Can a Libertarian Accept the ATSB?

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On September 22, 2001, President Bush signed into law the "Air Transportation Safety and System Stabilization Act" (ATSSSA). The Act provides for up to $10 billion in federal loan guarantees to assist air carriers who suffered losses in the wake of the terrorist attacks of September 11, and to whom credit is not otherwise reasonably available from financial institutions. In order to receive the loan guarantees, airlines' applications must be approved by the Air Transportation Stabilization Board (ATSB), whose membership includes designees of the Federal Reserve chairman, the secretary of the treasury, the secretary of transportation, and the comptroller general. The board can offer air carriers loan guarantees of less than 100 percent of the loan amount for up to seven years.

No one questions that the U.S. commercial aviation industry (especially the passenger sector) suffered severe financial losses as a result of September 11. Few people also question that the industry, overall, was teetering on the financial brink before the terrorist attacks; the eight largest air passenger carriers posted combined net losses of $7.5 billion in 2001, with estimated losses of $8 billion for 2002. Thus, many supporters of a free market/libertarian philosophy may look on the work of the ATSB with a cynical eye. But I believe the board's efforts can be lauded because its members have diligently stayed true to the ATSSSA's stated purpose and have not "mission crept" into the role of trying to "save" the airline industry from its non-September 11 malaise.

ATSB EVALUATION CRITERIA

As a former loan officer with the New Jersey Economic Development Authority, I am familiar with the criteria used for providing loans and loan guarantees to the business community. After reviewing the regulations for the ATSSSA program, I conclude that the set of financial and economic criteria used to evaluate and approve air carrier applications meets or exceeds that employed in the banking industry. For example, risk evaluation factors that underlie ATSB judgment include the borrower's ability to repay the loan by a specific date, adequate assets to secure the guarantee in case of default, and the ability of the lender to administer the loan in full compliance with the requisite standard of care. Furthermore, the ATSB also gives loan guarantee preference to applicants that meet the greatest number of the following criteria:

- A financially sound business plan.
- Greater participation in the loan by non-federal and private entities.
- Federal participation in the financial success of the air carrier and its security holders.
- Concessions by security holders, creditors, or employees that will improve the financial condition of the air carrier so that it will be better able to repay the loan and operate on a financially sound basis after repayment.
- The guaranteed loan proceeds will be used for a purpose other than repaying debt.
- The proposed credit instruments contain financial strictures that minimize the federal government's risk and cost associated with making loan guarantees.

This in-depth financial analysis supports the ATSB's charge (or fiduciary responsibility) to protect taxpayers' money, i.e., to ensure loans are repaid by the airlines to financial institutions. In addition to post-September 11 financial and economic data on each company's performance, the board examines data from previous years' financial statements to ascertain the economic health of the firm. Those data are compared to airline industry averages to ascertain whether the applicant air carrier has been exceeding, matching, or falling short of the industry annual performance data. The ATSB carefully evaluates the economic impacts of September 11 on each applicant firm, but poor pre-September 11 economic and financial performance is not rewarded with a loan guarantee. That was not the intended purpose of the Act nor has the board expanded its legislative charge.

THE ATSB'S RECORD

What has been the performance of the ATSB through the end of 2002? Of 15 air carriers who applied for loan guarantees, only six received approval or conditional approval.

The most newsworthy ATSB decision was the December 4, 2002 rejection of an application from United Airlines (the nation's second largest air passenger carrier) for a $1.8 billion guarantee of a $2 billion loan that the airline desperately needed. Five days later, United filed for Chapter 11 bankruptcy protection, which made it the largest bankruptcy in aviation history. Prior to its bankruptcy filing, the airline reported that it was turned down for loans from 25 banks, while credit agencies downgraded its debt well into the "junk" territory, thereby effectively eliminating its ability to raise funds from either debt (bond) or equity (stock) markets. While there has been criticism of the board's approval of the $900 million gurantee

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to U.S. Airways, the members' unanimous decision is predicated on a company business plan that offers convincing "substantial and diverse cost savings" as well as "credible revenue assumptions" that reasonably assure a viable airline.

The total amount of loan guarantees that the ATSB has extended as of the end of 2002 is a little over $1.6 billion on a total of just under $1.9 billion of total financing. The amount of loan guarantees rejected by the board through the end of 2002 totaled almost $2 billion. Therefore, the ATSB approved only 40 percent of air carrier applicants for 45.2 percent of all potential loan guarantees. That is only 16.2 percent of the ATSB's loan guarantee capacity of $10 billion. Those results verify that the ATSB has been evaluating each of the air carrier applicants on its individual merits. There is little doubt that the board's decisions have disappointed many of the nation's air carrier executives who had a preconceived notion that applications for loan guarantees were simply a formality for an industry-wide federal government bailout. The results show to the contrary.

A LIMITED ROLE FOR INDUSTRIAL POLICY

The active role that the ATSB has taken as a stabilizing factor in the passenger air carrier industry has been limited yet decisive. Following its legislative mandate, the board has directly intervened where it has found that an airline possesses a business model that has been successful prior to September 11 and, were it not for the economic fallout affecting the industry since then, would still be viable. The fiduciary responsibility of the ATSB's members makes it imperative that the overall financial health and business strategy of the firm be considered because repayment of the loan is of the highest importance.

Air carriers with sub-par performance and lackluster management before September 11 were certainly not going to rise to the occasion in the post-September 11 passenger aviation business environment. For those firms, the ATSB's decision to reject their applications relegated them to the bankruptcy court, either in reorganization (Chapter 11) or final dissolution (Chapter 7). Had the ATSB provided loan guarantees to all 15 airlines, it would have simply prolonged the inevitable march to the bankruptcy courts—but this time taxpayers would have been standing in line as one among many creditors.

What does this say about the ATSSSA exercise in industrial policy? The ATSB has followed its legislated mandate to provide appropriate stabilization of an American industry used as an instrument of war by terrorists. It has followed an economic and financial evaluation process that is similar to that employed by the banking industry. It has limited the financial exposure of public monies by granting loan guarantees to firms that have a reasonably successful business model and adequate security to ensure repayment of their loans. A laissez-faire libertarian who philosophically abhors industrial policy may have reason to feel comfortable that this industry-specific program to assist an industry directly harmed by terrorism has provided an effective policy model for those rare circumstances when government intervention may be a necessary palliative. R

Why Law School Costs so Much

By George C. Leef
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According to a recently released report, the high cost of attending law school is making it hard for government agencies and public interest organizations to recruit good, new lawyers. The report — "From Paper Chase to Money Chase," released by a group named Equal Justice Works — inadvertently calls attention to a harmful market intervention that ought to be ended.

The report concludes that the average law student today leaves school with debts of more than $84,000. Many law students who were surveyed by Equal Justice Works claimed that their need to pay off their law school debts affects their choice of employment options. Their high debt levels make them chase the money— that is, they gravitate toward law firms that offer higher pay. The public and non-profit sectors therefore lose out on a large number of those debt-plagued students who might otherwise have chosen to devote themselves to public service. The group also surveyed public-sector employers to learn if they are having difficulty in recruiting young lawyers. Unsurprisingly, most said that they are, although the degree of that difficulty was not explored in the report.

CONNIVANCE

The obvious question raised (but never mentioned) in "From Paper Chase to Money Chase" is why the cost of law school is so high. Should a legal education have to cost as much as it does?

The answer to that question is no, but thanks to a connivance between state legislatures and the American Bar Association, law school costs much more than it needs to. If we allowed a free market in legal education, the cost of preparing for a legal career would fall dramatically.

To see how the current connivance came about, let us look back in time. At the beginning of the twentieth century, those who aspired to enter the legal profession could take several different routes to do so. One was simply to study law individually, as Abraham Lincoln did more than a half-century earlier. A second route was to apprentice oneself to a law firm and learn "on the job," as Clarence Darrow did. A third option was to go to law school.

Law schools then varied greatly, with some offering a one-year course of study, many offering a two-year program, and a small number of elite schools offering a three-year curriculum. A prospective lawyer could choose the type of legal education he thought best, given his circumstances. Apprenticeship was the most common route, but notable lawyers rose into the profession through each of the approaches.

In 1921, the American Bar Association undertook to "professionalize" legal education. Using the age-old excuse that consumers would benefit from "high standards," the ABA sought to impose the three-year law school model as the only route into the legal profession. In truth, consumer welfare had little to do with the ABA's motivation; many lawyers were complaining of excessive competition that kept fees lower than they thought they should be, and the ABA simply wanted to restrict supply in order to raise the price. A renowned member of the legal profession, Richard Posner, has likened the ABA's move to the formation of a legal guild to restrict entry and limit competition as much as possible.

To accomplish its objective, the ABA began lobbying legislatures across the nation for statutes that would hamstring all kinds of legal study that were not in accordance with the three-year model. Most of the states obliged, enacting laws that limited eligibility to take the state bar exam to individuals with degrees from ABA-accredited law schools. Because most lawyers regard bar membership as crucial to their success, those laws shut down the non-law school avenues into the profession and put control of law schools in the hands of the ABA. Currently, only four states — Alabama, California, Massachusetts, and Tennessee — allow a new graduate of a non-accredited law school to sit for the bar exam.

The ABA also took the offensive against legal practitioners who were not members of the bar by successfully lobbying for laws to prohibit "unauthorized practice of law." Even when a non-bar member gives perfectly good legal assistance to another person who is aware that the individual assisting him is not a licensed attorney, the law against "unauthorized practice" has been violated. State and local unauthorized practice committees police such illegal competition with the ferocity of junkyard dogs.

In its quest for a monopoly over the training of future lawyers, the ABA has done what any self-interested guild would do: raise barriers to entry.

HIGH COSTS FOR LEGAL EDUCATION

The ABA's accrediting body, the Council of the Section of Legal Education, has established standards that are designed to keep law school very costly and restrictive. Among those standards:

- **Law schools must be non-profit institutions.** Assuming either that the profit motive is bad or that a profit-minded law school might be too interested in findings ways to reduce costs, the ABA's accreditation rules say that only non-profit institutions can qualify. So, while for-profit schools are finding innovative ways to deliver educational offerings to more and more Americans, the ABA will not allow those schools in the field of legal education.

- **Law school faculties must be staffed mostly with**

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full-time instructors. The ABA regards it as a sign of professionalism that law school courses are taught by full-time academics. Although it would be much less expensive (and perhaps more beneficial to students) in many cases to have courses taught by adjuncts — for example, a practicing criminal attorney might teach criminal law — the ABA is against it. The use of adjunct faculty is not entirely forbidden, but schools that do not rank among the elite are given significantly less leeway to do so; if Harvard wants to have a retired judge teach a class, it is no problem, but if a lesser renowned school wants to do the same thing, that may endanger its accreditation.

■ **The teaching workloads of faculty members must be kept low.** The ABA's professional model envisions law professors who are scholars and have lots of time for research. Many professors teach only three or four hours a week.

■ **Law schools must have a three-year program of instruction.** Most law students regard the third year as a great waste of time and money in which they obtain the needed credits by taking whatever courses look at least somewhat interesting or useful. Nevertheless, if a law school were to confer degrees after only two years of study and let its students go off to earn a living, the school would lose its accreditation.

■ **Law schools must have elaborate, expensive facilities.** Like many ABA rules, this one is vaguely written, saying that the physical facilities must not have "a negative and material effect" on the students' education. That vagueness gives the ABA great leverage to demand improvements and even new buildings. It is not unusual for university budgets to be thrown into disarray because the ABA has insisted that the law school needs improved facilities.

■ **Law schools must invest heavily in library holdings.** That requirement forces the schools to purchase thousands of hardcover volumes, most of which will rarely be opened because much legal research today is done online or by using CD-ROMs.

All of those input rules drive up the cost of legal education greatly. For example, the tuition cost of attending any of the ABA-accredited law schools in the Boston area is more than twice the cost of attending the unaccredited Massachusetts School of Law (which charges about $12,000 a year). But that comparison certainly does not go far enough. If entrepreneurs were free to find ways of delivering the optimal amount of legal education, there is no reason to doubt that many law students would be able to obtain the education they want at a far lower cost.

TRUE LEGAL EDUCATION

Is there a justification for the ABA model? Could it be argued that, given the enormous amount of law that we have these days, three years of law school is barely adequate? Would we have under-prepared lawyers if we again allowed law schools with one- or two-year programs?

The answer is no. The fact of the matter is that very little of what lawyers need to know is learned in law school. Every field of law is so vast that the most a student can do is become familiar with the major rules and cases. Almost everything that he needs to know in his chosen area of practice he will learn on the job. Not infrequently, a lawyer winds up specializing in a field that he did not study in law school, and he is none the worse for it.

Lawyers, like other professionals, have a strong incentive to make the optimal investment in knowledge. There is no need to require that prospective lawyers spend any particular length of time in schools of any particular kind. Lawyers will learn what they need to know about intellectual property or commercial law or whatever they specialize in, no matter what the state deems necessary for licensure. Mandating three years of law school does not protect consumers from incompetence; it protects existing legal practitioners against new competitors, and especially protects the employees of law schools against the effects of innovation and efficiency. R