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COMMENT

EFFICIENCY-WAGE THEORY AND LAW FIRM PAY

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Every first-year law student knows that Big Law pays $160,000 a year. In fact, this number is likely the biggest incentive for applying in the minds of most law-school hopefuls. Taking New York City as an example, a quick look at *Vault*'s salary data[1] reveals that, indeed, the large majority of New York firms with available salary data pay first-year associates exactly $160,000.

An initial inquiry might be: why do all these firms, with very few deviations in either direction, pay their first-year associates exactly the same salary across the board? The most obvious answer might involve the marginal product of labor – each additional first-year associate increases the revenue of a firm by some amount, $X. If any firm pays the associate less than $X in order to increase their profits, a competitor will offer that attorney some salary closer to $X, thereby poaching the attorney while increasing its profits. This process repeats until eventually, all firms pay first-year attorneys their marginal product of labor, in this case, $160,000.[2]

However, a closer look at the salary statistics reveals that, in fact, a few select firms offer first-year associates a salary greater than $160,000 – 8% of the over 100 firms surveyed pay over $160,000.[3] Why would these firms pay more, up to $174,000?

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1. *See Law Salary Table*, VAULT.COM, http://careerinsider.vault.com/wps/myportal/careerinsider/salaries/lawSalary?industryId=28&search_result_id=363&cityId=2380 (last visited Oct. 8, 2011).

2. *See generally*, Arthur O'Sullivan & Steven M. Sheffrin, Economics: Principles in Action 108 (2d ed. 2003).

3. *See Law Salary Table*, *supra* note 1.

One economic theory that might explain this phenomenon is the efficiency wage hypothesis. The efficiency wage hypothesis predicts that firms will pay employees more than the competitive market wage in order to incentivize them to work harder. In a stylized world where all firms are offering $160,000, a first-year associate has no incentive to work diligently. If he gets fired, he can pursue a job at another firm for the same wage. However, if one firm pays more, $170,000, for example, then that firm's employees have an extra incentive to work harder – if they are fired, they can only find work at firms paying a lower wage.[4]

Other factors that might encourage firms to pay more than the market wage include talent adverse selection and the reduction of search costs – firm offering higher wages will attract a greater number of applicants, giving the firm more power to choose the most talented and able candidates. The incentives to work hard also lessen the likelihood that attorneys will leave the firm. This reduces the costs the firm will incur to search for replacements.

Back to the real world, if we look at the firms that actually pay over $160,000, we can see these firms are indeed the cream of the crop – including big names such as Cleary Gottlieb Steen & Hamilton, Cravath Swaine & Moore, Skadden Arps Slate Meagher & Flom, and Wachtell Lipton Rosen & Katz. In fact, all but one of the firms on this list are part of Vault's top 25 most prestigious firms in New York City.

This is, of course, not the entire story, but it does shed some light on the debate over whether or not Big Law lawyers are overpaid. $174,000 plus bonuses for a first-year associate may seem like a lot of money, but perhaps that's what it takes in order to get the most talented law school graduates.

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4. For a technical model of the efficiency wage theory, *see, e.g.*, Carl Shapiro & Joseph E. Stiglitz, *Equilibrium Unemployment as a Worker Discipline Device*, 74.3 AM. ECON. REV. 433-44 (1984).