



The Law Society

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# Legal services sector forecasts

**2017-2025**

*31 October 2017*





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## SUMMARY OF FORECASTS

UK legal services sector	2013	2014	2015	2016	2017	2018	2019	2020
Real turnover (£bn constant 2010 prices)	£28.58bn	£27.94bn	£28.10bn	£28.36bn	£28.67bn	£29.21bn	£29.98bn	£30.82bn
% change	6.5%	-2.2%	0.6%	0.9%	1.1%	1.9%	2.7%	2.8%
Real net exports (£bn constant 2010 prices)	£3.16bn	£3.47bn	£2.99bn	£3.05bn	£3.46bn	£3.79bn	£4.03bn	£4.25bn
% change	5.2%	9.8%	-13.9%	2.2%	13.2%	9.6%	6.4%	5.4%
Total employment (number)	314,000	326,000	323,000	320,541	317,854	316,304	315,382	315,676
% change	-0.6%	3.8%	-0.9%	-0.8%	-0.8%	-0.5%	-0.3%	0.1%
Total employment (full-time equivalents)	289,000	294,500	293,000	291,218	289,029	287,835	287,209	287,606
% change	-0.2%	1.9%	-0.5%	-0.6%	-0.8%	-0.4%	-0.2%	0.1%
Housing transactions (E&W)	815,539	971,175	964,616	925,045	850,418	824,061	817,006	811,466
% change	22.5%	19.1%	-0.7%	-4.1%	-8.1%	-3.1%	-0.9%	-0.7%

Source: Law Society Research Unit (13 Sep 2017)

- The current Law Society forecasts suggest that real turnover of firms in the UK legal services sector (a measure of the 'volume' of legal work done by the sector) is expected to show comparatively modest growth over the next three years. This forecast is based on projections of lower economic growth, and lower volumes of housing transactions in at least the medium-term future. We expect these factors to be offset, to some extent, by increased exports, and the potential for increased Brexit-related legal work. We currently expect modest growth in real turnover of the sector for 2017, and then some pick-up in 2018/19. However growth will not reach the levels seen before the financial crisis.
- Housing transactions are expected to be lower in 2017 compared with 2016 as individuals find themselves unable to afford to buy due to lower real income growth and high house prices. We currently expect housing transactions in England and Wales to drop by over 8% from an estimated 925,000 in 2016 to 850,000 in 2017 and to remain at around that level for the next three years.
- Net exports of legal services (mainly work undertaken in the UK by UK-based law firms for non-UK clients) could increase in 2017 and 2018 as the depreciation of the pound's exchange

rate makes UK-based law firms more competitive internationally. Increasing world growth is also likely to boost overseas demand for UK-based firms' legal services.

- Relatively modest growth in the legal services sector's turnover over the next three years implies that employment in the sector is likely to continue to decrease, although more growth in the economy feeding through to demand for legal services could lead to a more stable level of employment from 2020. We currently expect total employment in the sector in terms of the number of jobs to decrease from 321,000 in 2016 (equal to 291,000 full-time equivalent jobs) to 315,000 in 2019 (287,000 full-time equivalent jobs), but then to stabilise at around 316,000 (equal to 288,000 full-time equivalent jobs) from 2020.
- Over the longer term, the number of jobs in the legal services sector will be increasingly affected by automation of legal services functions. This could mean that by 2038 total employment in the sector could be 20% less than it would otherwise have been, with a loss of 78,000 jobs – equal to 67,000 full-time equivalent jobs – compared to if productivity growth continued at its current rate. In the final forecasts the job losses due to automation are, however, offset at least to some extent, by continuing growth in the demand for legal services from elsewhere in the UK economy.

## DETAILS OF FORECASTS

The forecasts for the UK legal services sector are based on the August 2017 macroeconomic forecasts for the UK economy produced by the National Institute of Economic and Social Research (NIESR) and the April 2017 forecasts for World economic demand produced by the International Monetary Fund (IMF). The macroeconomic forecasts have then been fed into our forecasting model for the UK legal services sector. Further details of this model are in Appendix B.

The forecasts relate to the UK legal services sector as a whole (i.e. the combined turnover, exports, employment, and average prices of solicitor firms, barrister firms, and other legal service providers such as licensed conveyancers, patent and copyright agents that undertake 'paid for' legal work).

### Total turnover of firms in the legal services sector

The current Law Society forecasts suggest that real turnover of firms in the UK legal services sector is likely to show relatively modest growth over the next three years, compared with past growth in the sector. This is due to the UK economy being expected to show lower growth, and due to the volume of housing transactions being expected to decrease over the coming year and remain relatively low in the

medium-term at least. These factors will, though, be offset to some extent by increased exports, and by the potential for increased legal work related to the process of Brexit.

We currently expect real turnover in the UK legal services sector to increase by 1.1% in 2017, followed by a 1.9% increase in 2018 and a 2.7% increase in 2019. This compares to growth of approximately 5% per year in the years before the 2008 financial crisis (see Graph 1, page 8).

These growth percentages – and subsequent forecasts of net exports and employment for the sector – reflect factors detailed below under broad areas of demand. The factors can also be seen in the flowchart of the legal services sector model in Appendix B.

### Business demand

Total GDP of the UK economy is currently expected to increase by 1.7% in 2017, 1.9% in 2018 and 2.0% in 2019 based on the latest (August 2017) NIESR macroeconomic forecasts. The NIESR forecasts show some pick-up in UK GDP growth, but growth in 2018 and the following years is still expected to be relatively modest.<sup>1</sup> As a result, real profits of (non-financial) businesses in the economy are expected to show only modest growth, although real profits have been boosted over the past year by the significant decrease in the £ exchange rate increasing the value of firms' overseas earnings. Although the recent increase in real profits will offset lower growth in the economy to some extent this year, the modest growth in real profits over the medium-term is likely to lead to lower growth in demand for legal work from the business sector.

Growth in output of the UK financial sector has been depressed since the financial crisis, although it did

<sup>1</sup> Some other forecasters expect UK GDP growth to be lower in 2018 than in 2017. In particular the latest (September 2017) OECD forecasts show growth decreasing from an estimated 1.6% in 2017 to 1.0% in 2018. It is therefore possible that the next update of the NIESR macroeconomic forecast (expected November 2017) could show lower growth in the UK economy in 2018. There is therefore probably a greater downside risk for our forecasts for the UK legal services sector in 2018 than normal.

show some recovery in 2016. Over the medium term we expect growth in the financial sector output to remain relatively modest. The financial sector is an important source of business for law firms (see Law Society Research Unit report 'Economic value of the legal services sector' March 2016) and therefore modest financial sector growth is likely to contribute to relatively lower growth in demand for legal work from the business sector over the medium term.

### Consumer demand

Lower growth in the UK economy is also likely to be reflected in significantly lower growth in households' real disposable (i.e. after tax) incomes, with average earnings showing only very small increases. In the short-term, real incomes will also be eroded by increased inflation following the depreciation of £ exchange rate, increasing import prices. Real households' disposable income (i.e. income after tax) is expected to decrease by -0.4% in 2017, and increase by only 1.8% in 2018, and 2.2% in 2019.<sup>2</sup> Lower real income growth combined with relatively high house prices is also likely to lead to a decrease in housing transactions over 2017 and to transactions remaining relatively low in the following years (see also details of housing transaction forecasts below). These factors mean we also expect relatively lower growth in demand for legal work from the personal consumer sector.

Unemployment in the economy will increase slightly. Under normal circumstances this would be expected to lead to some increase in legal work (e.g. increased social welfare work) but the increase in unemployment is likely to be small and therefore any offsetting increase in legal work is expected to be negligible.

### Overseas demand

The slightly less positive outlook for the legal sector will be offset for some firms by increasing exports of legal services, due in the short-term to the depreciation of the £ exchange rate increasing international competitiveness of UK-based law firms, and in the medium-term due to expected higher growth in world demand (see also details of net exports forecasts below).

Brexit is a major source of uncertainty with respect to the forecasts for both the UK economy and the forecasts for the UK legal sector. Over the medium-to-longer term, our analysis indicates that Brexit will have a negative effect on the legal sector in terms of both output and employment (see Law Society Research Unit report, 'The UK legal services sector and the EU' September 2015). However, over the short-to-medium term Brexit could result in increased legal work from the process of leaving the EU.

To get a provisional estimate of the likely size of this increase, we asked members of our Insight survey panel and respondents to our Annual Firms Survey how much they thought their firm's turnover might increase as a result of increased legal work from the process of leaving. Using these responses, we have assumed that the additional legal work could increase turnover by approximately 0.3-1.0% over the period 2017-2025, across the sector as a whole, although large international law firms will inevitably benefit more from additional legal work arising from the process of Brexit. This estimate is, though, inevitably tentative given the nature of the questions asked and the uncertainties around Brexit.

<sup>2</sup> The August 2017 NIESR forecasts for increases in households' real disposable income in 2018-2021 have been adjusted downwards slightly by the Law Society Research Unit, due to particular concerns about their projections for the pick-up in wage inflation. The real households' disposable income forecasts used here are therefore now closer to the latest Bank of England projections.

### Technical note – ONS turnover figures underpinning the forecasts

The legal services sector turnover figures in our forecasts are based on Office for National Statistics (ONS) Annual Business Survey data up to 2015. For 2016, we expect real turnover in the sector to show a small increase of just 0.9% compared with 2015. The ONS also produces preliminary estimates of turnover from its TOPSI (Turnover and Output of the Production and Services Industries) service, and these figures indicate that legal services sector turnover may have fallen in 2016. However, the TOPSI figures can show significant differences from the Annual Business Survey figures, as they are based on preliminary estimates of turnover by firms and are also based on a significantly smaller sample size. We are therefore currently continuing to use our estimate of turnover for 2016 based on Annual Business Survey data.

Graph 1: UK legal services sector – real turnover forecasts (% change per year)



Source: Law Society Research Unit (13 Sep 2017)



## Housing transactions

Housing transactions are expected to be lower in 2017 compared with 2016 and to remain relatively subdued in the following years, due to lower real income growth and continuing relatively high house prices affecting the affordability of housing. Residential conveyancing work accounts for a relatively small proportion (between 4% and 6%) of the total value of legal work undertaken. However the magnitude of increases and decreases in housing transactions that can occur from year to year mean that they can have a significant effect on the rate of change in the total turnover of the legal services sector. We currently expect housing transactions in England and Wales to decrease by 8% from an estimated 925,000 in 2016 to 850,000 in 2017 as a whole and to remain at around that level for the next three years (see Graph 2, page 10).

The main factor affecting our forecasts of housing transactions is the continuing low level of affordability (i.e. high average house prices relative to average income per household). Average house prices increased by 7.0% in 2016 according to Land Registry figures. The Halifax house price index suggests that the annual rate of increase could have slowed to 2.6% in the three months to August 2017, and the current NIESR forecast is that prices will show an increase of 4.9% over 2017 as a whole. However, the significant slowdown in income growth means that the ratio of house prices relative to income could increase to around 4.75:1 in 2017, having already risen to 4.61:1 in 2016 from 4.38:1 in 2015 and a low in the recession of 3.97:1 in 2012. House prices could decrease by 1.5% in 2018 and increase by only 0.7% in 2019,<sup>3</sup> but with relatively low growth in incomes, the house price to income ratio is likely to decrease only slightly to 4.64:1 in 2018 and to 4.50:1 in 2019.

Housing transactions in 2017 will also be affected by the ending in December 2016 of the Government's help-to-buy Mortgage Guarantee scheme. The number of house purchases directly supported by the scheme is relatively low, but the targeting of the scheme on first-time buyers and 'second movers' and the resulting knock-on effects on confidence in the market mean that the scheme is likely to have a more widespread effect on transactions. Similarly, the proposed ending of the help-to-buy Equity Loans scheme in 2020 could also have a significant effect on transactions.

Bank base rates are currently expected to remain at 0.25% until the end of 2017 in the most recent NIESR macroeconomic forecasts, to rise to 0.50% in 2018 Q1, to 0.75% in 2019, to 1.25% in 2020, and to 1.75% in 2021.<sup>4</sup> US rates have already risen, but the uncertainties around Brexit mean that UK rates are unlikely to rise as quickly. Therefore average UK mortgage rates are expected to remain at around their current level of around 2.80%-3.00% until 2020, and only rise to an expected 3.20% in 2021. This could help prevent a further sustained fall in housing transactions after 2017.

<sup>3</sup> NIESR August 2017 forecasts for increases in house prices over the period 2018-2021 have been adjusted downwards slightly by the Law Society Research Unit in line with the downwards adjustments to growth in households' real disposable income.

<sup>4</sup> There has been speculation recently that UK interest rates could rise by 0.25% points before the end of 2017, however rates are still expected to remain at low levels over our forecast period.

Graph 2: Housing transactions – number of transactions (England & Wales)



Source: Law Society Research Unit (13 Sep 2017)

### Net exports of legal services

Net exports of legal services mainly reflect work undertaken in the UK by UK-based law firms for non-UK clients. They could possibly show a significant increase in 2017 and 2018 due to the depreciation of the £ exchange rate increasing the international competitiveness of UK-based law firms. This could occur through lower non-sterling currency prices for their services, and also the shifting of work from non-UK offices to UK offices by global firms. Increasing world growth is also likely to boost overseas demand for UK-based firms’ legal services. We currently expect real (i.e. the volume) of net exports to increase by just over 13% in 2017 and by around 9% in 2018 (see Graph 3, page 11).

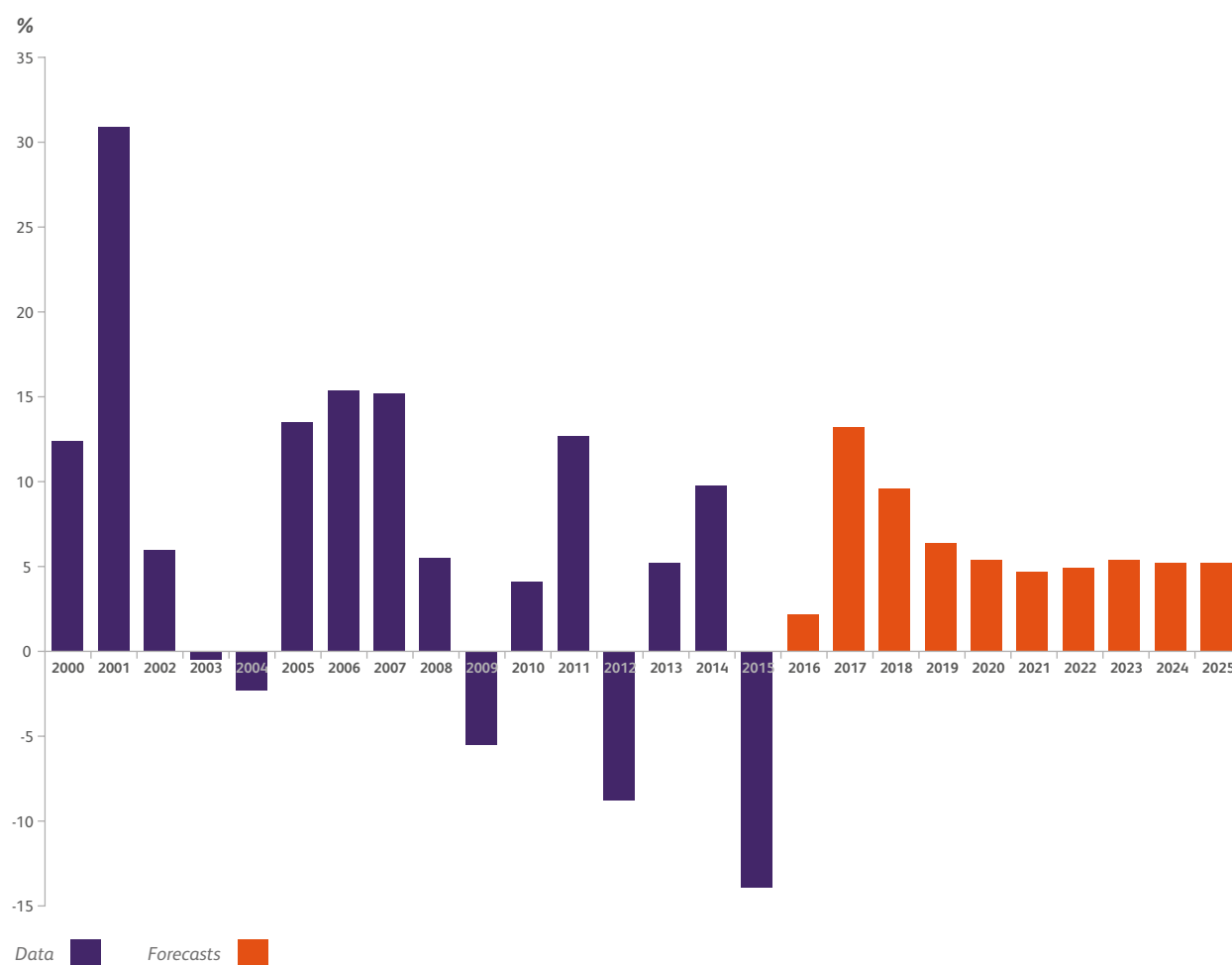
The main factor suggesting that real net exports will increase significantly in the short-term is the depreciation of the £ exchange rate. Against the US

dollar, the £ has fallen from US\$1.53/£ on average in 2015 to around US\$1.30/£ by August 2017, and against the euro from €1.38/£ on average in 2015 to around €1.10/£ by August 2017. The demand for legal services exports is typically not as sensitive to exchange rate movements as the demand for exports of goods, but the size of the depreciation does imply that net exports of legal services could show a significant increase.

The main caveat here is that almost all the depreciation has been due to uncertainty over the outlook for the UK’s international trading position. It is therefore not clear how much of the current exchange rate improvement in the competitiveness of UK-based law firms will be translated into increased exports, although we are currently assuming that the depreciation of the £ will lead to an increase in net exports broadly in line with past effects of changes in the exchange rate.

Over the medium-term, net exports of legal services are likely to benefit from increasing world economic growth. The April 2017 IMF forecasts suggest that growth in the advanced economies could increase from 1.7% in 2016 to 1.9% in 2019.<sup>5</sup> For the UK legal services sector, demand from other advanced economies continues to be the most important source of overseas work. The April 2017 IMF forecasts also suggest that growth in the emerging economies could increase from 4.1% in 2016 to 4.9% in 2019 which is also likely to contribute to increasing exports over the medium-term.

**Graph 3: UK legal services sector – real net exports (exports minus imports) forecasts (% change per year)**



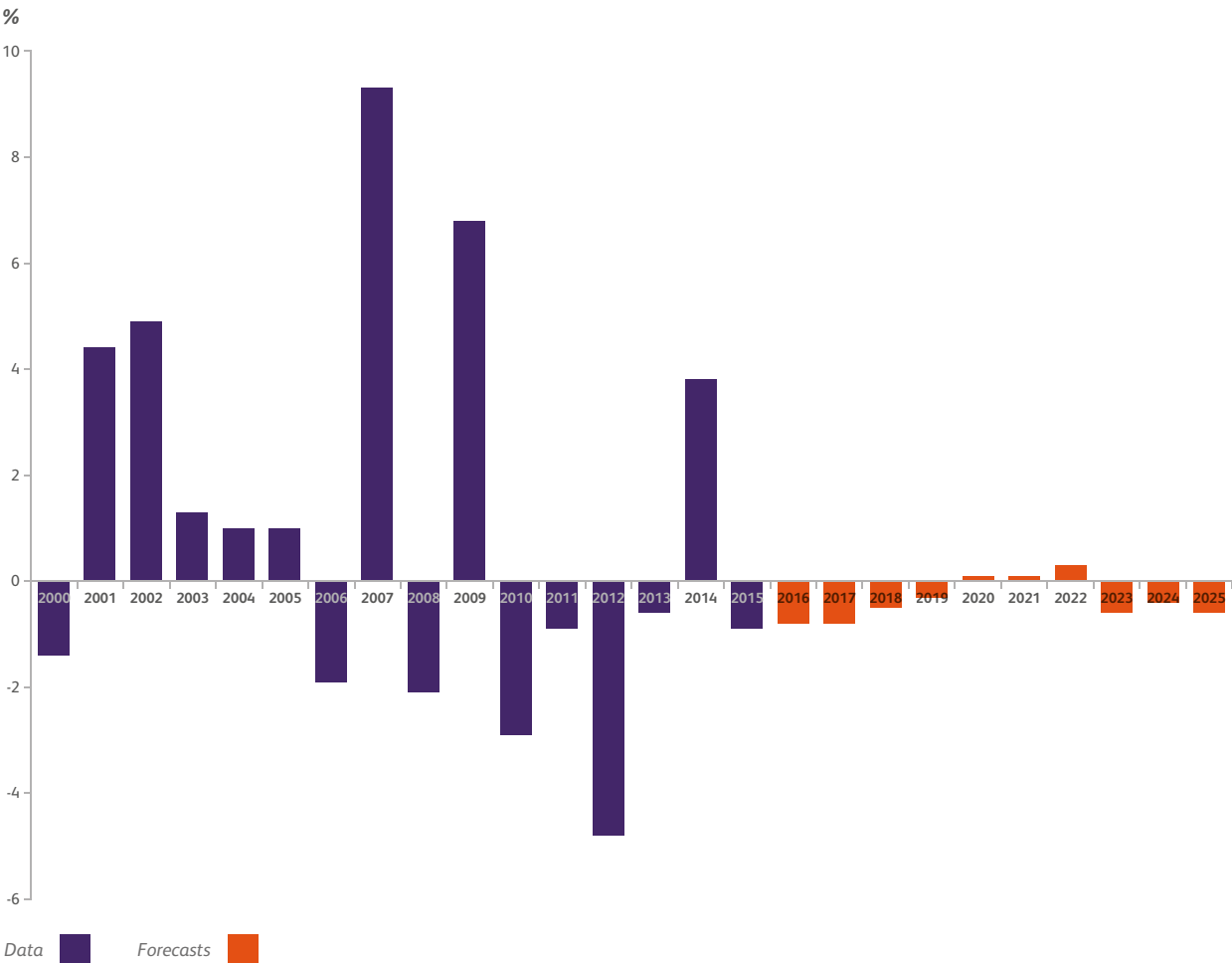
Source: Law Society Research Unit (13 Sep 2017)

<sup>5</sup> The IMF released an update of its World Economic Outlook forecasts on 10 October 2017, after the forecasts in this report were finalised. However, provisional analysis suggests that the updated IMF forecasts do not affect the legal services net exports forecasts significantly, and would lead to a less than 1% change in forecast growth.

## Employment in the legal services sector

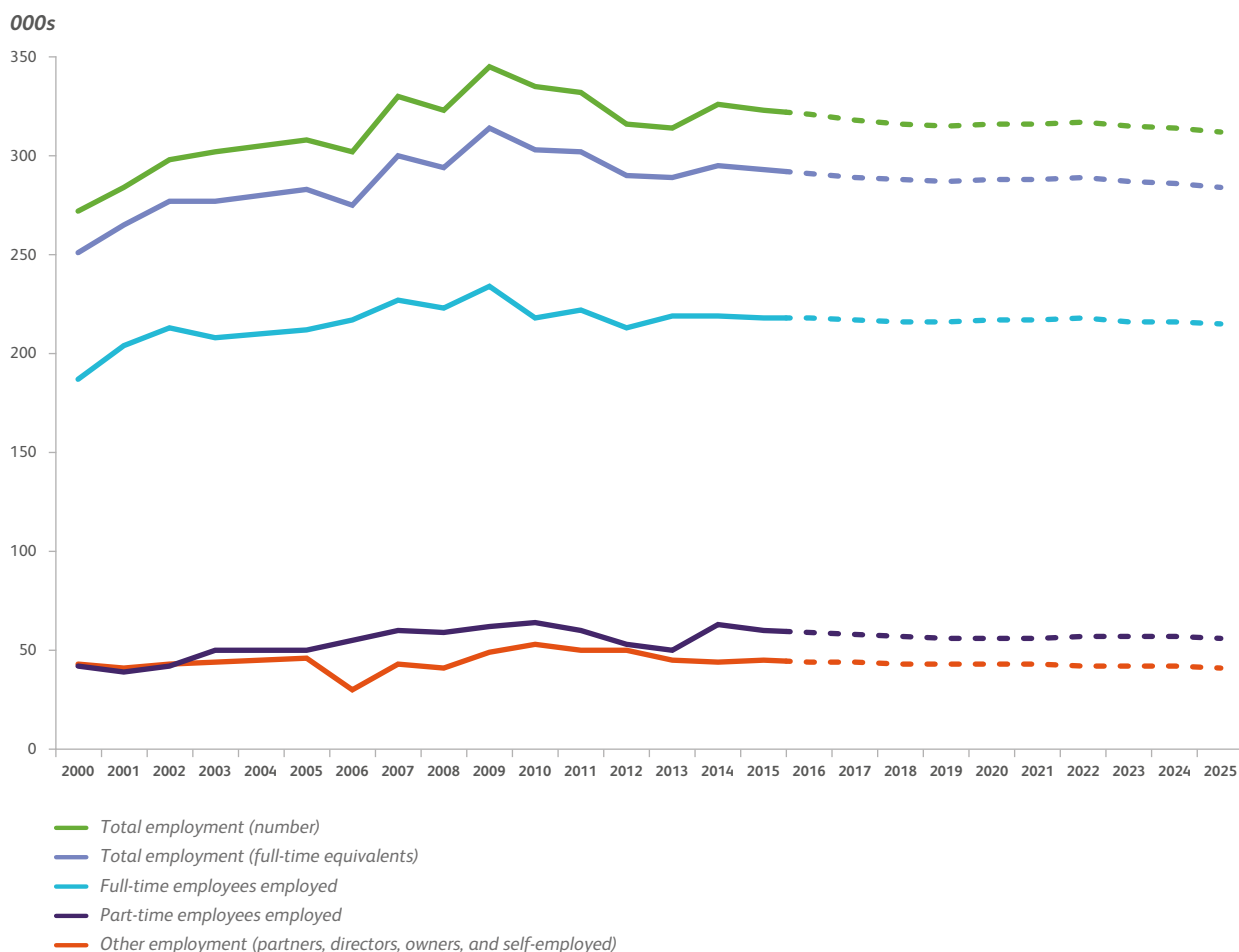
Relatively modest growth in legal services turnover over the next three years implies that employment in the sector is likely to continue to decrease, although more growth in the economy feeding through to demand for legal services could lead to a more stable level of employment from 2020. We currently expect total employment in the sector in terms of number of jobs to decrease from 321,000 in 2016 (equal to 291,000 full-time equivalent jobs) to 315,000 in 2019 (287,000 full-time equivalent jobs), but then stabilise at around 316,000 (equal to 288,000 full-time equivalent jobs) from 2020 (see Graph 4 and Graph 5).

Graph 4: UK legal services sector – forecasts of total employment (% change per year)



Source: Law Society Research Unit (13 Sep 2017)

**Graph 5: UK legal services sector – employment forecasts (000s)**



Source: Law Society Research Unit (13 Sep 2017)

Over the longer term it is likely that the number of jobs in the legal services sector will be increasingly affected by automation of legal services functions (see for example the recent Law Society Report, ‘Capturing Technological Innovation in Legal Services’ January 2017).

Results from the Law Society Research Unit’s Annual Firms’ Survey show that solicitor firms are beginning to adopt technologies automating legal functions. Large firms are more likely to be early adopters of these technologies, and functions previously carried out by paralegals and support staff are more likely to have been replaced. We are also seeing functions previously carried out by qualified solicitors beginning

to be replaced, with 15% of large firms in the 2015/16 survey reporting that this is happening in their firm, an increase from 3% in 2013/14 (see Table 1, page 14).

Assuming that firms increasingly adopt new technologies, the resulting rise in automation of legal services functions means underlying productivity (output per person employed) growth in the legal services sector could increase from its average of 1.2% per year. We have assumed that underlying productivity growth will gradually accelerate over the next 10 years to 2.4% per year – approximately the long-term rate previously seen in the rest of the economy. This would mean that by 2038 total


employment in the sector would be 78,000 less than it would otherwise have been (equal to 67,000 full-time equivalent jobs), or approximately 20% less jobs than otherwise due to this factor by itself. However, the job losses due to automation are likely to be offset to some extent by continuing increases in the demand for legal services, and as a result the total number of full-time equivalent jobs in the sector is likely to only fall by around 26,000 in our central forecasts.<sup>6</sup>

(It is important to note that the estimate of the long-term effects of automation of services functions

is the amount that employment could be *less than it would otherwise have been*. Demand for legal services is still expected to grow due to growth in the economy, and this will offset some of the above job losses due to automation of functions. The estimates of the potential effects of automation of functions also take into account that automation of functions will lead to lower unit labour costs (staff costs divided per unit volume of work produced). This is likely to result in lower prices and some offsetting increase in demand, although these ‘price effects’ are likely to be relatively modest in the legal services sector.)

**Table 1: Has any work undertaken by these types of staff been replaced with automated/IT based systems during the last three years? (% of firms in survey answering ‘yes’)**

	Year	All firms	Size of firms		
			Small	Medium	Large
Qualified solicitors	2013/14	2%	2%	3%	3%
	2014/15	2%	2%	3%	8%
	2015/16	3%	2%	5%	11%
	2016/17	3%	2%	3%	15%
Paralegals	2013/14	3%	3%	5%	8%
	2014/15	3%	2%	4%	17%
	2015/16	4%	2%	5%	19%
	2016/17	5%	4%	6%	26%
Non-fee earning staff	2013/14	9%	7%	14%	30%
	2014/15	14%	12%	19%	27%
	2015/16	12%	7%	19%	36%
	2016/17	9%	6%	12%	38%

 = evidence that significantly greater for these firms

Source: Law Society Research Unit Firms Survey 2016/17, 2015/16, 2014/15 and 2013/14

<sup>6</sup> For these projections, our model was run up to 2050, with our central projections for underlying trend productivity growth based on increasing adoption of new technology in the legal services sector, and without any increase in underlying trend productivity growth. Then comparing these two scenarios, we can quantify the effects on the sector of increasing adoption of new technology.

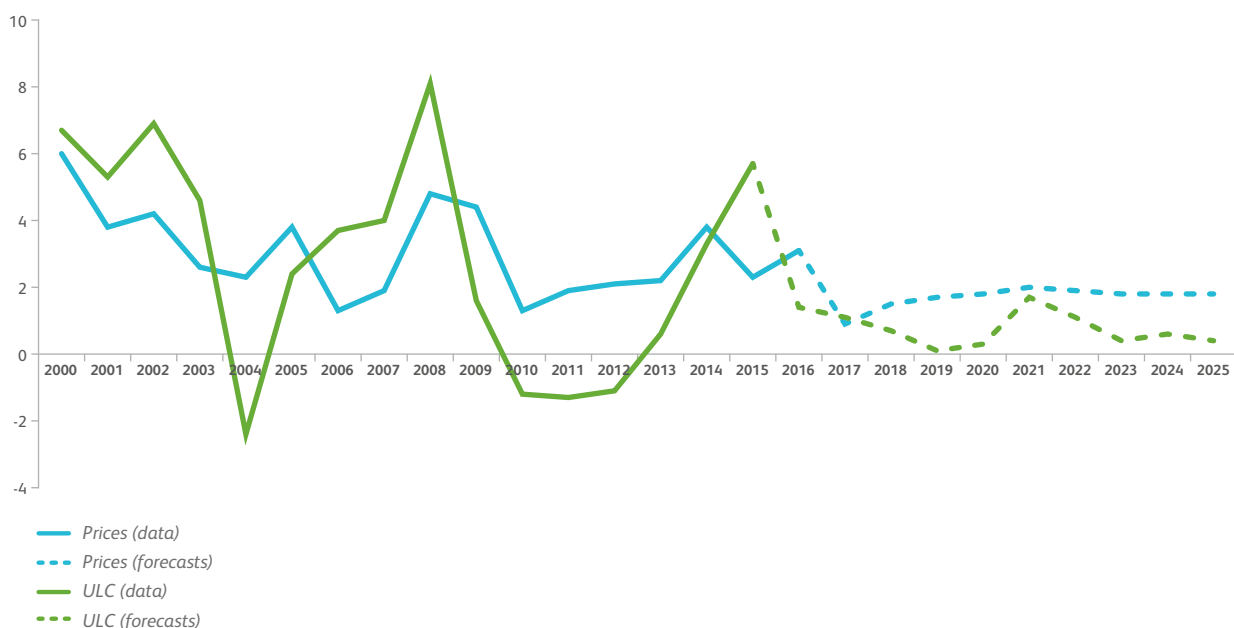
## Prices of legal services

The forecasts also incorporate the effects of changes in the prices of legal services. Firms supplying legal services appear mostly to set prices as a mark up on costs (mainly unit labour costs<sup>7</sup>) and relative to the general level of inflation in the economy as a whole. Prices are also adjusted slightly upwards or downwards according to whether demand was previously above or below average, although these 'pressure of demand' effects on firms do seem to be relatively small in the legal services sector (see Graph 6).

Prices can affect the demand for legal services from business and personal consumers, and there is some evidence that users of legal services have become more price sensitive over the past 3-4 years. However the demand for legal services overall does still appear to be relatively insensitive to price changes. Prices therefore do not have a major direct effect on the turnover and employment forecasts.

We have assumed that over the longer term the prices of legal services increase slower than they would otherwise have done, and that consumers continue to become more price sensitive, due to the likelihood of increasing competition and further regulatory changes in the market. However, even with these changes incorporated, prices do not have a substantial direct effect on the forecasts. Nevertheless, prices relative to unit labour costs can significantly affect the profitability of firms in the sector, as legal services are labour intensive in their provision. This could be particularly important in the longer-term if increasing competition and regulatory changes constrain price increases, and if firms do not adopt new productivity increasing technology as fast as we are assuming.

**Graph 6: UK legal services sector – prices relative to unit labour costs (% change per year)**



Source: Law Society Research Unit (13 Sep 2017)

<sup>7</sup> Unit labour costs are defined as total employment costs divided by the total volume of turnover. They can therefore be thought of as 'total staff costs per hour of work undertaken'.

## APPENDIX A:

### TABLES OF FORECAST FIGURES

#### UK legal services sector – real turnover forecasts

Years	£m constant 2010 prices	% change per year
2000	20575	3.8
2001	22224	8.0
2002	22561	1.5
2003	23247	3.0
2004	24030	3.4
2005	24845	3.4
2006	26418	6.3
2007	28250	6.9
2008	26393	-6.6
2009	25108	-4.9
2010	25463	1.4
2011	26701	4.9
2012	26850	0.6
2013	28582	6.5
2014	27940	-2.2
2015	28098	0.6
2016	28364	0.9
2017	28670	1.1
2018	29207	1.9
2019	29985	2.7
2020	30824	2.8
2021	31237	1.3
2022	31905	2.1
2023	32532	2.0
2024	33169	2.0
2025	33817	2.0

5-year periods	Average per year over period	Average % change per year over period
1996-2000	18655	5.5
2001-2005	23381	3.8
2006-2010	26326	0.5
2011-2015	27634	2.0
2016-2020	29410	1.9
2021-2025	32532	1.9
2026-2030	36121	2.3
2031-2035	40494	2.3

Source: Law Society Research Unit (13 Sep 2017)

#### UK legal services sector – real net exports (exports minus imports) forecasts

Years	£m constant 2010 prices	% change per year
2000	1387	12.4
2001	1815	30.9
2002	1925	6.0
2003	1915	-0.5
2004	1870	-2.3
2005	2122	13.5
2006	2448	15.4
2007	2820	15.2
2008	2974	5.5
2009	2810	-5.5
2010	2926	4.1
2011	3296	12.7
2012	3006	-8.8
2013	3162	5.2
2014	3471	9.8
2015	2988	-13.9
2016	3055	2.2
2017	3457	13.2
2018	3789	9.6
2019	4031	6.4
2020	4247	5.4
2021	4446	4.7
2022	4665	4.9
2023	4916	5.4
2024	5174	5.2
2025	5445	5.2

5-year periods	Average per year over period	Average % change per year over period
1996-2000	1213	4.1
2001-2005	1929	8.9
2006-2010	2796	6.6
2011-2015	3185	0.4
2016-2020	3716	7.3
2021-2025	4929	5.1
2026-2030	6362	5.2
2031-2035	8210	5.2

Source: Law Society Research Unit (13 Sep 2017)



### UK legal services sector – total employment (number)

Years	000s	% change per year
2000	272	-1.4
2001	284	4.4
2002	298	4.9
2003	302	1.3
2004	305	1.0
2005	308	1.0
2006	302	-1.9
2007	330	9.3
2008	323	-2.1
2009	345	6.8
2010	335	-2.9
2011	332	-0.9
2012	316	-4.8
2013	314	-0.6
2014	326	3.8
2015	323	-0.9
2016	321	-0.8
2017	318	-0.8
2018	316	-0.5
2019	315	-0.3
2020	316	0.1
2021	316	0.1
2022	317	0.3
2023	315	-0.6
2024	314	-0.4
2025	312	-0.6

5-year periods	Average per year over period	Average % change per year over period
1996-2000	#N/A	#N/A
2001-2005	299	2.5
2006-2010	327	1.7
2011-2015	322	-0.7
2016-2020	317	-0.5
2021-2025	315	-0.2
2026-2030	306	-0.6
2031-2035	299	-0.4

Source: Law Society Research Unit (13 Sep 2017)

### UK legal services sector – total employment (full-time equivalents)

Years	000s	% change per year
2000	251	-1.2
2001	265	5.4
2002	277	4.7
2003	277	0.0
2004	280	1.1
2005	283	1.1
2006	275	-3.0
2007	300	9.3
2008	294	-2.2
2009	314	7.0
2010	303	-3.5
2011	302	-0.3
2012	290	-4.1
2013	289	-0.2
2014	295	1.9
2015	293	-0.5
2016	291	-0.6
2017	289	-0.8
2018	288	-0.4
2019	287	-0.2
2020	288	0.1
2021	288	0.1
2022	289	0.3
2023	287	-0.6
2024	286	-0.4
2025	284	-0.6

5-year periods	Average per year over period	Average % change per year over period
1996-2000	#N/A	#N/A
2001-2005	276	2.4
2006-2010	297	1.4
2011-2015	294	-0.7
2016-2020	289	-0.4
2021-2025	287	-0.3
2026-2030	279	-0.6
2031-2035	272	-0.4

Source: Law Society Research Unit (13 Sep 2017)

*UK legal services sector – full-time employees in employment*

Years	000s	% change per year
2000	187	-1.6
2001	204	9.1
2002	213	4.4
2003	208	-2.3
2004	210	1.0
2005	212	1.0
2006	217	2.4
2007	227	4.6
2008	223	-1.8
2009	234	4.9
2010	218	-6.8
2011	222	1.8
2012	213	-4.1
2013	219	2.8
2014	219	0.0
2015	218	-0.5
2016	218	0.0
2017	217	-0.6
2018	216	-0.2
2019	216	0.0
2020	217	0.3
2021	217	0.0
2022	218	0.3
2023	216	-0.6
2024	216	-0.3
2025	215	-0.5

5-year periods	Average per year over period	Average % change per year over period
1996-2000	#N/A	#N/A
2001-2005	209	2.5
2006-2010	224	0.6
2011-2015	218	0.0
2016-2020	217	-0.1
2021-2025	216	-0.2
2026-2030	211	-0.5
2031-2035	207	-0.4

Source: Law Society Research Unit (13 Sep 2017)

*UK legal services sector – part-time employees in employment*

Years	000s	% change per year
2000	42	-4.5
2001	39	-7.1
2002	42	7.7
2003	50	19.0
2004	50	0.0
2005	50	0.0
2006	55	10.0
2007	60	9.1
2008	59	-1.7
2009	62	5.1
2010	64	3.2
2011	60	-6.3
2012	53	-11.7
2013	50	-5.7
2014	63	26.0
2015	60	-4.8
2016	59	-2.3
2017	58	-1.7
2018	57	-1.2
2019	56	-1.0
2020	56	-0.4
2021	56	0.5
2022	57	0.9
2023	57	-0.4
2024	57	-0.3
2025	56	-0.6

5-year periods	Average per year over period	Average % change per year over period
1996-2000	#N/A	#N/A
2001-2005	46	3.5
2006-2010	60	5.1
2011-2015	57	-1.3
2016-2020	57	-1.3
2021-2025	57	0.0
2026-2030	55	-0.7
2031-2035	54	-0.4

Source: Law Society Research Unit (13 Sep 2017)

**UK legal services sector – other employment  
(partners, directors, owners and self-employed)**

Years	000s	% change per year
2000	43	2.4
2001	41	-4.7
2002	43	4.9
2003	44	2.3
2004	45	2.3
2005	46	2.2
2006	30	-34.8
2007	43	43.3
2008	41	-4.7
2009	49	19.5
2010	53	8.2
2011	50	-5.7
2012	50	0.0
2013	45	-10.0
2014	44	-2.2
2015	45	2.3
2016	44	-2.4
2017	44	-0.9
2018	43	-0.8
2019	43	-0.8
2020	43	-0.5
2021	43	-0.1
2022	42	-0.1
2023	42	-1.1
2024	42	-0.8
2025	41	-1.0

5-year periods	Average per year over period	Average % change per year over period
1996-2000	#N/A	#N/A
2001-2005	44	1.4
2006-2010	43	2.9
2011-2015	47	-3.2
2016-2020	43	-1.1
2021-2025	42	-0.6
2026-2030	40	-1.0
2031-2035	38	-0.9

Source: Law Society Research Unit (13 Sep 2017)

**Housing transactions – number of transactions  
(England & Wales)**

Years	Number	% change per year
2000	1111404	-5.6
2001	1226922	10.4
2002	1329753	8.4
2003	1236738	-7.0
2004	1249639	1.0
2005	1044991	-16.4
2006	1308139	25.2
2007	1255348	-4.0
2008	638164	-49.2
2009	617370	-3.3
2010	656975	6.4
2011	655612	-0.2
2012	665610	1.5
2013	815539	22.5
2014	971175	19.1
2015	964616	-0.7
2016	925045	-4.1
2017	850418	-8.1
2018	824061	-3.1
2019	817006	-0.9
2020	811466	-0.7
2021	775006	-4.5
2022	774974	0.0
2023	777090	0.3
2024	779047	0.3
2025	780855	0.2

5-year periods	Average per year over period	Average % change per year over period
1996-2000	1070544	7.2
2001-2005	1217609	-1.2
2006-2010	895199	-8.9
2011-2015	814510	8.0
2016-2020	845599	-3.4
2021-2025	777394	-0.8
2026-2030	790356	0.4
2031-2035	805161	0.3

Source: Law Society Research Unit (13 Sep 2017)

## APPENDIX B:

### FURTHER DETAILS OF THE LEGAL SERVICES SECTOR MODEL

The model and forecasts are for the UK legal services sector as a whole (i.e. the combined turnover, exports, employment etc of solicitor firms, barrister firms, and other legal service providers such as licensed conveyancers, patent and copyright agents that undertake 'paid for' legal work).

The model is based on Office for National Statistics (ONS) Annual Business Survey data for the UK legal services sector and ONS data for the UK economy, over the period 1995-2016. The relationships (equations) in the model are estimated using econometric techniques. This has enabled us to determine (a) which factors best explain movements of key variables (turnover, employment, net exports, and prices) in the legal services sector, (b) the magnitude of the effects of these factors on the variables, and (c) how quickly the factors affect the variables. The methodology also enables us to assess the degree of confidence in the estimated relationships (i.e. how closely the estimated relationships accurately reflect how the market actually works). The scope of the model is constrained slightly by the data available, but the model does explain at least 90% of the movements of key variables in the legal services sector.

The detailed structure of the model is shown in the flowchart on pages 24 and 25.

Real turnover (variable **rturn**) of firms in the UK legal services sector (the measure of the 'volume' of legal work done by the sector) is broadly determined by factors relating to the demand for legal work from the business sector and factors relating to the demand for legal services from personal consumers. The two main factors relating to business demand are the real profits of (non-financial) businesses in the economy (**rprof**) and output of the UK

financial sector (**yfin**). Financial sector output is included separately as it is an important source of business for the legal sector. The main factors relating to demand from personal consumers are the real (i.e. inflation-adjusted) disposable (i.e. after tax) income of households (**rhhdi**), the number of housing transactions (**htrans**), and the average unemployment rate (**ur**). Unemployment is included in the real turnover part of the model as, under normal circumstances, an increase in unemployment would be expected to lead to some increase in legal work (e.g. through increased social welfare work and also possibly increased criminal law work). However, the effects of unemployment are relatively small compared to the effects of other factors. Real net exports (inflation adjusted exports minus imports) of legal services (**rnetexp**) and prices of legal services (**pdlegserv**) relative to the general level of consumer price inflation (**cpi**) are also included in the real turnover model. Exports relate to work undertaken in the UK by UK-based law firms for non-UK clients and are therefore included in UK legal services sector turnover. Legal services prices do not appear to have a major effect on real turnover, reflecting that most legal services are a 'derived demand' (i.e. are bought as a necessary input into other activities or actions). However, there is some evidence that users of legal services have become more price sensitive over the past three to four years (approximately the post LASPO period) and this change is incorporated in the model using a 'shift' variable (**dlaspo**) on the real prices of legal services. The real turnover model also includes an adjustment for the expected increase in legal work from the process of the UK leaving the EU.

Housing transactions (**htrans**) are included in the model in more detail as, although residential conveyancing work accounts for a relatively small proportion of the total value of legal work undertaken (approximately 4-6% of solicitor firms total turnover is accounted for by residential conveyancing work), the magnitude of increases and decreases in housing transactions that can occur from year to year mean that they can have a significant effect on the rate of change in total turnover of the legal sector. The

main factor determining the number of housing transactions each year is the affordability of housing (**afford**) (i.e. average house prices relative to average disposable income per household. Affordability is calculated as average 'real' house prices (**rhp**) divided by average real disposable income per household, where average real house prices are defined as average £ house prices (**hp**) divided by consumer prices (**cpi**) and average real disposable income per household is defined as total real disposable income of households (**rhhdi**) divided by the total number of households in the UK (**hh**). Average mortgage rates (**mortrate**) are also included in the housing transactions model, although changes in mortgage rates mainly only have an effect on transactions in the short-to-medium term, as increases in rates mostly lead people to delay house moves rather than abandon them altogether. Similarly, decreases in rates can enable people to bring forward moves. There are also two types of one-off factors included in the transactions model. Factors are included relating to the Government's help-to-buy Mortgage Guarantee scheme (which ran from 1 April 2013 to 31 Dec 2016) (dummy variable **dhtbmg**) and its Equity Loans scheme (which was introduced on 8 Oct 2013 and is expected to finish at the end of 2020) (dummy variable **dhtbels**). As these two schemes have only been in existence since 2013, they appear in the model as a single combined weighted average variable (**dhtbwtdav**) as it is difficult to distinguish between their effects over this short time period. Special factors are also included to take account of the run-up to the 2007-08 financial crisis (dummy variable **d2006**) and the actual downturn in 2008 (dummy variable **d2008**). These factors show that the crisis not only involved a sharp downturn in 2008, but also an unusually buoyant market in the run-up to the crisis in 2006. It is estimated from the model that the financial crisis was responsible for approximately a 60% fall in transactions in 2008, but the unusually buoyant market in the run-up to the crisis was responsible for transactions being approximately 29% higher in 2006 than they would otherwise have been.

Real net exports of legal services (**rnetexp**) are mainly determined by the level of economic activity in other advanced economies (**gdpadv**), as these economies continue to be the main source of non-UK business for law firms. Real net exports are also affected by the level of economic activity in emerging economies (**gdpemerg**), although the effect is less than that of the advanced economies, and also appears to be more related to significant changes in the rate of growth in the emerging economies. Exchange rates effects are also included in the model, and separate variables are included for the US\$/£ exchange rate (**xrusdgbp**) and the euro/£ exchange rate (**xreurgbp**). Generally, exports of legal services (and other services) are less affected by changes in exchange rates, compared to for example exports of manufactured goods, but the size of the recent change in the £ exchange rates does mean that it could have a significant effect on legal services exports.

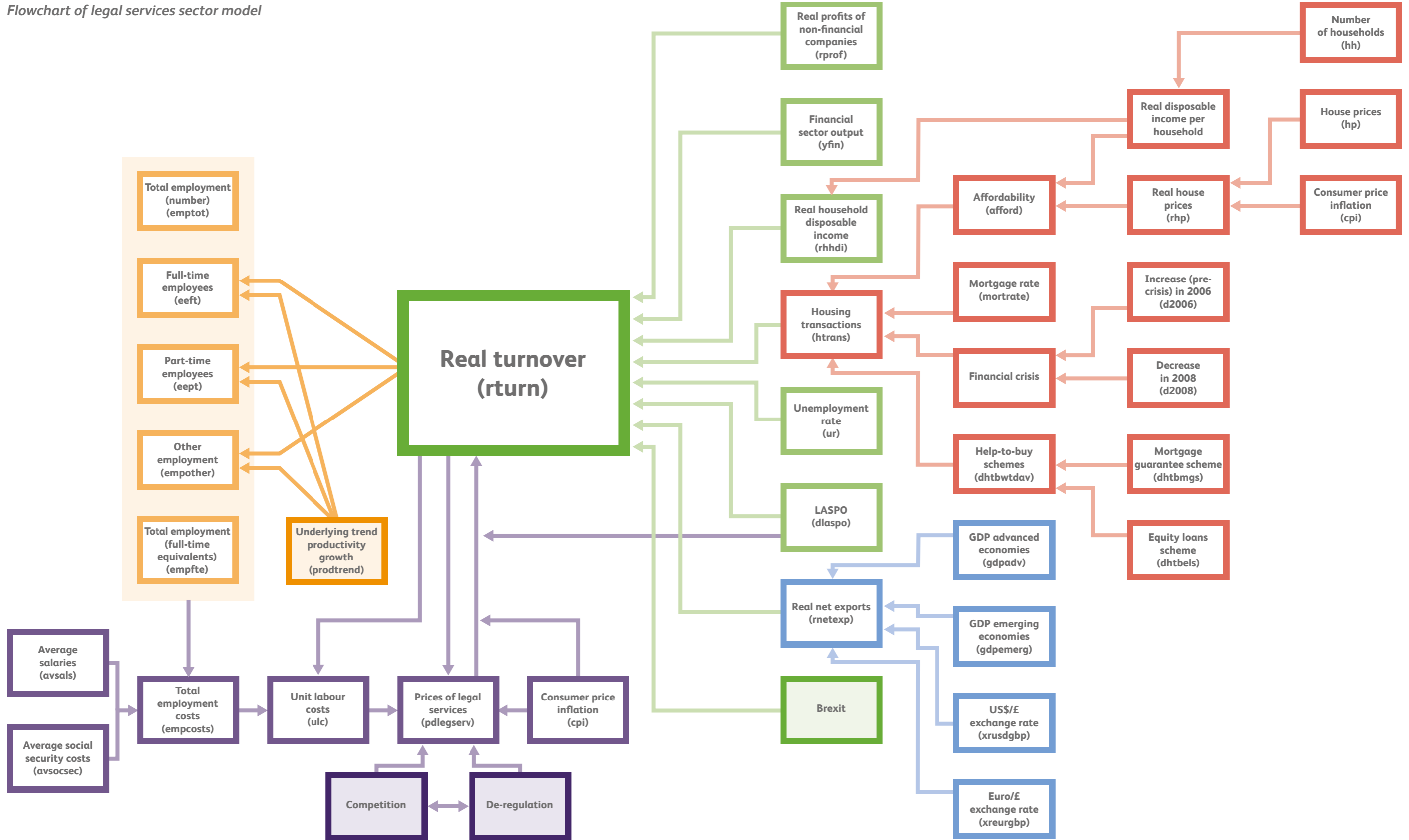
Employment in the legal services sector is determined by the level of real turnover in the sector, and in the longer term also by the underlying trend rate of productivity growth. The employment models also take into account that a change in firms' turnover does not immediately lead to a change in employment, as when turnover increases, the costs of hiring and training new staff and the initial uncertainties about whether an increase in turnover will persist, mean that changes in turnover may not be fully reflected in employment until after a year or possibly two years. Similarly, when turnover decreases, it may take time to be fully reflected in employment numbers. Separate models are included for the number of full-time employees employed in the sector (**eeft**), the number of part-time employees employed (**eept**), and for the number of 'other' staff employed (**empother**) which in the legal services sector mainly consists of partners, directors, owners and the self-employed. Total employment in the sector (**emptot**) is the sum of these three variables. The main constituent of total employment in the sector though is the number of full-time employees employed, accounting for approximately 65%-70%

of total employment. Total employment in terms of the number of 'full-time equivalent' jobs (**empfte**) is also calculated, where each full-time job is counted as one position and each part-time job is counted as ½ position. Underlying trend productivity growth is estimated from a time trend variable (**prodtrend**), and appropriate changes are made to the time trend for the forecasts to take into account expected increases in productivity from factors such as increasing automation of legal services functions.

Firms in the sector mostly set prices as a mark-up on costs (mainly unit labour costs) and relative to the general level of inflation in the economy as a whole. This is represented in the price model in which average prices charged for legal services (**pdlegserv**) are determined by unit labour costs (**ulc**) and the general level of inflation in the economy as measured by the consumer prices index (**cpi**). The model also includes a 'pressure of demand' variable (the variable **rturn** from the real turnover model) to take account of how prices are also adjusted slightly upwards or downwards according to whether demand is above or below average, although these 'pressure of demand' effects on firms do seem to be relatively small in the legal services sector. Unit labour costs are calculated as total employment costs (**empcosts**) divided by the total volume of work undertaken as measured by real turnover (**rturn**). Total employment costs are calculated as average salaries per member of staff (**avsals**) plus average social security costs (i.e. employer's National Insurance Contributions and employer's pension contributions) (variable **avsocsec**), multiplied by the total number of full-time equivalent staff employed. Assumptions are currently made in the model about the likely future change in average salaries and average social security costs. The legal services' prices model also includes an adjustment for expected lower prices resulting from competition and further regulatory changes in the market.

The forecasts for the UK legal services sector are based on the macroeconomic forecasts for the UK economy produced by the National Institute of Economic and Social Research (NIESR) and forecasts for world economic demand produced by the IMF. These macroeconomic forecasts have then been fed into our forecasting model. Projections for the total number of households in the UK from the Department for Communities and Local Government are also used to calculate disposable income per household to use in the affordability term in the housing transactions model. Key assumptions relating specifically to the legal services sector are made with respect to underlying trend rate of productivity growth, the effects on prices of increasing competition and regulatory changes, and the effects on real turnover of the expected increase in legal work from the process of the UK leaving the EU.

Flowchart of legal services sector model





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