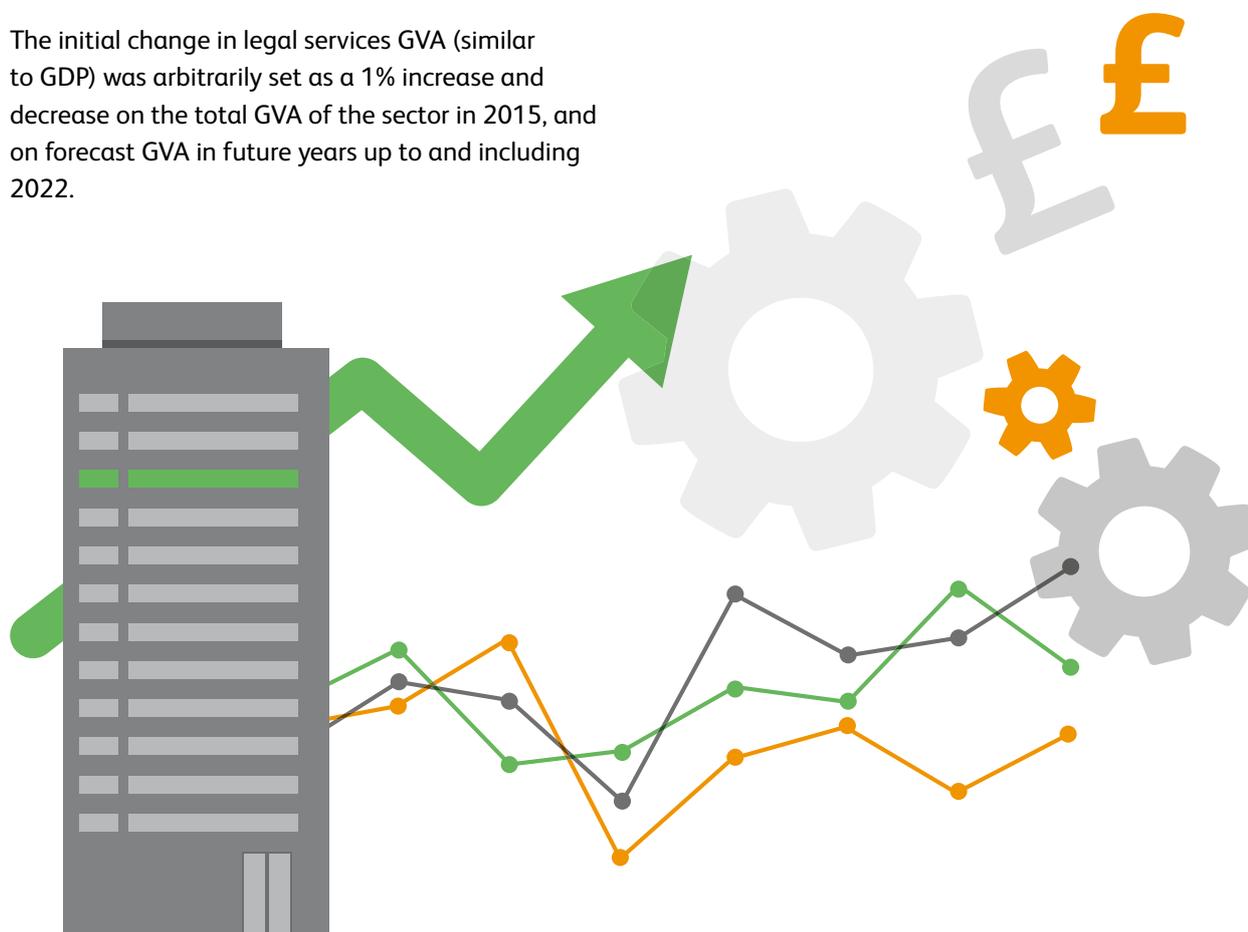
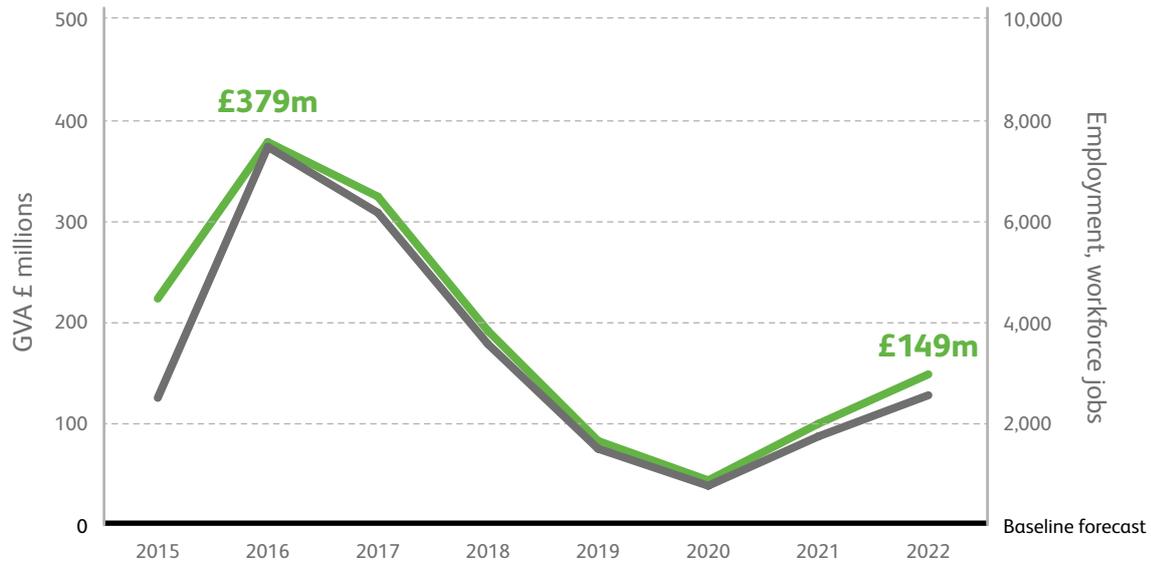
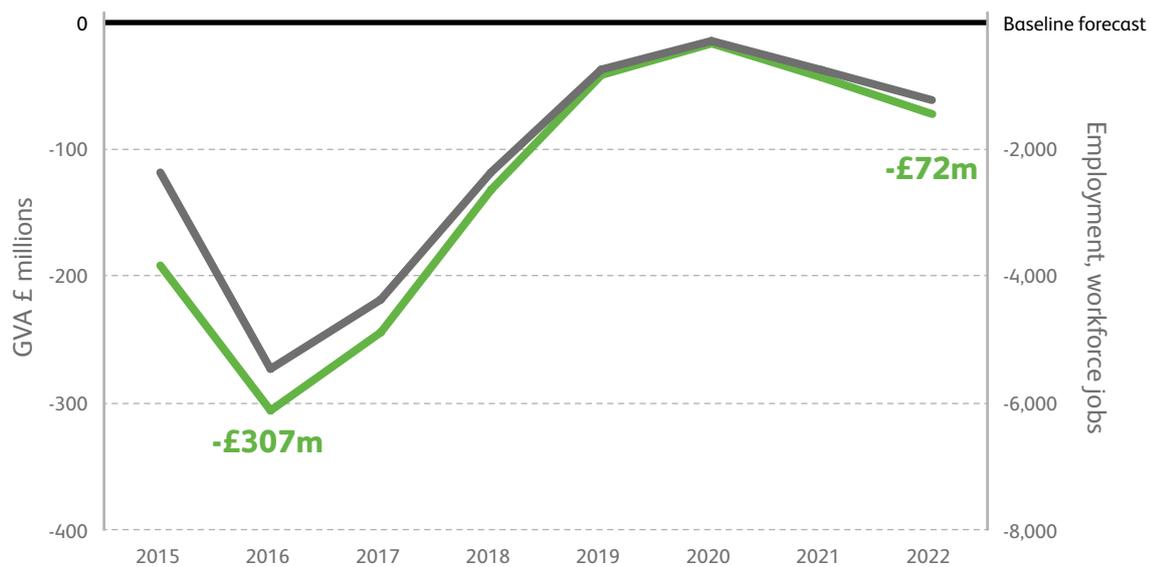


Figure 7: Changes in UK GVA and employment following a 1% shock to legal services output from 2015, over forecast values

(a) Following a 1% expansion of legal services from 2015



(b) Following a 1% contraction in legal services from 2015



— GVA £ millions — Employment, workforce jobs

Source: Oxford Economics and Law Society Research Unit

The reduction in UK output resulting from 1% loss of legal sector value (analogous to withdrawal of public funding for legal aid) would be £307 million, and a loss of 5,500 jobs, in the year after the shock and moderating thereafter.

The total additional boost to total UK GVA as a result of the hypothetical 1% increase to legal services output from 2015 would be maximised at £379 million, and 8,000 additional jobs in 2016. The medium-term stream of additional UK GVA is shown in Figure 7(a).

In the early years after the legal services shock, resulting changes in total UK GVA and employment exceed the heightened levels in the Legal services sector due to multiplier effects similar to those outlined in the previous static analysis. The impact on total UK GVA and employment relative to the forecast values remains positive throughout the period. However, the scale of the impact diminishes after the early years as the Legal sector has to compete over time for extra resources to sustain higher output.

Similar to the hypothetical positive shock to the Legal sector's GVA analysed above, we can look at the effects of hypothetical negative shock of the same size but in the opposite direction (a 1% shock decrease in the sector's GVA), equivalent to a £242 million reduction in GVA in the initial year. While it can be harder to imagine a shock that would detract forecast value from the sector in any one year, examples of interventions that reduce sector GVA are already in evidence.

Other interventions with similar impacts might include any measures which remove lawyers from the processes of seeking redress for legal wrongs or pursuing legal certainty. Such interventions may include the current proposal to raise the limit for small claims (for which lawyers are not used) from £1,000 to £5,000.

The legal aid changes provide a timely example to bring the modelling of a 1% negative shock to sector GVA to life. The reduction in spending implied by civil legal aid reforms following LASPOA in 2013, and criminal legal aid fee cuts in 2014, is broadly consistent with the modelled 1% negative GVA shock. In addition, the changes in expenditure within the sector due to these legal aid reforms will prevail in future years (as is the case with the 1% negative shock).

The reduction in the scope and amounts of public funding for legal aid since 2013 therefore suggests a reduction in overall UK GVA in the early years greater than the amount saved on the public finances, and loss of jobs both within and outside the sector. While the size of the effect peaks one year later, the negative impact on forecast UK GVA continues over the medium term.



4. CONTRIBUTORS TO MARKET VALUE – SUPPLY CHAIN AND DEMAND

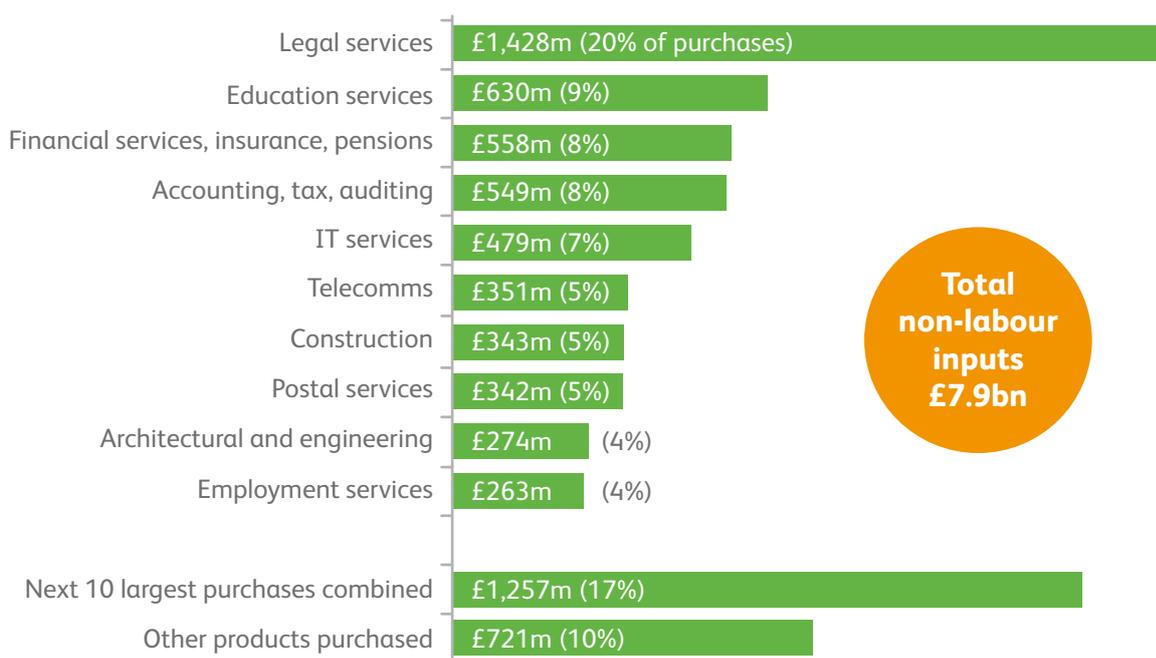
Intra-sector trade is an important and relatively unique feature of the Legal sector – 20% of non-labour purchases within the sector are from other legal services providers.

Consistent with the 2010 Input-Output Table data underpinning Figure 3, Figure 8 shows that one-fifth of purchases undertaken in order to supply legal services were by legal services providers – indicating a relatively self-sufficient sector. That sector self-sufficiency is likely to reflect two things: the historic distinctions in remit between solicitors and barristers and referrals of work between the two; and the nature and extent of specialisation within legal businesses and in-house teams. These features mean that many legal services providers do not have all the legal expertise required internally to

operate their own businesses and therefore purchase expertise that they lack. Education services are a major resource in the supply chain due to some firms funding Legal Practice Courses for their prospective trainees, and continuing professional development training purchased for qualified staff in order to meet regulatory requirements. While the CPD framework changed in 2015, shifting away from a mandatory number of hours of CPD per year for each individual, a need for education services to meet lifelong learning and professional development requirements is likely to remain.

IT and Telecommunications purchases made up 12% of products purchased in 2010. Assuming further adoption of technology and computerisation by the sector, that proportion should increase. Long term, further adoption of technology could see a reduced role for postal services in the provision of legal services (for example if more contracts and settlements can be formalised electronically).

Figure 8: Top purchases used in the supply of legal services (£ millions)



Source: ONS 2010 Input-Output Table

Business customers account for over 60% of total UK sales of legal businesses.

Turning to demand, the ONS input-output data depicted in Figure 9 on the following page show that the majority of sales are to business clients, with the majority of other domestic demand arising from the Public sector and Investment activity.

The proportion of demand shown in the chart for Households undervalues the true level of demand from households because much of what might typically be considered as household use of legal services is accounted for by ONS in Public sector and Investment purchases, and some is captured within Business purchases. Bearing in mind these definitional caveats, the input-output data indicates that business customers account for 63% of total UK sales of legal services. An estimate that 69% of Legal sector turnover was generated by work for businesses, based on the 2010 ONS Services Turnover Survey, corroborates this finding within normal margins of error (See Legal Services Part 3 – Key Markets, Law Society, 2013).

Public sector purchases totalling £3.5 billion include legal aid fees paid to legal businesses for their provision of services to legally aided clients. Government accounts for a comparable period show that funding for legal aid in the financial year 2010-11 (not including overheads) totalled £2.3 billion, although this includes some payments made to the not-for-profit sector (approximately 2% of the total).

Almost all other public sector work was on health related legal matters – with a total of £1.3 billion spent on legal services in order to facilitate what the ONS categorise as ‘Non-market Human Health Services’. This category broadly corresponds to NHS spending on legal services in the UK, and almost 70% of the £1.3 billion total was compensation and legal fees paid in clinical negligence cases against the NHS in England (the remaining 30% will include clinical negligence cases from the rest of the UK). The NHS England compensation in fact accounted for around half of the total legal services expenditure from health, based on NHS Litigation Authority Accounts for 2010/11, with legal fees for England (claimant, defence, and other related costs) making up just under 20% of the total. The compensation payments should not in fact be classified as spending on legal services, since they represent payment of compensation to those who have suffered clinical negligence (transfers in economic terms). The classification is only accurate to the extent that it reflects that the compensation is related to legal claims.

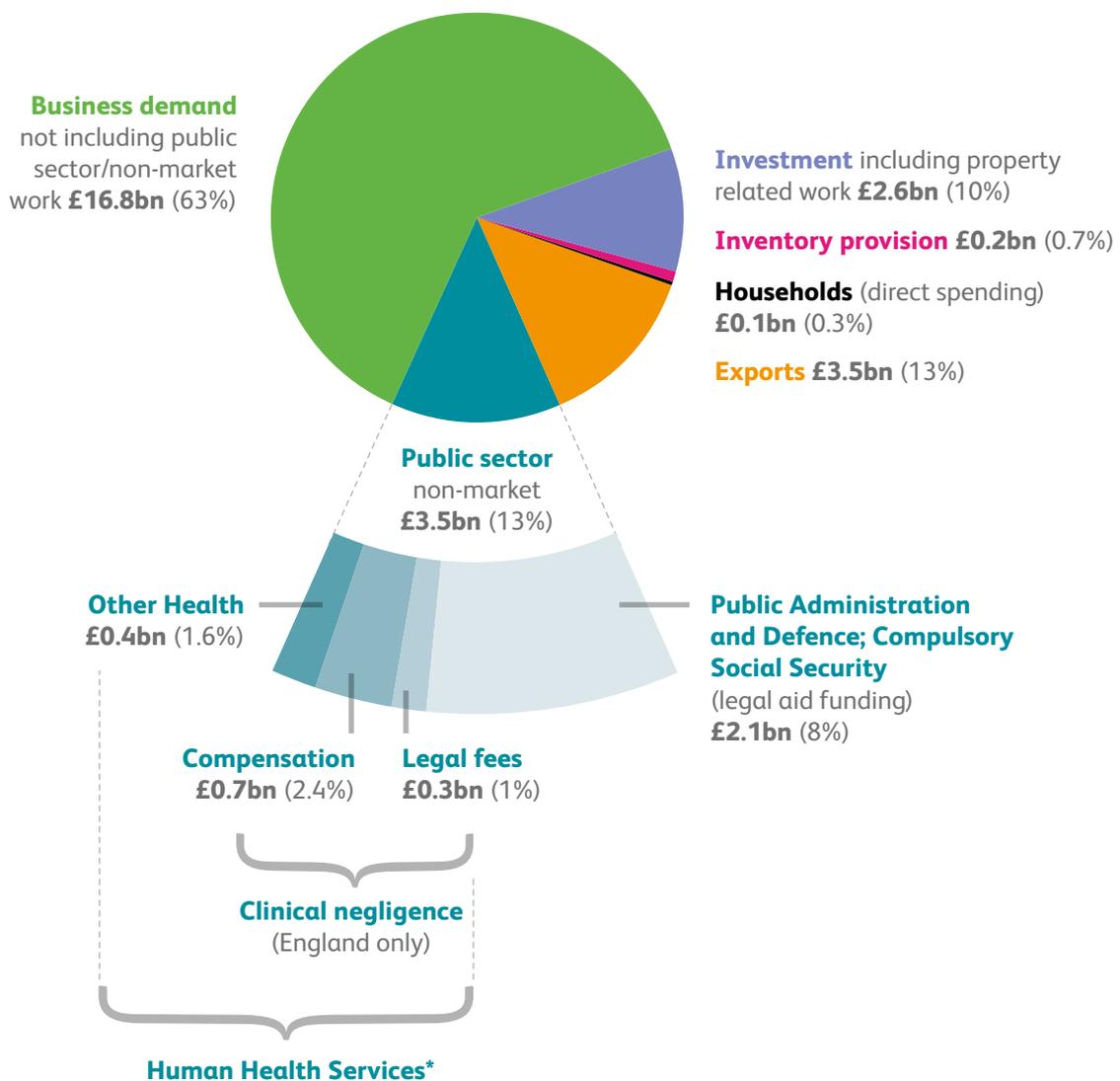
Investment demand under ONS’ classification includes conveyancing activities, which are the most common legal service purchased by private individuals. Household demand accounted for in Business sector purchases would include situations where businesses pay for legal services that might otherwise be borne by private individuals, for example, in personal injury litigation where claimant costs are paid by losing defendants through insurers.



The provision of legal services to facilitate publicly funded services represents only 13% of total sales by the sector.

Figure 9: Broad components of demand for legal services (£ billions)

Total UK sales of legal services: £26.7 billion



Source: ONS 2010 Input-Output Table, NHS Litigation Authority Report and Accounts 2011-12

* Expenditure on Legal Services in the ONS Human Health Services Non-market category includes both legal fees and compensation paid in clinical negligence cases – estimates of which have been made using NHS Litigation Authority financial results for 2010/11.

A small amount of other public sector demand is not shown on the chart (£0.05bn or 0.2% of total demand).

Financial, insurance and pension services are the biggest purchasers of legal services, accounting for 17% of total business demand.

The types of business sector demand for legal services are reasonably varied compared with the range of sectors supplying products and services to the legal sector. To a large extent the sources and distribution of demand reflect the relative size of those business sectors in the UK economy.

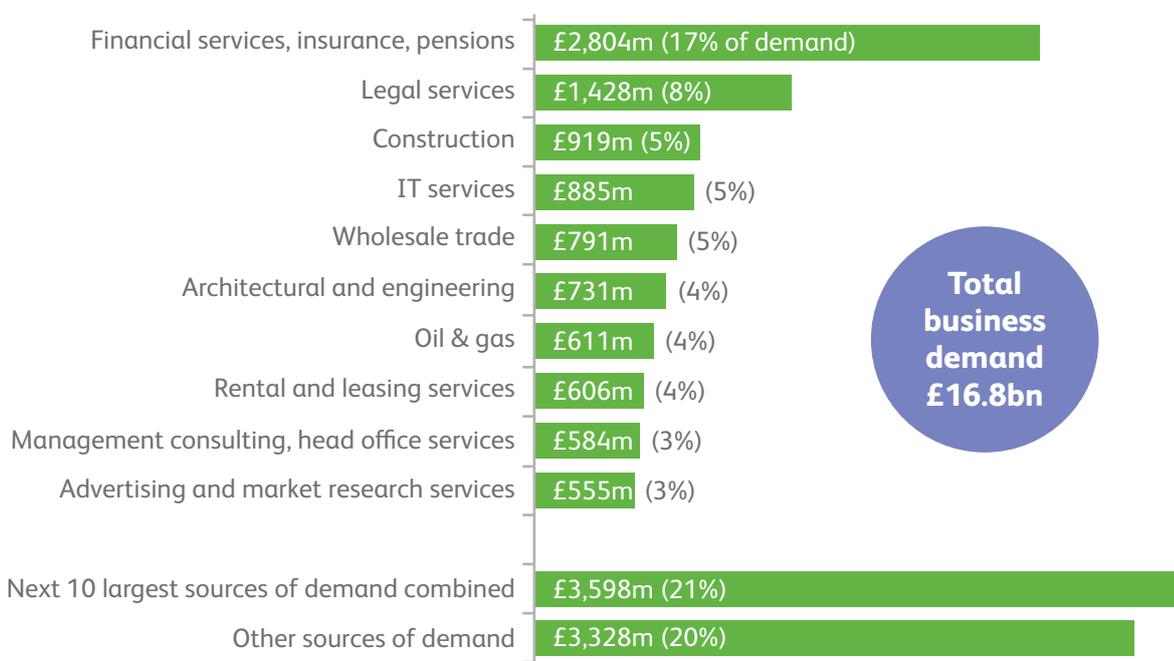
The single largest source of business demand for legal services is the Financial services sector, including insurance and pensions activity. Discounting internal demand from within the legal services sector itself,

the share of demand from Financial services (17%) is more than three times that of the next largest external source (Construction at £919 million or 5% of total business demand).

The next ten largest sources of demand outside of those named in Figure 10, and other sources of demand, feature a broad mix of Business services, Retail and Manufacturing sectors.

The range of demand for legal services reflects the role that the rule of law and legal services providers play in facilitating most types of economic activity. This is unquantified value generated by rules, systems and the activities of providers which reduce transaction costs and risks, thereby creating incentives for investment, market exchange and innovation.

Figure 10: Top sources of business demand for legal services by value (£ millions)



Source: ONS 2010 Input-Output Table

Education and IT services have played an increasingly important role in delivering legal services, while Financial services have grown as a source of demand relative to other business sectors.

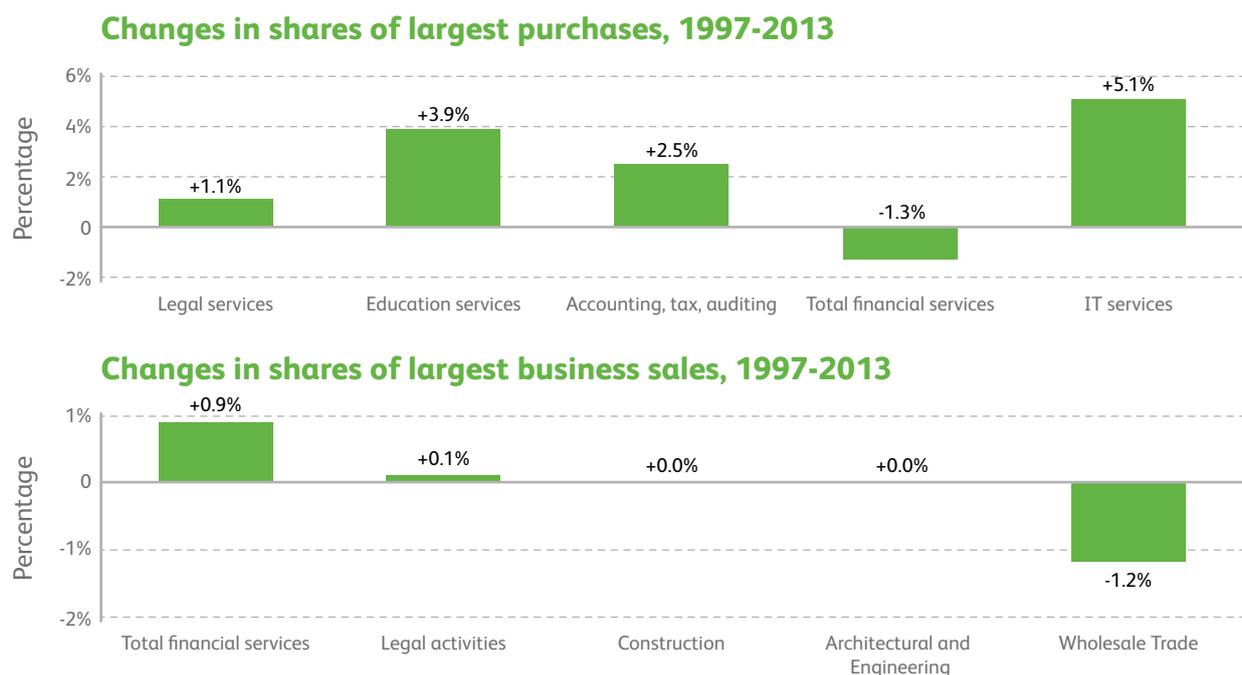
Along with the 2010 product level Input-Output Table used to derive multipliers and provide other consistent data thus far, more recent sector level data is available to assess changes in patterns of supply to, and business demand from, the Legal services sector as a whole (excluding public sector work).

The changes shown in Figure 11 highlight the expanded role that Education services and IT services are playing within law firms relative to other resources. Of the sectors shown – representing the five largest suppliers to the Legal services sector

in 2013 – only Financial services supplies a lower share of total inputs compared with 1997. Purchases from the Financial services sector were still higher in 2013 than 1997 in absolute terms, but had not expanded as sharply as IT and Education purchases (which grew at average annual rates of 20% and 13% respectively). The gain for IT reflects the increasing adoption of technology by legal services firms. The introduction of the Legal Practice Course provided by private colleges from the mid-1990s, and growth in provision of CPD training, both likely contributed to a greater proportion of law firms’ purchases on education.

In contrast to its reduced role as a supplier to the legal services sector, the Financial services sector expanded moderately as a customer of legal services relative to other sectors. Law firms, like businesses in general, would use a wide variety of financial services including commercial banking, insurance against lost cases, pension provision and professional indemnity insurance.

Figure 11: Changes in the market shares of purchases from, and services sold to, other business sectors, 1997-2013. Sectors shown were the five largest suppliers and sources of business demand for the legal services sector in 2013.



Source: ONS 2010 Input-Output Table

5. SUMMARY AND CONCLUSION

The evidence shows that legal services are an important contributor to economic value, both directly and through the sector's supply chain, despite the narrow definition used for analytical purposes.

This report has shown the extent to which UK legal services and solicitors, as the largest group of legal services providers, support other economic activity through the supply chain. The static input-output analysis provides evidence that, holding all other things equal, extra spending on legal services has the potential to generate significant additional spending and jobs across the economy. The additional economic activity would be on a similar scale to the benefits that would result from higher spending in industries such as Financial services and Accounting. This wider value is in addition to a direct economic contribution that has grown in real terms over the long term (by 2015, the direct contribution had risen to £25.7 billion from £12.1 billion in 1999 counted in 2012 prices).

The 2010 ONS input-output data used to estimate economic multipliers for legal services (and other products and services) provide a snapshot of the Legal services sector at a pivotal point in time, before the implementation of major market reforms and as the UK began to emerge from the global financial crisis.

This unique analysis illustrates the self-sufficiency of the sector, in terms of its relatively unique reliance on the skills of its workforce and relatively low reliance on inputs outside of the sector to produce market value. Also noteworthy is the relative importance of Education, Financial services and IT in delivering services and value.

Moreover, data available on a sector basis up to 2013 evidenced growing adoption of IT by law firms, and further growth in the relative importance of Education and training in firms' business models. On the demand side, UK businesses form the largest customer base for legal businesses (accounting for almost two-thirds of all spending on legal services) and 2013 data show that the Financial services sector has grown in relative importance as a buyer of legal services. This trend is expected to persist as the Financial sector continues to recover steam following the financial crisis.

Given the government's austerity programme, and proposals to remove qualified lawyers from some justice processes, the share of demand borne by the Business sector is likely to increase over time.

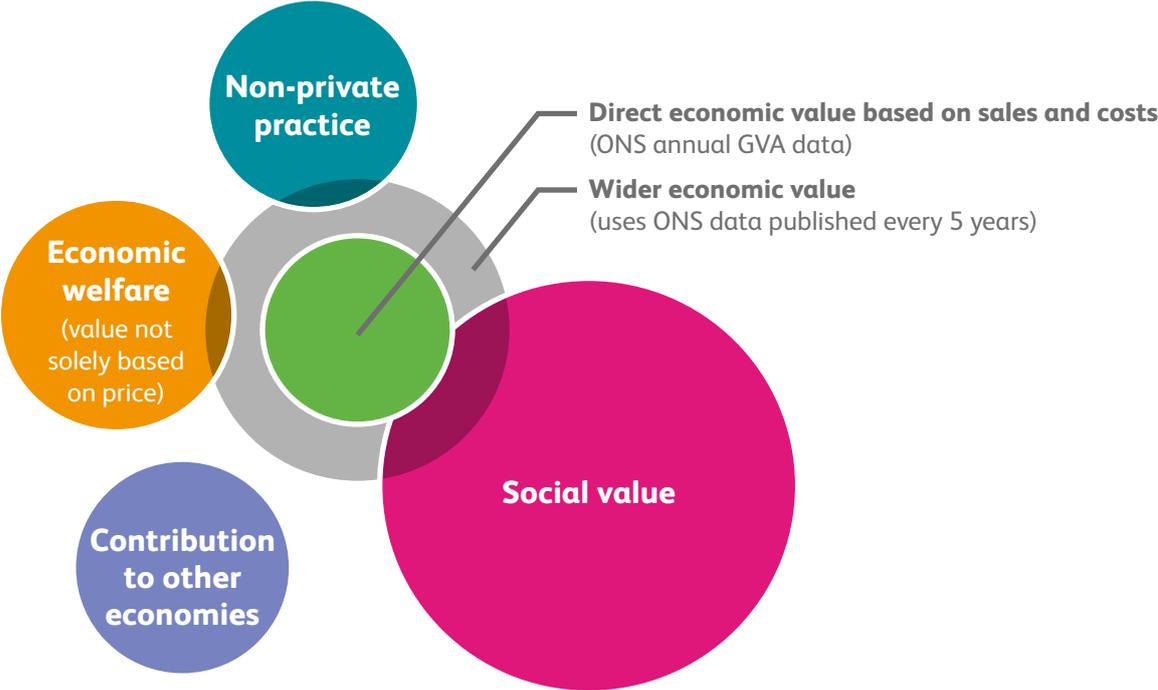


A wide range of benefits were outside the scope of analysis, so estimates provided in this report are merely a starting point for thinking about the true value of legal services.

The direct and wider contribution of legal services to the economy highlighted in this report are on a par with Financial and other professional services. However, it is important to recognise that the figures represented do not account for the value that is created beyond supply and demand relationships in the market for legal services. The limitations of the data available mean that quantifying the following types of value has been outside of the scope of analysis:

- The pro bono and corporate social responsibility contribution of legal businesses;
- Economic welfare (or surplus), which captures value experienced by suppliers and purchasers over and above prices paid;
- The contribution made by UK legal firms and English and Welsh law to other economies;
- The economic output of legal services delivered outside of private practice in the UK (for example by in-house teams in companies); and
- Social value, defined as the value from all external benefits and public goods derived by non-purchasers as well as purchasers of legal services through delivering the rule of law. This value includes the deterrence value of law, and the effects of law and legal services which encourage investment, market exchange and innovation.

Figure 12: Concepts of value of legal services, including potential overlaps and indicative scale of value



6. APPENDICES AND REFERENCES

APPENDIX A

Glossary of ONS and other technical terms to describe the value generated by legal services.

Economic and national accounting terms used throughout this report to describe the structure and value generated by legal services and other areas of the UK economy. For readers not familiar with the economic and national accounting language, and because many of the terms are used inconsistently in the media, the glossary below is to ensure maximum understanding of the structure and value of legal services analysed in this report. Terms are grouped according to whether they relate to total value, creation (supply), or demand for products and services, and separately with reference to the ONS input-output data.

Total value terms

Gross Domestic Product (GDP): A measure of economic activity which captures the total monetary value of goods and services that the UK produces during a given period. Approaches to measure GDP are to look at production (outputs less inputs produced by firms or individuals), income (individuals' wages and firms' profits), and expenditure (total expenditure on finished goods and services).

Gross Value Added (GVA): The contribution to the economy of each individual producer, industry or sector in the United Kingdom – for example the Legal services sector. In the production or income approaches to GDP the contribution to the economy of each industry or sector is measured using GVA.

GVA (at current basic prices; available by industry only) plus taxes on products (available at whole economy level only) less subsidies on products (available at whole economy level only) equals GDP (at current market prices; available at whole economy level only).

Jobs: Often used to represent value to demonstrate the size of a particular sector. Workforce jobs is the measure used in our analysis of the size of the Legal services sector. Workforce jobs captures all private and public sector jobs, both full and part time. Workforce jobs generally reflects the location of jobs rather than the residence of jobholders.

Market value/sales/turnover: The monetary value of all goods or services sold by a particular firm or by firms and individuals that make up a sector. Turnover represents a gross measure of value compared with the net GDP or GVA indicator which captures additional value generated by firms and individuals.

Multiplier: A ratio of a wide measure of economic output supported by a sector (typically including direct and wider value supported through the supply chain), to the direct output produced by the same sector.

Total output: A term which can be used to describe either total sales or the GDP or GVA measures of economic value. In this report output should read as market value or turnover. The total output of an industry is the aggregate value of the goods and services together with the work-in-progress produced by the industry.

Creation (supply) of legal services and other products

Supply: For the purposes of this report the terms supply and supply side refer to the process and resources used to produce legal services for all types of clients, public and private.

Labour inputs: In the context of legal services labour inputs are the people resources (measured in full time equivalent jobs or hours worked) involved directly in the creation of those services; including solicitors, barristers, para-legal and support staff working for legal services firms.

Non-labour inputs: Non-labour inputs to produce legal services are products ranging from IT equipment to Business services, and include legal services themselves involved where there is intra-industry trade (for example solicitors' services provided to barristers' chambers). More generally non-labour inputs are products for which there is intermediate demand by firms to produce finished goods and services.

Employee compensation: The salaries paid to employees directly involved in the creation of different types of products – in the case of legal services to lawyers and other support staff at legal services firms. Employee compensation does not cover sums paid to partners of law firms as profits on account of an equity share.

Gross operating surplus (GOS): The excess money generated by operating activities after paying for labour costs. GOS can be viewed as an approximate measure of profits although differs from profits shown in company accounts in subtracting only a subset of costs from gross output, and ignoring depreciation of capital.

Demand for legal services and other products

Business (intermediate) demand: Demand for legal services by firms and non-market sectors in order to produce other products for use by households, government, and other businesses. Within the ONS national accounting framework the majority of demand for legal services is accounted for as business (intermediate) demand including by non-market sectors such as Public Administration (legal aid provision), Education and Health. All government and much of household demand for legal services is then captured through government and households' purchases from the market and non-market sectors that have already utilised legal services.

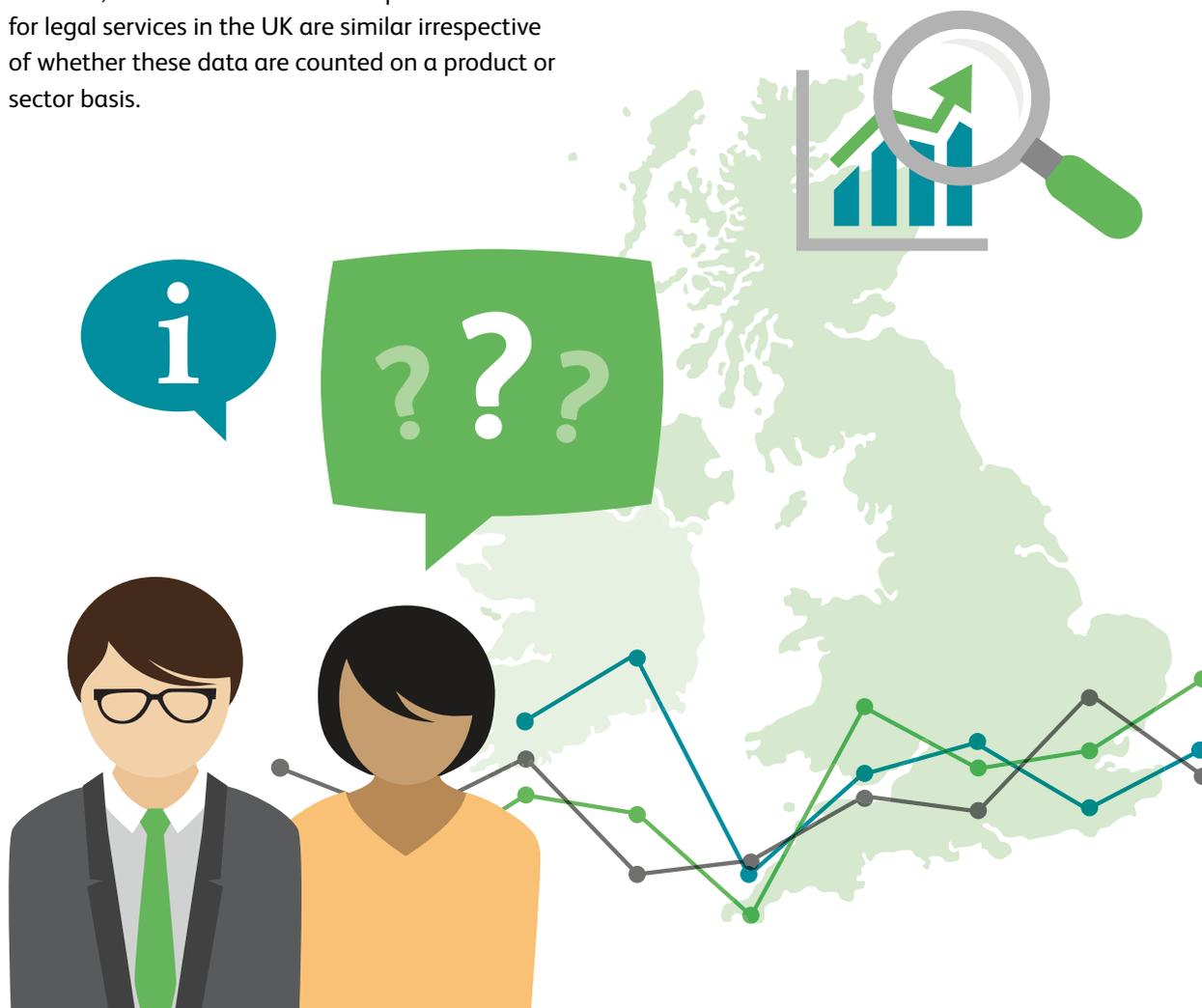
Household demand: Within the national accounting framework much of what would commonly be considered as 'household' use of legal services is accounted for in Public Administration and Defence (legal aid provision), Investment (including conveyancing work) and other business sectors (for example personal injury litigation costs paid by defendant businesses). According to the 2010 ONS Services Survey, 69% of Legal sector turnover was generated by work for businesses and 31% work for individuals.

Input-Output Analytical Tables and Supply and Use Tables

The final ONS Input-Output Table, contained in the set of ONS IOATs, includes legal services defined on a product basis, in contrast to a Legal services sector definition in other data published by ONS on a more frequent basis. For instance the sector definition is used for latest GVA and other data in the Supply and Use Tables and other, more timely, GVA releases. The difference between the two definitions is due to some legal services provided from outside of the sector (for example by in-house legal teams and in ABS structures) and the Legal services sector generating some products that are not strictly legal services (such as commercial advice given by City law firms). However, the levels of GVA and output recorded for legal services in the UK are similar irrespective of whether these data are counted on a product or sector basis.

The Input-Output Table contains the value of non-labour inputs to the sector separated by domestic inputs, imported goods and services, and taxes on products. The 'Non-labour inputs' definition used for Figure 3 comprises all three of these components.

Gross Value Added in the Input-Output Table includes Employee Compensation, Gross Operating Surplus and separately taxes on production. The split of Gross Value Added underpinning Figure 3 excludes taxes on production (2% of GVA).



APPENDIX B

Input-Output analysis methodology and limitations.

Static input-output analysis is a useful tool to demonstrate the role that a sector plays in supporting other economic activity (measured as spending, GVA or jobs) at a point in time. However, the input-output methodology has several limitations that should be recognised when interpreting the resulting multiplier figures.

Methodology

The multipliers for output and employment for the legal services and other sectors are derived from what is known as the Input-Output Table, which shows the combinations of goods and services that are used to produce other types of products (with data plotted on a square product by product grid). The Input-Output Table is itself estimated by ONS from annually published Supply and Use Tables, which provide data on a sector basis (how much each sector purchases and sells to other sectors).

The multiplier figures are derived from the final Input-Output Table using matrix operations which take into account the indirect relationships within the economy.

For economic output and jobs these multipliers are labelled as:

- **Direct:** This is the immediate effect caused directly by the change in final demand (for the direct multiplier the example given in the report is a £1 increase in output of legal services)
- **Indirect:** This is the subsequent effect caused by the consequent changes in intermediate demand (purchases from suppliers to the Legal services sector)
- **Induced:** The effect attributable to the ensuing change in compensation of employees (at suppliers and the original sector receiving extra demand) and other incomes, which may cause further spending and hence further changes in final demand.

The direct effect is the smallest measure and enlarged by indirect and induced effects in that order respectively.

Limitations

Timeliness of the Input-Output Table is one limitation that should be recognised when considering multipliers that are derived from the table for a particular year. For example, the multipliers shown in this report are based on 2010 data, which is currently the latest available data for the UK.

The multipliers based on the published Input-Output Table are also restricted to **product groups, for which some data relies on certain assumptions**. In the case of legal services this means that multipliers reflect the activities of private practice firms and services in other types of organisations, but with the scale of activity in non-private practice settings estimated with simplifying assumptions. Interested readers should refer to the most recent ONS IOAT guide.

From a **theoretical perspective** input-output multipliers can legitimately be used to demonstrate the output and employment supported by a particular sector such as Legal services. However, it should be noted that the use of multipliers to signal economic impacts from supposed or actual expansion of a sector over time is limited due to the following features:

- 1 Lack of supply-side constraints – multipliers assume that extra output can be produced in one area of activity without taking away resources from other activities. That is they ignore opportunity costs.
- 2 Absence of budget constraints – so that changes in household or government consumption occur without reducing demand elsewhere.
- 3 Fixed prices – so that effects of relative price changes play no role in the allocation of scarce resources between activities.
- 4 No allowance for households purchasers' marginal responses to change – so that real budget shares remain unchanged with changes in household income and relative prices.

Crucially, limitations 1 and 2 reflect a lack of acknowledgement in input-output multipliers of the opportunity costs associated with an increase in final demand from a particular sector.

If multipliers were applied across a number of sectors, total output across the economy would be overestimated because effects would be double counted.

The limitations 1 and 2 are addressed by undertaking a dynamic analysis as outlined in the report, although this does require access to a large macro-econometric model of the economy as we used.

These issues do not detract from the fact that multipliers derived from the Input-Output Table provide valuable information about the structure of economies not otherwise available. The Input-Output Table also forms the basis of the more sophisticated models designed to examine the dynamic effects of increases in final demand from a sector.



APPENDIX C

Dynamic modelling to consider the scale of effects of Legal sector expansion relative to a baseline forecast over the medium term.

Dynamic modelling provides an additional, and totally different, approach to thinking about value in the context of the supply chain for the Legal services sector and demand for legal services. Therefore the results are not comparable to static input-output analysis findings reported earlier.

The static analysis provides multipliers which measure the output (or number of jobs) supported in the rest of the economy by a marginal increase in spending in a sector at a particular point in time and for a particular level of total spending or GVA. Dynamic modelling, on the other hand, looks at the scale of the effects of a particular increase in the output of a sector on the rest of the economy, and how these effects come through over time given resource constraints and competition for resources from other sectors. The starting point for dynamic analysis is a hypothetical expansion or 'shock' (alternatively a contraction), the effect of which on the wider economy can then be modelled over time.

Oxford Economics was commissioned to develop its proprietary Global Economic Model (GEM) by building an extension covering the Legal services sector. The enhanced GEM was first used to estimate baseline forecasts for GVA and employment over a fifteen year period, for the UK as a whole and for the Legal services sector. The knock-on effects of a change in the size of the sector were then assessed relative to those baseline forecasts.

The choice regarding the size of the hypothetical expansion or 'shock' to be applied initially in the model is somewhat arbitrary. However, the amount of additional legal services growth that constituted the shock had to be of sufficient scale to allow the Oxford model to operate effectively (the GEM is designed to capture the effects of step changes rather than fluctuations of a handful of £s), while representing a plausible change.

The matter of how such an arbitrary jump in output of legal services might come about is not addressed explicitly here. All that is important to appreciate when considering results of the analysis is that dynamic modelling enables a 'shock' to be applied to a model representing the interconnections between different sectors in the economy and to explore the scale of effects of that shock over time. The analysis provides an alternative representation of the value of a sector which is relative to a baseline projection based on 'normal' circumstances.

The dynamic results provided in the report illustrate the scale of the difference between short and long term wider economic effects that would follow a short term boost to the Legal services sector. Dynamic modelling accounts for the likelihood that any shock will have a diminishing impact over the long term, partly reflecting the different constraints on resources that apply in an economy as one sector expands at the expense of another or others. These are features which a snapshot, static estimate cannot factor in.

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