LIBERAL PROFESSIONS CONFERENCE: 28 OCTOBER 2003

Overview of the Commission's stocktaking exercise (Part II)

Niels J. Philipsen

Thank you. Yes, there is a significant body of theoretical and empirical research on the economic impact of professional regulation. What I can offer here is a brief taste of what economists are telling us about regulation in the professions, focusing on price regulation, advertising restrictions, entry restrictions and recent examples of regulatory reform. I will end with a short comment on the findings of the IHS report.

Let us start with *price regulation*: Fixed prices and recommended prices are the regulatory instruments which have the most detrimental effects on competition. If professionals do not have any options to compete on price, then, in theory, they are only able to compete on quality. However, one of the main arguments for regulating the professions is that many individual consumers find it difficult or impossible to assess the quality of professional services. We economists say that there is "asymmetry of information" between professionals and clients: All this means is that the professionals have better information about the quality of the services they provide than their clients. Given the difficulties that individuals face in assessing the quality of professional services, the vast majority of economists believe that fixed prices are unlikely to do anything to encourage practitioners to maintain high standards.

Moreover, economists believe that fixed or recommended prices reduce the incentives for professionals to work cost-consciously. Until very recently, for example, Dutch architects fixed their prices as a percentage of construction costs. Such a system undermines the incentives for architects to design in a way that reduces unnecessary construction costs.

As for *recommended prices*, economists fear that they are likely - in practice - to have the same effects as fixed prices, at least for individual consumers. As one of the respondents to the Commission's consultation has suggested, practitioners may treat recommended prices as fixed prices when dealing with individual consumers. As a result, only major customers will be able to negotiate discounts.

One can conclude that, although *quality* regulation may often be needed to some extent in professional markets, it is doubtful whether price regulation leads to any benefits for consumers. As early as 1970, the UK's Monopolies and Mergers Commission argued that "*price competition in the supply of a professional service is likely to be the most effective single stimulant to greater efficiency and to innovation and variety of service*".

Let us now turn to *advertising restrictions*: An extensive body of empirical literature has developed on the effects of advertising restrictions for professional services and on what happens to fee levels when these restrictions are relaxed. An overview of this literature is presented in the Encyclopedia of Law and Economics (2000). Following a detailed review of seventeen studies on advertising, Stephen and Love state that "*the general* *thrust of this empirical literature is that restrictions on advertising increase the fees charged for the profession's services and that the more advertising there is the lower the fees*." In 1975, Benham and Benham published a landmark paper on advertising restrictions in the US eyeglasses market (Journal of Law and Economics). The authors found that prices were significantly higher in those US states where the opticians' profession exerted greater control on information and publicity. The increase in price as a result of advertising restrictions was estimated to be between 25 and 40%. In 1980, Bond et al (Federal Trade Commission) found that the average price for certain eye care services was approximately 33% higher in cities where restrictions prevent both advertising and commercial practice.

There is also a large body of literature on the effects of *entry regulation* - such as licensing and establishment restrictions - on fees and quality of service. In a recent paper for the Journal of Law and Economics (2000), Kleiner and Kudrle use data on the dental health of incoming Air Force personnel to analyse the effects of varying licensing restrictions among US states. They find that tougher licensing raises prices and profits while it does not improve overall dental health. In a report written in 1990, the Federal Trade Commission concluded that, while a few studies indicate that higher quality levels may result from business practice restrictions, a majority of the studies finds quality to be unaffected by licensing or business practice restrictions associated with licensing. In some cases quality even decreases.

Let us now turn briefly to *academic research on the effects of deregulation in the professions*. A large body of literature exists on the deregulation of the legal profession in the UK, notably with respect to *conveyancing services* (that is, transfer of property) in England and Wales. Until the mid-1980s, solicitors had the exclusive right to provide conveyancing services for financial reward. This monopoly was revoked in 1985 and by 1987 the first licensed conveyancers – who were not solicitors – began to offer services in competition with solicitors in some areas of England and Wales. Paterson et al (Journal of Law and Society, 1998) found that solicitors reduced fees in 1986 in anticipation of imminent competition with the new licensed conveyancers. Moreover, survey data for 1989 showed that solicitor's conveyancing fees were lower in those areas where they faced competition from licenced conveyancers, and higher in those areas where they retained a monopoly in conveyancing services. In Australia, Baker (Justice Research Centre, 1996) found that the introduction of competition in conveyancing services resulted in a reduction of fees of 17% in real terms. While, for the Netherlands, in 2002 Bruinsma found that conveyancing fees fell by 12%.

In the Netherlands, the "MDW" project set up by the Ministry of Economics and the Ministry of Justice, has resulted in reform of the regulation for lawyers, real estate agents, accountants and insurance brokers. With respect to lawyers, admission to the Dutch Bar was simplified, recommended fees were abolished and the regulatory powers of the Bar were restricted. This resulted in differentiation of fees, some new legal products and an expansion of the profession. With respect to real estate agents, the professional monopoly held by real estate agents was abolished. This led to greater numbers of new real estate agents entering the market, falling costs of real estate transactions and a more flexible provision of services.

The IHS report on the professions reached the conclusion that excessive levels of regulation appear to be linked with higher prices. A small number of correspondents have questioned this finding, in particular the authors' reliance on turnover figures as an indication of profits in a given profession. This could be a valid point. However, as I have shown with my examples, the IHS conclusions are broadly in line with other empirical and academic work. I would therefore like to conclude by saying that most academic studies on individual professions point to similar links between excessive regulation and economic inefficiency.