

# RETHINKING PROFESSIONAL REGULATION

Competitive professional regulation would lead to lower costs for consumers, argues **Krystian Seibert**

**D**espite the free market reform and liberalisation that has taken place in many of the world's economies over the last three decades, professional regulation has managed to avoid significant reform. Many professions, such as medicine, dentistry, law, and accountancy, are still highly regulated.

Indeed, in the United States the level of professional regulation has increased over the last 50 years. Only 4.5 percent of the labour force was covered by professional regulation at a state level in the early 1950s compared with 18 percent in the late 1980s and 29 percent in 2006.<sup>1</sup> The extent of such regulation is generally determined by professional regulatory bodies, which set requirements relating to education and training, administer examinations, and monitor the conduct of members of their professions.

## The problem with professional regulation

Professional regulators claim that one of their main roles is consumer protection—maintaining quality standards in markets characterised by imperfect information—where a consumer cannot always be sure about the background and abilities of a professional service provider. However, since regulators often also service the interests of their fee-paying membership, it is often the case that professional regulation harm consumers. Regulators have a government-granted monopoly

to regulate their respective professions. Therefore they act like any other monopoly. Rather than simply adopting regulations intended to protect consumers, they tend to adopt regulations that restrict entry into their particular professions. If they can restrict entry, they can restrict competition, enabling their members to charge higher fees for their services.

Milton Friedman and Simon Kuznets first identified some of the issues relating to professional regulation of the medical and dental professions in their book *Income from Independent Professional Practice*.<sup>2</sup> In 1962, Friedman devoted an entire chapter of *Capitalism and Freedom* to an analysis of professional regulation and its effects.<sup>3</sup> Various recent quantitative studies have also documented the outcomes of professional regulation.

In particular, a study by Morris Kleiner and Robert Kurdle, which analysed the regulation of dentists in the United States, concluded that increased regulation did not improve dental

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health, but did raise the prices of dental services.<sup>4</sup> Further investigation of the effects of professional regulation on malpractice insurance rates, or complaints to state licensing boards also found few positive effects resulting from more stringent regulations.

### No regulation or competitive regulation?

#### *No regulation*

In *Capitalism and Freedom*, Friedman put forward a hypothetical model of what the medical profession could be like without professional regulation. Rather than having the combination of individual practice and large private or public institutional hospitals as is currently the case, medical partnerships or corporations may have developed. He referred to these medical partnerships or corporations as ‘medical teams.’

Such medical teams—department stores of medicine, if you will—would be intermediaries between patients and the physician. Being long lived and immobile, they would have a great interest in establishing a reputation for reliability and quality. For the same reason, consumers would get to know their reputation ... Individual private practice would continue, just like the small store with limited clientele exists alongside the department store.<sup>5</sup>

There are distinct advantages to such an arrangement—in particular because it would open up the medical profession to more competition and lead to lower fees, which in turn would benefit consumers.

Rather than having a single body that regulates a particular profession, multiple regulators would be allowed to undertake this role.

However, there are some other important aspects also worth considering. Even though medical teams, keen to uphold a reputation, would provide an assurance of quality to consumers

and, therefore, overcome some of the problems caused by imperfect information in the market for medical services, there would still be significant risks to consumers who seek to use the services of doctors working in individual private practice.

It is possible that doctors would work in individual private practice if they cannot obtain work as part of a medical team, possibly because they do not meet quality standards. They would most likely charge less than doctors working in medical teams and offer an inferior service. Therefore, consumers who use the services of doctors working in individual private practice would still be exposed to considerable risks.

#### *Another option—competitive regulation*

Other than having no regulation, certification and registration are alternatives to professional regulation. Another option would be to remove the monopoly status of regulators and open professional regulation to competition and market forces. This framework would provide a balance between allowing more liberalised entry into professions and maintaining appropriate quality standards. It would therefore overcome the negative effects arising from the monopoly status of regulators. Such a possibility has previously been discussed by Stephen Choi and Andrew Guzman in the context of corporate regulation in the United States. Their proposal involved having multiple private corporate regulators, with companies choosing by whom they are regulated.<sup>6</sup>

Similarly, in the context of professional regulation, rather than having a single body that regulates a particular profession, multiple regulators would be allowed to undertake this role. All members of a profession would have to submit to regulation by a regulator of their choice. They would pay the appropriate fees and adhere to requirements set by the regulator.

Importantly, there would be two countervailing effects that would determine what requirements these regulators would adopt. Regulators would compete for members of a profession to submit to their regulation. Therefore, they would have an incentive not to adopt particularly restrictive regulations in order to encourage professionals to join their organisation and provide revenue for the regulator. At the same time, they would be aware

that the confidence and trust of consumers is very important. If consumers do not have confidence and trust in a particular regulator, they will not seek the services of those regulated by it. And in turn, members of a profession would choose to be regulated by another regulator with a better reputation. This would translate into *decreased* revenue for the regulator that loses members and *increased* revenue for the regulator that gains members. This effect would provide an incentive for regulators to maintain appropriate quality standards for its members. It would be similar to the reputational effect of the 'medical teams' discussed by Milton Friedman.

### How to implement competitive regulation

#### *Free entry or auctioning licences*

One model for implementing competitive regulation would be for the government to allow members of a profession to come together and form their own regulator, and therefore effectively allow free entry into the market for professional regulation. Once formed, other members of the profession would then be permitted to submit to its regulation. Sufficient scale could be necessary to ensure that the regulator is large enough that the public can develop an awareness of their reputation. Therefore, it would be necessary to have a requirement that a minimum of one hundred current members of a profession (or some other appropriate number) are necessary before they are permitted to form their own regulator. Professionals could form commercial partnerships with private organisations to assist them with forming a regulator, particularly with the funding component of this process. There are various private organisations that would be well suited to fulfilling this role, such as large private medical care providers, law and accounting firms.

Another model would involve the government auctioning a certain number of licences permitting the licensees to act as a regulator for a particular profession. There could be a requirement that only current members of the profession are entitled to bid for a licence, and again it would be possible to form commercial partnerships with private organisations to gain assistance with the bidding process. Once more, sufficient scale would be

necessary and, therefore, the number of licences auctioned off would need to be fairly small. Choi and Guzman advocate the auctioning model in the context of corporate regulation in the United States.<sup>7</sup> However, one disadvantage of the model would be that because it would grant a fairly small number of licences, it would restrict new entrants into the market for regulation and decrease the level of competition between regulators.

#### *The role of government and competition authorities*

There would be very limited role for the government in a competitive regulation framework. Other than administering applications from members of a profession who would like to form their own regulator or auctioning licences, there would be no need for government to intervene in the regulatory process by specifying minimum regulation standards that apply to all regulators. The degree of regulation would be determined entirely by the regulators themselves.

Another model would involve the government auctioning a certain number of licences permitting the licensees to act as a regulator for a particular profession.

There would possibly be a very limited role for competition authorities. It may be necessary to monitor conduct by regulators, who could seek to restrict entry into a particular profession indirectly (for example, regulators might collude with one another and enter into agreements with universities to reduce the number of graduates entering particular professions). But it is unlikely that the role of competition authorities would extend to approving mergers between regulators. Where there is free entry into the market for regulation, if two major regulators decided to merge and then use their market power to restrict entry into a profession, then other members would be able to set up their own regulator, which could then compete on the basis of having less restrictive regulations. The barriers to entry in terms of setting up a regulator would be relatively

low, and therefore the potential to maintain strong levels of competition in the market for regulation would be high. In cases where licences are auctioned, there would be a requirement that licensed regulators do not merge. The minimum number of regulators for a particular profession would be fixed, and there would be no role for competition authorities in approving mergers.

*Regulators with no regulations and the role of courts*

Because government would not specify minimum regulation standards, it would theoretically be possible for a regulator to have no regulations. However, such a scenario would be unlikely because of the requirement that a minimum number of current members of a profession would be required before they are permitted to form their own regulator. It would be counterintuitive for current members of the profession to set up a regulator that has no regulations and, therefore, allows anybody to become a member and practise the profession. There would be a high risk that these unqualified members would tarnish the regulator's reputation, and that of the original members, through the improper practise of their profession. This could translate into a loss of members and decreased revenue for the regulator. Therefore, there would always be a strong incentive for regulators to adopt regulations that maintain appropriate quality standards and require its members to adhere to them.

The courts would also have a role in ensuring regulators maintain appropriate quality standards and require their members to adhere to them. If the law of negligence is applied to regulators, then they would be under a duty of care to consumers of the professional services of their members. If they breached this duty of care—for example, by admitting members who were not properly trained and caused harm to consumers—they would then be liable and would be required to pay compensation. It is possible that the courts themselves would apply the law of negligence to regulators. If not, then it could require some legislative action by government.

**Conclusion**

As long as professional regulators continue to have a government granted monopoly over their respective professions, the problems associated with this status will continue to exist. Regulators will continue to restrict entry into their professions, and in doing so they will reduce competition and enable current members to charge higher fees for their services. Consumers of professional services will pay the cost of these higher fees, with little compensation in form of the higher quality standards the professional regulators supposedly provide. Increased competition and market forces have delivered considerable benefits where they have been introduced in other parts of the economy. These benefits could also be realised if competition and market forces are applied to professional regulation by removing the monopoly status of professional regulators and introducing competitive regulation. Such competitive regulation would maintain quality standards and lead to lower fees for professional services to the benefit of consumers.

**Endnotes**

- 1 Morris M. Kleiner and Alan B. Krueger, 'The Prevalence and Effects of Occupational Licensing,' National Bureau of Economic Research, Working Paper 14308, September 2008. Morris M. Kleiner, *Licensing Occupations—Ensuring Quality or Restricting Competition?* (Kalamazoo, MI: WE Upjohn Institute for Employment Research, 2006).
- 2 Milton Friedman and Simon S. Kuznets, *Income from Independent Professional Practice* (New York: National Bureau of Economic Research, 1945).
- 3 Milton Friedman, *Capitalism and Freedom* (Chicago and London: The University of Chicago Press, 1962).
- 4 Morris M. Kleiner and Robert T. Kudrle, 'Does Regulation Affect Economic Outcomes? The Case of Dentistry,' *Journal of Law and Economics*, 43:2 (2000) 575.
- 5 Milton Friedman, *Capitalism and Freedom* (Chicago and London: The University of Chicago Press, 1962), 159.
- 6 Stephen J. Choi and Andrew T. Guzman, 'Choice and Federal Intervention in Corporate Law,' *Virginia Law Review*, 87:961 (2001) 969.
- 7 As above, 969.