VIII

REMARKS AT WEDNESDAY MORNING SESSION

By Michael N. Simkovic

Associate Professor at Seton Hall University School of Law and 2015 ALI Young Scholars Medal Co-Recipient

The Wednesday morning session of The American Law Institute convened in the Ritz-Carlton Ballroom, Washington, DC, on May 18, 2016. President Roberta Cooper Ramo presided and The Honorable Goodwin Liu, Chair of the ALI Young Scholars Medal Committee, introduced Professor Simkovic.

President Ramo: It's very exciting for me to call to the podium Justice Goodwin Liu, who is the Chair of our Young Scholars Medal Committee, and Michael Simkovic, who is our second Young Scholar of this round to make a presentation. So, Michael and Goodwin, if you will come forward.

I might note, while they come forward, that we're very appreciative to several of you who make significant contributions to allow us to support the Young Scholars Program, and those of you who have made gifts to the Class Gift efforts because that also helps support the Young Scholars Program. Thank you.

Justice Goodwin Liu (CA): Good morning. It's my great pleasure to have chaired the ALI Young Scholars Medal Selection Committee for the last few years. This is the third round of awards that the ALI has given, in an effort to recognize early-career academics who are engaged in practical scholarly work with real potential to influence law reform.

Our definition of "young" in Young Scholars encompasses anyone who has been a full-time academic for at least three and not more than 10 years and who is within 15 years of having received his or her law degree. Each medal recipient is awarded a $5000 prize and, in addition, is given an opportunity to speak at an ALI Annual Meeting and to convene an ALI conference on issues that are related to their work.

This past round, we received 61 nominations, spanning a very wide range of subject matters and analytical methods and lots of different law schools, by the way, from all across the country. Our Committee narrowed this pool down to 10 finalists, and for each of these candidates we considered his or her most substantial work.

This typically meant reviewing 150 to 200 pages of writing for each candidate. So this was a lot of work, and I want to give credit to the members of the Committee for all the time and effort they put in.

This past round, the Committee was comprised of Kate Bartlett from Duke; Rochelle Dreyfuss from NYU; Christine Durham from the Utah Supreme Court; Jesse Furman, a federal judge in the Southern District of New York; Phoebe Haddon from Rutgers–Camden; Howell Jackson from Harvard; Jack Jacobs from the Delaware Supreme Court [and now with Sidley Austin]; George Newcombe from Simpson Thacher; Eric Posner from the University of Chicago; Roberta Ramo from everywhere; Randy Shepard from the Indiana Supreme Court and now Indiana University; Stuart Singer from Boies, Schiller; Henry Smith from Harvard; Kate Stith from Yale; David Stras from the Minnesota Supreme Court; and Jon Tigar from the Northern District of California. And, of course, Ricky was lending us his wisdom and insight at every stage of this process.

For the next round, this process will be chaired by my colleague on the California Supreme Court Tino Cuéllar. I guess it has become a qualification for the Chair of this Committee to be a member of the California Supreme Court. We are looking for new nominations of candidates. Those of you who are familiar with the scholarly world may want to give some thought to that and give input to the law deans who are out there.

From my experience on this Committee, I would say that the most significant, distinguishing factor that makes a candidate competitive in this process is that the scholarly work has to have some real payoff in the world, some real practical potential to influence law reform. We do get a number of submissions every year that look like tenure files, and tenure files are fine. But some of the work is a little too theoretical. That kind of scholarship can get you tenure, but it will not get you a Young Scholars Medal from the ALI. So that's something just to keep in mind.

We had a very robust and thoughtful discussion, in a locked room in our courthouse at the California Supreme Court. And at the end of it, we were pleased to select two recipients. The first was Professor Elizabeth Chamblee Burch from the University of Georgia, whom you heard last year, at this Meeting, speak about her expertise on civil procedure and aggregate litigation.

And this year, we're very delighted to welcome Professor Michael Simkovic from Seton Hall. Professor Simkovic joined the faculty of Seton Hall in 2010, and his research focuses on the regulation of credit markets through the U.S. Bankruptcy Code, and the regulation of financial markets in general through disclosure requirements. He's an expert on the credit-card industry, the causes of the financial crisis of 2008, credit default swaps, securitization, leveraged buyouts, and other topics at the intersection of law and financial markets.

Just six years into his academic career, Professor Simkovic has authored more than a dozen articles on these subjects, already with very significant impact. Congress cited his research when it enacted reform of the credit-card industry in 2009. His work showed that changes to the Bankruptcy Code that reduced losses to credit-card companies did not lead to lower credit prices but rather increased the profits of credit-card lenders. And this work was featured on the front page of *The New York Times*, and the 2009 credit-card legislation addressed many of the problems Professor Simkovic identified by mandating simpler disclosures and more standardized credit-card terms. And I believe he's going to tell us a little bit about that research in his talk today.

One of his articles, called "Competition and Crisis in Mortgage Securitization" [88 IND. L.J. 213 (2013)], is one of the most widely read articles about the causes of the subprime mortgage crisis. It's rigorous yet written in a very accessible way, which our Committee appreciated. And this article was cited by the Government Accountability Office, the GAO, in setting the framework for housing-finance reform.

I first encountered Professor Simkovic's work while serving on an ABA task force on the financing of legal education. In addition to his research on credit and the financial markets more generally, Professor Simkovic is widely cited for his 2014 article with Frank McIntyre in the *Journal of Legal Studies* called "The Economic Value of a Law Degree" [43 J. LEGAL STUD. 249 (2014)]. In that article, he counters the most vocal critics of legal education today with sober, empirical analysis showing that for most law graduates, the present value of a law degree exceeds its costs by several hundred thousand dollars. This work continues to play a major role in debates on federal student loans and higher-education policy and it even earned him a photo on the cover of *National Jurist* magazine as one of the most influential persons in legal education.

Professor Simkovic is going to speak to us today on credit markets and their coordinating function. This talk is a tour of all of his scholarship woven together into a very integrated narrative, and I look forward to hearing it.

Please join me in welcoming our Young Scholars winner. (*Applause*)

[*Footnotes provided by the speaker have been included here for the benefit of the reader.*]

Professor Michael N. Simkovic (NJ): Good morning. Thank you, Justice Liu, for your kind introduction and thank you to everyone at The American Law Institute. I'm very grateful for this honor.

In 1897, Oliver Wendell Holmes said in *The Path of the Law* that "For the rational study of the law, the blackletter man may be the man of the present, but the man of the future is the man of statistics and the master of economics."[1] As Holmes predicted, economic analysis and quantitative methods are reshaping legal scholarship today.

My research uses economic analysis to explore how laws affect financial markets and how courts and regulators can use financial information to make legal and policy decisions.

Ideally, financial markets help solve a fundamental problem: how to coordinate billions of people's activities to increase the world's collective standard of living. Isolated individuals can barely feed, clothe, and shelter themselves. On the other hand, a system that enables individuals to specialize can support a modern, sophisticated civilization.

---

[1] Justice Holmes, *Path of the Law*, 1 BOSTON L. SCHOOL MAG. 1, 11 (1896).

Credit markets help coordinate activities by expanding the concept of reciprocity—"I will do something for you now if you do something for me later"—to vast numbers of individuals who are unrelated and do not know each other. Resources can be moved through time and space, collected and distributed seamlessly and efficiently.

Many of us came to this conference using transportation networks that were financed and built decades ago by people we have never met. I like to think of credit as "time travel for reciprocity."

Financial markets serve another vitally important function—they allocate resources by enabling investors with different views and different pieces of information to vote on the likelihood that an investment will be successful by putting their own resources at risk. Credit markets are three times as large as equity markets.[2]

From the perspective of creditors, equity exists to absorb unpredictable risks so that credit functions smoothly and predictably. Like the hood of the modern automobile, equity is there to crumple on impact so that the passenger compartment, where the creditors sit, remains safe.

Credit markets usually work well. However, there is a fundamental tension between credit markets' resource-allocation function and market participants' goals.

What economists see as information asymmetries, business people view as proprietary information and a source of competitive advantage. What economists see as efficient competition, corporate strategists view as barriers to profitability. I have spent much of my academic career exploring these tensions.[3]

---

[2] Susan Lund et al., McKinsey Global Institute, Financial Globalization: Retreat or Reset? Mar. 13, 2013 at 2.

[3] Amedeo De Cesari et al., *The Effects of Ownership and Stock Liquidity on the Timing of Repurchase Transactions*, 18 J. CORP. FIN. 1023 (2012); Michael Simkovic, *The Effect of Mandatory Disclosure on Open-Market Repurchases*, 6 BERKELEY BUS. L.J. 96 (2009).

In the mid-2000s, bankruptcy-reform advocates promised Congress that restricting Chapter 7 discharge of consumer debts would reduce the cost of credit to consumers. I found that the 2005 bankruptcy reforms did reduce credit-card companies' losses but did not lead to lower credit-card prices for consumers.[4] Rather, credit-card lenders earned higher profits. The credit-card industry consolidated and used complicated contracts that made it difficult for consumers to shop for better prices and terms.

If the consumer-credit markets were perfectly competitive and efficient, we would expect legal changes that reduced credit-card-company losses to benefit consumers with lower prices or increased access to credit. But my research and the research of other scholars suggest that consumer-credit markets are less than perfectly competitive and efficient.[5]

In 2009, Congress responded by enacting the CARD Act [the Credit Card Accountability, Responsibility, and Disclosure Act, Pub. L. No. 111-24, 123 Stat. 1734 (2009) (codified as amended in scattered sections of 15, 16, and 31 U.S.C.)] to simplify credit-card pricing and make it easier for consumers to understand.[6] In 2010, Congress created the Consumer Financial Protection Bureau.

When the credit system does not work well, the ramifications are widely felt. Studying periodic financial crises can generate new insights and strengthen the credit system.

---

[4] Michael Simkovic, *The Effect of BAPCPA on Credit Card Industry Profits and Prices*, 83 AM. BANKR. L.J. 1 (2009); Michael Simkovic, *Credit Card Reform and Bankruptcy Reform*, 1 NORTON BANKR. L. ADVISER 1 (2009).

[5] Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50 (1991); Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behaviorism, and the Misguided 'Reform' of Bankruptcy Law*, 84 TEX. L. REV. 1481 (2006); Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2003); Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Evidence from U.S. States*, 24 REV. FIN. STUD. 3139 (2011); RAJEEV DAROLIA & DUBRAVKA RITTER, DO STUDENT LOAN BORROWERS OPPORTUNISTICALLY DEFAULT? EVIDENCE FROM BANKRUPTCY REFORM (2015).

[6] CAROLYN B. MOLONEY & CHARLES E. SCHUMER, VICIOUS CYCLE: HOW UNFAIR CREDIT CARD PRACTICES ARE SQUEEZING CONSUMERS AND UNDERMINING THE RECOVERY (2009).

For instance, why did the mortgage system malfunction in the mid-2000s, financing massive quantities of housing that borrowers could not afford? I will limit my discussion to one aspect of the mortgage crisis.[7]

Most mortgages were originated by a different entity from the entity that held those mortgages as investments. Originators generally faced little risk if loans ultimately defaulted. Originators were often thinly capitalized. Originators therefore had incentives to maximize volume and to minimize quality-control costs.

Originators sold the mortgages to securitizers, and securitizers then structured mortgages into investment vehicles. Many securitizers had incentives to be cautious. Private-label securitizers such as investment banks often retained the equity or first-loss tranche of the securitization. Other securitizers, the Government Sponsored Enterprises (or GSEs—Fannie Mae and Freddie Mac), guaranteed the mortgages, selling only interest-rate risk but retaining default risk.

Initially, the GSEs were the only game in town. The GSEs restrained originators. If an originator provided too many faulty mortgages, the GSEs stopped buying from that originator.

But then the market structure changed. Originators consolidated. Private securitizers expanded their operations, competing with the GSEs for the supply of mortgages. Power shifted from the securitizers to the originators and riskier mortgages proliferated. The loans with the worst initial characteristics and the worst ex post performance were originated in the years when securitizer power was at its lowest ebb relative to originators.

Yet throughout the mid-2000s, the largest and most powerful securitizers, the GSEs, continued to securitize relatively safer and better-performing loans than their smaller private competitors.

---

[7] Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213 (2013).

Many people find this surprising because the GSEs famously required large injections of capital during the government rescue of the financial-services industry. GSEs required government capital infusions because they securitized and guaranteed such a huge volume of loans that even very low loss rates were enough to exhaust their limited equity capital.

An important implication of this analysis is that market structure influences the power of gatekeepers to regulate risk. We've all heard about "too big to fail." But a system in which gatekeepers like securitizers are small and weak could pose greater dangers.

Another important question raised by the mortgage crisis is why mortgage losses wreaked so much havoc on financial institutions. Why didn't financial institutions have enough equity to absorb these losses? In an efficient and transparent market, financial institutions' creditors should have realized how thinly capitalized financial institutions were relative to the risks they were taking, and insisted that the financial institutions either raise more equity or pay much higher interest rates to compensate creditors for the risk of loss.

In "Secret Liens and the Financial Crisis of 2008," I explored financial institutions' use of opaque credit instruments to hide leverage and risk from investors and regulators.[8] Financial institutions thereby disabled credit markets' self-regulatory mechanisms and borrowed more for less.

For hundreds of years, creditors have been required to disclose their priority to other creditors so that creditors do not overestimate debtors' remaining borrowing capacity.

This centuries-old bargain has been undermined in recent decades by changes to the bankruptcy and commercial law to accommodate new financial instruments such as bankruptcy safe harbors for derivatives. The new laws privilege the least transparent financial

---

[8] Michael Simkovic, *Secret Liens and the Financial Crisis of 2008*, 83 AM. BANKR. L.J. 253 (2009); Michael Simkovic, *Paving the Way for the Next Financial Crisis*, 29 BANK. & FIN. SERVICES POL'Y REP. 3 (2010).

instruments. Greater transparency and disclosure could strengthen the self-regulatory capacity of credit markets, and help prevent future financial crises.

However, notwithstanding some high-profile problems in the last decade, credit markets usually function extremely well. Studies have found that corporate credit markets generally do a much better job than credit-rating agencies or accounting-based financial ratios of assessing risks of default and credit losses.

The ability of credit markets to anticipate risks better than most bellwethers makes credit-market data extremely useful for analyzing whether a corporate debtor was insolvent or inadequately capitalized at a particular point in time.[9] Credit-market data can be useful for solvency opinions in anticipation of leveraged buyouts or other leveraging transactions. Credit-market data is also useful for litigation in areas such as constructive fraudulent transfer and fiduciary duties to creditors in the zone of insolvency.

Fraudulent-transfer litigation has traditionally focused on discounted cash flow and comparable companies' financial analyses. However, these metrics are easily manipulated and subjective. A measurement based on credit-market data such as bond spreads and credit-default-swap spreads, would be more objective, consistent, and predictable.

I developed an objective measure of capital adequacy based on bond and credit-default-swap spreads. Spreads, or the difference in yield between a corporate bond—which *carries* default risk—and a treasury bond—which does *not* carry default risk—largely reflect the corporate-bond issuer's default risk. Bond yields cannot reflect hindsight bias because fixed-income traders price bonds contemporaneously. In liquidly traded and well-informed credit markets, credit-

---

[9] Michael Simkovic, *Making Fraudulent Transfer Law More Predictable*, in HANDBOOK ON BANKRUPTCY (Barry E. Adler ed., 2016); Michael Simkovic & Benjamin S. Kaminetzky, *Leveraged Buyout Bankruptcies, the Problem of Hindsight Bias, and the Credit Default Swap Solution*, 2011 COLUM. BUS. L. REV. 118 (2011).

spread-based measures can provide a contemporaneous assessment of credit risk that is updated on a daily basis.

Recent case law in the Third Circuit and in the Southern District of New York, including the *VFB* case [VFB LLC v. Campbell Soup Co., 482 F.3d 624 (3d Cir. 2007)] and *Iridium* [In re Iridium Operating LLC, 373 B.R. 283 (Bankr. S.D.N.Y. 2007)], support the use of market-based measures. However, these cases used equity and bond prices relative to par—measures that can lead to incorrect results. Bond *prices* can reflect changes in interest rates rather than credit risk. Equity prices could reflect option value rather than risks to creditors. My credit-spread approach avoids these problems. I'm hopeful that courts will move in the direction I have suggested.

If credit-market prices reflect useful information about risk and inform investors' choices, could a market-like mechanism be incorporated into public-lending programs to help guide related private investments? My next project, "Risk-Based Student Loans," proposed using loan-performance data such as default rates and loss severity to inform federal-student-loan pricing.[10] I proposed risk-adjusting interest rates according to field of study to encourage students and universities to prioritize fields that are most in demand in the labor market.

After I presented "Risk-Based Student Loans," some readers asked whether law-student interest rates should be increased (*laughter*) because of poor employment prospects for law graduates. However, I noticed that default rates for law-school borrowers, even from very low-ranked institutions, were much *lower* than overall student-loan default rates. This suggested that law graduates were likely doing relatively well financially.

I investigated law-degree earnings premiums in "The Economic Value of a Law Degree" with labor economist Frank McIntyre.[11] Our

[10] Michael Simkovic, *Risk-Based Student Loans*, 70 WASH. & LEE L. REV. 527 (2013); Michael Simkovic, *A Value-Added Perspective on Higher Education*, 6 U.C. IRVINE L. REV. __ (forthcoming 2016).

[11] Michael Simkovic & Frank McIntyre, *The Economic Value of a Law Degree*, 43 J. LEGAL STUD. 249 (2014); Frank McIntyre & Michael Simkovic, *Timing Law School*, __ J.

findings suggested that a law degree boosts lifetime earnings far more than the cost of the degree for most students under most conditions. Our findings challenged popular narratives. But our findings were consistent with labor-economics studies that find that education generally increases lifetime earnings.

The consistently high returns to higher education raised another important question. How can education possibly be such a good investment? In an efficient market, unusually high returns attract a flood of investment that pushes down returns to ordinary levels.

One possible explanation is our tax system. My article, "The Knowledge Tax," argued that our federal tax system disproportionately taxes labor income more than it taxes income from capital.[12] This places investments in education at a serious disadvantage and leads to inefficient underinvestment in education.

Law depends on predictions about human behavior and how law alters that behavior. These predictions will inevitably be imperfect. Therefore, laws will have unexpected consequences. I believe that improvements in law require an iterative process that tests hypotheses using data. The results of these empirical studies refine our intuitions and enable us to refine our laws. Just as medicine advances by studying the impact of treatments, we can use empirical methods to improve law. We make mistakes, and we learn from those mistakes.

Today, Holmes's vision of a legal system informed by economic and statistical analysis continues to inspire a new generation of legal scholars.

EMPIRICAL LEGAL STUD. __ (forthcoming 2016); MICHAEL SIMKOVIC & FRANK MCINTYRE, VALUE OF A LAW DEGREE BY COLLEGE MAJOR (2016); FRANK MCINTYRE & MICHAEL SIMKOVIC, VALUE OF A LAW DEGREE BY RACE (2016); Michael Simkovic & Frank McIntyre, *Populist Outrage, Reckless Empirics: A Review of Failing Law Schools*, 108 NW. U. L. REV. ONLINE 176 (2014); Michael Simkovic, *Overall Stagnation in Legal Jobs Hides Underlying Shifts*, N.Y. TIMES DEALBOOK, April 1, 2016.

[12] Michael Simkovic, *The Knowledge Tax*, 82 U. CHI. L. REV. 1981 (2015); Shu-Yi Oei, *Supply, Demand, and the Taxation of Knowledge: A Response to Professor Simkovic*, 83 U. CHI. L. REV. DIALOGUE 268 (2015); Michael Simkovic, *Taxes, Subsidies & Knowledge: A Reply to Professor Oei*, 83 U. CHI. L. REV. DIALOGUE (2016).

Thank you very much. I look forward to your thoughts and questions. (*Applause*)

Justice Liu: I think you now know why we selected this young scholar for the prize. Questions from the audience? Microphone 3.

Mr. Vance K. Opperman (MN): I'm curious if you've taken a look at the impact of—specifically, the impact of the Durbin Amendment [Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068-2074 (2010) (codified at 15 U.S.C. § 1693o-2)]. It was passed in 2010. You have perfect economic conditions. You can look at Australia. You can look at the situation in Canada. You can look at the amount that was increased, decreased by the Federal Reserve.

Much of the scholarship I have seen suggests that it was anti-consumer in its effect. But I'm just curious if, in terms of looking at bank fees, if you ever took a look at that?

Professor Simkovic: I have not specifically looked at that, but I can tell you how you would want to go about looking at it. If you're interested in the impact of a law which affects the fees that banks can charge in a particular market, the concern might be that it would make credit less available in that market than it otherwise would have been, which means you need a control.

Imagine what the world would have been like if this law had never been passed, and what would the available credit have been to consumers in that market. This control doesn't actually exist. So you need to create the next best thing, which might be the availability of credit to consumers in a similar market that was not affected by this law, which would generally move in parallel to the availability of credit in the market that was affected. So in order to assess that, you'd need to find other credit markets, probably other U.S. consumer-credit markets where you'd expect credit availability to move in the same direction.

The challenge with the Durbin amendment is that it was passed at a time when consumer credit generally was becoming a lot less available because of economic developments and not just because of legal developments. So you need to tease out whether or not the Durbin amendment caused consumer credit to contract more than it otherwise would have because of other things that were taking place at the same time.

Mr. Opperman: Just one other comment. It was passed, as you may know, with no hearings. It was introduced on the floor. So we don't have any advantage of the usual congressional process. The Federal Reserve had the matter essentially remanded to it by Congress to set a reasonable rate, and they did do some empirical studies, which they were not very anxious to publish.

The comparison that I've seen done is between the credit-card industry, which was not affected by Durbin, some in a different class of creditor is the problem, and the debit-card industry, which was affected by Durbin. And those studies have tended to show an anti-consumer effect.

But thank you for your comment.

Professor Simkovic: Absolutely.

Judge A. James Robertson II (CA): So with respect to the value of a law-school education, there have been a number of lawsuits, class-action suits that have been filed against law schools. Do you have any comments about those? Some of them have had some success. Some haven't.

Professor Simkovic: Right.

Judge Robertson: They're all based on the theory that the law schools overrepresented what the value of an education was through their employment statistics.

Professor Simkovic: That's right. So if you look at the definition of employment that is typically used by labor economists, it's used by the Census. It's used by the Bureau of Labor Statistics. It's a very broad definition.

Employment means employment in any job, whether full or part time, whether related to what the person studied or not, whether requiring your level of education or not. And law schools used that definition of employment, which makes it comparable to many other sources of statistics regarding alternatives to law school.

My understanding is that plaintiffs' claim is twofold. First, that using "employment" in that way was misleading because law schools should have limited employment to only full-time employment or only employment as a lawyer. But that is not how almost anyone else uses employment when they're disclosing employment statistics.

And the second part of the claim is that individuals were harmed by having attended law school financially.

So I'm somewhat skeptical of the claim that using employment, in the way that it's commonly used by people who are compiling employment statistics, for the purposes of disclosing law-school employment statistics is misleading, especially when many law schools were also publishing bar-passage rates, which clearly showed that many of their graduates who were employed were not employed as lawyers.

And with respect to harm, there probably are some individuals who had really great opportunities other than going to law school. Maybe someone had an offer from a fabulous investment bank or had an admissions letter from medical school. And those people might have been harmed by going to law school. It's possible that those people would have been better off pursuing one of those alternatives.

But that is going to be a very small subset of the group of people who attended law school. For many of the people who attended law school, it's unlikely that they had an alternative that was financially superior.

Judge Robertson: So thank you. My further comment or question to you has to do with the statistics. So the claim in the suits is that it's very misleading to use statistics for students that are employed in restaurants or something like that, when they're undergoing a lot of debt to attend law school with the expectation that they'll get a law job afterwards.

Professor Simkovic: Right.

Judge Robertson: So do you have any comment on that? I take it you were skeptical that those statistics were misleading?

Professor Simkovic: I think, ideally, people would have statistics that were as granular as they wanted and consistent and comparable across all of their different options. So if you want to have law-school statistics, which not only say was the person employed in any capacity, but which also say was the person employed full time? Were they employed part time? Were they employed at something that requires their degree or is closely related to their degree?

That's great, but we should also have those statistics available for every other alternative that the person would be considering, and they should be collected in the same way, defined in the same way, and completely comparable. And when you do this, and when you actually use consistent definitions, and you compare the outcomes of law graduates to the outcomes of people with a bachelor's degree who look pretty similar, most of the time, the law graduates end up doing much better.

Many people with a college degree are not working in jobs that are closely related to what they studied, or are not working jobs which traditionally require their degrees. Nevertheless, on the whole, if you play the odds, education usually does pay off. And even people who are working jobs that don't officially require their level of education tend to make more money than similar individuals in those same jobs who have a lower level of education.

And there are many labor economic studies which suggest that these economic benefits of education are largely, though not entirely, caused by the education.

Judge Robertson: Thank you very much.

Justice Liu: I'm going to, in the interest of time, take all three questions in a row now, and Michael, you'll have to keep track of the questions so that everybody can ask their questions, and you can sort of give them one composite answer. So microphone 3.

Mr. Joseph Michael Matthews (FL): With respect to the research you did in connection with the legal education, did you attempt to adjust or take into account the impact of licensing requirements that imposed, perhaps, additional obligations or incentives on repayment of debt?

Justice Liu: Microphone 2.

Mr. Larry S. Stewart (FL): My question has a little bit different focus. I am concerned that recent movement in the financing of education, shifting the cost of education away from government and onto the backs of the students through student loans, is eliminating what we would traditionally think of as public education in this country.

And I'm wondering if you've done any work on what the impact of these large student loans being borne by these students, graduating both from law school and from undergraduate school, is having on the economy of this country and the productivity of that economy?

Justice Liu: Microphone 1.

Ms. Melanie Sloan (DC): On a totally different topic, you talked about GSEs, and I'm wondering if your research has given you an opinion on efforts in Congress to dissolve Fannie Mae and Freddie Mac?

Justice Liu: Okay. If you could briefly address those, and then I'll have one last question for you, and we can wrap up.

Professor Simkovic: Sure. The first question was about licensing requirements and how those might affect loan repayment. So one possible concern that I've heard is that perhaps law graduates are more likely to repay their loans, even though they're encountering financial hardship, because not doing so could make it difficult for them to be admitted to the bar. It could be a character and fitness issue.

One thing that I've looked at is repayment rates for two years out and also three years out, and there is no difference in the relative advantage that law graduates have in terms of having lower default rates. So even after the period when it's very unlikely that defaulting on their loans would affect their admission to the bar, because they are, in all likelihood, admitted to the bar at that point, they do still have this large advantage in terms of having lower default rates.

It doesn't seem to be explained by income-based repayment either. It seems to be explained by having higher incomes.

The second question is public education and the privatization of the costs of education. If you look at the benefits of education, around 40 cents on the dollar ends up going to the U.S. government. That's about the marginal tax rate which is applied to the higher-education earnings premium. The government is not paying 40 percent of the costs.

And if you think that people are making rational decisions about education, then it makes sense for people to under invest in education, that is, to invest less in education for themselves than what would be socially optimal for society as a whole. Because the economy would probably be growing faster if we had a more educated population, and we know that because the returns to education before taxes are so high.

So I do think that we may be overtaxing or under subsidizing higher education and that it's probably a drag on economic growth in the United States.

And the last question was about efforts to dissolve the GSEs. I tend to think that it's probably not the best idea. I think that it's important to have large securitizers. They don't necessarily have to be our GSEs. They could take another form.

But the role that large securitizers play in helping to regulate the quality of loans, and the way in which securitization increases liquidity and takes interest-rate risk out of financial institutions and moves it to investors who are better prepared to absorb it are extremely important, and we need to be cognizant of that and not reflexively think that smaller is better, more competition is better. It is a lot of the time, but it's not always, and this might be a context in which it's not.

Justice Liu: So I have one concluding big-picture question for you, Michael, as you think about your overall scholarly approach and portfolio. And it is that here at ALI, you know, we are devoted to law, not economics, as the primary object. And you made a very interesting comment, I think, in the beginning about the tensions between the general frame of the efficiency of the credit market versus things like information asymmetries, which in the hands of lawyers are regarded as sources of competitive advantage, and transaction costs, which many people think lawyers are the transaction costs of society.

Is there a theory of property rights that is—is there a complementary body of scholarship that you have to contend with that suggests to us what is a legitimate set of bundle of sticks that people can hold? What kind of information, what kind of profit is legitimate for people to have and to hold?

Your frame is from the standpoint of efficiency.

Professor Simkovic: Right.

Justice Liu: But others might argue that there are other claims that can be made normatively in the system, and I just wonder if you could say something about how you think about those two spheres. One sounds more like law. The other sounds more like economics. And how does that come together?

Professor Simkovic: Right. Well, I think of the role of the legal scholar, or at least the kind of legal scholar that I am and I hope to be, as similar to the role of a scientist. My job is to figure out what causes what, to figure out what is likely to happen if certain choices are made, and to provide that information to policymakers, who bring their own values to bear and might care about things that are different from the things that I care about, or might be the same.

My role is to help policymakers understand the parameters of the tradeoffs that they're facing. If there are tradeoffs between economic growth and equality or various values that we care about, they need information to understand the nature of those tradeoffs.

You can only have one absolute value. As soon as you have two absolute values, then you need to start making tradeoffs because they sometimes come into conflict. Which means you need some method of measuring those values against each other, and the measurement that economists use is money. Now you can adjust that in various ways. There are utility curves that tend to assume declining marginal utility of wealth, various ways of saying that you favor equality.

But my role is not to tell people whether equality is morally right or morally wrong. My role is to inform them of the tradeoffs in terms of what our society will look like depending on the policy choices that they make.

Justice Liu: Please join me in thanking our Young Scholars Medal winner. (*Applause*)

President Ramo: The Young Scholars Program, as everybody knows, is very important to me. And one of the things that I think is so wonderful about it, originally, we thought how great it would be for the Young Scholars to have an opportunity to present to the membership of The American Law Institute.

It turns out, in each case, that it is equally wonderful for the members to hear about the scholarly work, which, in the normal course of our work, we rarely have a chance to. Let me also just acknowledge, because she is here, last year's speaker, Beth Chamblee [Burch] from [the University of Georgia School of Law]—would you stand up, Beth, so we can say hurray for you one more time?

(*Member stood.*) (*Applause*)