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## Liberalization of Closed Professions: Opening Pandora's Box

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## I. INTRODUCTION

On February 16, 2011, the Greek parliament plenary passed a bill on liberalizing so-called “closed professions.” The deregulation of closed professions, which has drawn strong criticism both from the opposition parties and members of the closed profession categories that will be opened, is one of the most important demands made by the International Monetary Fund and European Union in exchange for Greece's drawing on the EUR 110 billion bailout to avoid sovereign debt default.

According to the Greek Prime Minister during his address to the cabinet, opening up closed professions represents a historic change to the benefit of society, since it guarantees new business and growth opportunities. Further, it will boost Greece's competitiveness, which means new jobs, growth, cheaper products, and better services for citizens and businesses.

The new law abolishes regulations on a large number of closed professions, sweeping away rules that govern everything from minimum fees to geographical restrictions to the number of permits issued each year. The focus of the legislation is mainly on a handful of key linchpin sectors—such as lawyers, auditors, engineers, architects, and notaries—but the scope of the plan is designed to invigorate the overall Greek economy.

To be more specific, according to the current legal regime, liberal professions are subject to pervasive public regulation that cover many aspects of professional activities, among which are the exclusive exercise of certain functions, entry requirements and access mechanisms, minimum price determination, prohibition of advertising, etc. Each profession is protected from competition by a tangle of regulations and licensing requirements that have resulted in high prices for consumers and a reliable living for insiders. For instance, Greece has issued only a few new licenses for truck drivers since 1970, though Greece's economy has more than tripled in that time. The consequence of this situation was a huge price increase in license acquisitions, which has been sold at prices approaching EUR 350,000. Not surprisingly, a report of the Foundation for Economic and Industrial Research (“IOBE”) found that it was more expensive to truck something from Athens to Thebes, about 45 miles, than from Athens to Rome, a distance of more than 600 miles.<sup>2</sup>

## II. THE ROLE OF THE SERVICE SECTOR IN THE ECONOMY

The new regulations target the service sector, especially. The service sector of the economy covers the non-agricultural and non-industrial productive and distributive activities in

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<sup>2</sup> Foundation for Economic and Industrial Research (IOBE), Quarterly Bulletin No 60, July 2010. The Report can be found at <http://www.iobe.gr/media/engoik/iobeeng210.pdf>

the transportation, communication and storage, trade, finance, real estate, private services, and government service industries. The share of the sector in national income is quite substantial and has been increasing over the years.

Professional services have an important role to play in improving the competitiveness of the Greek economy. They are inputs for the economy and business, and their quality and competitiveness have substantial spill-over effects. Thus, greater variety in prices and quality, as well as greater innovation in professional services, could go a long way in improving the competitiveness of Greek enterprises and fostering GDP growth in Greece.

A survey by the Foundation for Economic and Industrial Research (“IOBE”) indicated that, in the long term, the gradual liberalization of such closed service sector professions as lawyers, notaries, architects, and others would add some 13.2 percent to the gross domestic product. It would also lead to a 15.5 percent increase in private consumption and boost investments to the tune of 11.3 percent. Furthermore, it should generate an increase in real wages by 10.8 percent, due to the drop in prices and the rise in productivity.<sup>3</sup>

Professional services also have a direct import for consumers. Greater choice in the range of services available and their prices empowers users to choose for themselves the combination of price and quality that best suits their needs.

### **III. NATIONAL REFORMS TOWARDS MODERNIZATION OF PROFESSIONAL SERVICES**

The rapid growth of the services sector in Europe has been attributed to various factors, including the greater openness of economies to international commerce, moves toward efficient production, intense competition that accompany the process of globalization, and rapid introduction of technologies. Furthermore, consumers have become more educated and empowered.

For these reasons, in the last decade voices began to say that the level of regulation for professionals was out of step with economic developments and technical progress. In this view, the process of liberalization has become a crucial agenda item to exploit the potentials of the sector in contributing to national income, employment, and growth.

As a consequence, in many European countries, State regulators as well as self-regulators have undertaken a process to ease some of these restrictions. The targeted reforms are aimed at removing some of the most severe restrictions on competition in this sector, including price-fixing agreements, bans on advertising, quantitative restrictions on entry, and disproportionate entrance requirements. Additionally, in a few countries, new professions have been created with lower entrance requirements to perform tasks previously performed by traditional professions. There is also progress towards opening professions to international competition by such means as mutual recognition of qualifications and the elimination of citizenship and residence requirements as a step towards opening professions to international competition.<sup>4</sup>

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<sup>3</sup> *Id.*

<sup>4</sup> Organization for Economic Cooperation and Development, 1999, “Competition in Professional Services”. The Report can be found at <http://www.oecd.org/dataoecd/35/4/1920231.pdf>

#### **IV. TYPES OF PROFESSIONAL REGULATION**

Five common types of professional regulation fit the category described above: (i) price-fixing, (ii) recommended prices, (iii) advertising regulations, (iv) entry requirements and reserved rights, and (v) regulations governing business structure and multi-disciplinary practices.

##### **A. Price-Fixing—Recommended Prices**

In this area of regulation, fees for professional services are set by regulation or agreement, not by market competition. Furthermore, professional organizations may have established recommended or even obligatory fee schedules whereas fee competition and competitive bidding are generally considered unethical. The argument supporting price-fixing is that competition would lead to lower prices, and a general lowering of price levels would lead to a lowering of service quality.

Fixed prices or recommended prices are the regulatory instruments that are likely to have the most detrimental effects on competition, eradicating or seriously reducing the benefits that competitive markets deliver for consumers. Consequently, over the last two decades, a number of Member States have focused on abolishing fixed prices.

##### **B. Advertising prohibitions**

Restricting, and even banning, advertising has been defended as necessary to preserve professional integrity and independence and to protect consumers against malpractice. Another argument in favor of advertising restrictions is based on what economists call “asymmetry of information” between practitioners and consumers of professional services. According to this argument, consumers find it difficult to assess information about professional services and therefore need particular protection from misleading or manipulative claims.

##### **C. Entry and Access**

Licensing regulations determine who will be allowed to practice; only professionals gaining the license may interact in the market for services. Decisions whether to issue licenses determine how many providers are in the market, thereby operating as barriers to entry. These regulations can take the form of minimum periods of education, professional examinations, and minimum periods of professional experience. In many cases, entry restrictions are followed by reserving rights to provide certain services. The scope of these restrictions ensures that only practitioners with appropriate qualifications and competence can carry out certain tasks, thereby guaranteeing the quality of professional services

##### **D. Restrictions on Organizational Forms**

Professional services may also be subject to regulations on their business structures. There are rules restricting the organizational forms that can be adopted by service providers. Corporations or franchise relationships and even branch offices have often been prohibited, as well as partnership and corporate or employment relationships with non-practitioners. For instance, for many years in many countries, lawyers could only operate as sole practitioners or in partnerships with other lawyers and could not incorporate, as limited liability arising from being a corporate entity was deemed to be in contrast with the personal and unlimited liability typical for the legal profession.

The reason usually given for these prohibitions is to ensure the practitioner's personal responsibility to and liability towards clients, as well as to avoid conflicts of interest. It has also been suggested that these regulations may be necessary to ensure practitioners' independence. According to this argument, if professional service companies were controlled or influenced by non-professionals, this might compromise practitioners' judgment or respect for professional values.

## V. WHY REGULATE PROFESSIONAL SERVICES?

A principal justification offered for regulation is concern that market forces would fail to produce acceptable safety or other quality. One cause of market failure could be the above mentioned information asymmetry: the buyer knows much less about the proposed transaction than the seller does (or vice versa). Since the essence of professional services is the high level of the professional's knowledge, the level of information available to the provider and to the consumer of services is different. Consumers can find it difficult to assess information about professional services and, therefore, need particular protection against malpractice. In other words the professional knows and the consumer does not know anything (or very little), and may not be able to weigh the quality of the service paid for. In these circumstances, sellers may have an incentive to reduce overall quality as consumers, unable to judge quality differences, may make their decisions based on the average quality they expect. Furthermore, in such a situation, there is a risk that the professional over supplies the service to the client, or supplies a higher quality than necessary to satisfy the client's needs, so that higher prices are charged to the customer than he/she could have achieved were he/she fully informed (deceptive over-treatment).

Another reason market responses may fail to produce acceptable quality is externality. In certain markets, the provision of a service may have an impact on third parties who are not directly involved as well as the purchaser of the service. There is a danger that the providers and purchasers of these services fail to take proper account of these external effects. For instance, lawyers draft contracts, and the quality of such contracts indirectly determines the rate of civil litigation: the clearer the agreements, the less litigation before courts and, therefore, the less cost parties and the community as a whole will bear.<sup>5</sup>

A third argument is based on the concept of "public goods." As certain professional services are considered to produce public goods that are of value for society in general there is a danger that, without regulation, some professional services markets may undersupply or inadequately supply public goods.

A typical response to these risks of failure is direct or indirect regulation designed to maintain the quality of professional services and to protect consumers from malpractice. Licensing rules ensure that only practitioners with appropriate qualifications and competence can carry out certain tasks guaranteeing the quality of professional services provided. Restricting and even banning advertising may be necessary to preserve professional integrity and independence and to protect the public against incompetents.

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<sup>5</sup> K. Hellingman, *An Economic Analysis of the Regulation of Lawyers in the Netherlands*, REGULATION OF PROFESSIONS (M. Faure, J. Fisinger, J. Siegers & R. Van Den Bergh R. (eds.), pp. 179-180 (1993).

## VI. NEGATIVE EFFECTS OF PROFESSIONAL SERVICES REGULATION

However, despite the abovementioned advantages of regulation of professional services, in the last ten years the European Commission and national competition authorities have been broadly considering and criticizing the effects of regulation of the liberal professions and they have expressed the view that this highly regulated sector should be opened to competition.

A research paper prepared for D.G. Competition of the European Commission was published in 2003.<sup>6</sup> According to the outcome of the study, there is a positive relationship between high levels of professional regulation and excess profits (i.e. profits above the normal competitive level) for professionals. More specifically, the authors of the paper found that professionals gain higher profits in more regulated countries. In their view, this finding supports the idea that economic benefits are gained by highly regulated professions at the expense of consumers' welfare.

In addition, they found a negative correlation between the degree of regulation and volume of output. The authors, therefore, concluded that output could be increased if regulation intensity was to be reduced. The study points out that there have not been any serious cases of market breakdown in the less regulated countries. The professions in these countries function effectively, making it harder to argue that a regulatory framework more restrictive of competition is genuinely essential for the protection of consumers.

Likewise, ten comparative studies about price effects all showed that stricter regulation against competitive practices led to higher prices for services.<sup>7</sup> Where restraints on commercial dimensions of professional practice have been relaxed, prices are lower and new services appear in response to consumer demands.

Furthermore, the European Commission also produced a report on Competition in Professional Services on February 9, 2004, setting out the Commission's thinking on the scope to reform or modernize specific professional rules.<sup>8</sup> This Report was supplemented by the Stocktaking Exercise on Regulation of Professional Services in the new EU Member States, published in November 2004.<sup>9</sup> The scope of the Report was to show the negative effects that excessive or outdated restrictive regulations may have for consumers.

The above research has also proven that excessive regulation of advertising and licensing has led to lower quality and higher prices in professional services markets. According to the European Commission such regulations may eliminate or limit competition between service providers and thus reduce the incentives for professionals to work cost-efficiently, to lower prices, to increase quality, or to offer innovative services.

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<sup>6</sup> I. Paterson I., M. Fink M., & A. Ogus A., *Economic Impact of regulation in the field of liberal professions in different EU Member States*, Institute for Advanced Studies, Vienna 2003.

<sup>7</sup> C. Cox & S. Foster, *The Costs and Benefits of Occupational Regulation*, Bureau of Economics Staff Report to the Federal Trade Commission, 1990.

<sup>8</sup> Communication from the Commission, *Report on Competition in Professional Services*, (February 2004).

<sup>9</sup> Full details of the activity of the Commission in this field (the Commission report, the study, transcripts and recordings of the speeches at the Conference) are accessible at: <http://europa.eu.int/comm/competition/liberalization/conference/libprofconference.htm> .

## VII. PRINCIPLES OF GOOD REGULATION

In spite of the necessity of eliminating the above restrictions the European Commission in its Report also acknowledged that some regulation in this sector is justified in order to protect user interests and ensure good governance of the professions. However, in the European Commission's view, in all scrutiny of professional regulation a proportionality test should be applied. Rules must be objectively necessary to prevent conflicts of interest and malpractices—provided that they will be the mechanism least restrictive of competition to achieve that objective. Such rules should serve the interests of consumers and professionals alike. Ultimately, the European Commission believes that, in order to correct market failures, in some cases more pro-competitive and non-regulatory mechanisms can, and should, be used instead of certain traditional restrictive rules.

In view of the above we should conclude that regulations relating to professions should be reviewed against principles of good regulation. Such principles require a targeted regulation that does not restrict competition more than is necessary. This means that regulators should only intervene when necessary and that remedies should be appropriate to the risks posed, and costs identified and minimized. Regulation of professions should be focused on those markets in which undesirable effects (e.g. information asymmetry problems) remain and should address the market failure using means that restrict competition least.

The better regulation agenda rightly includes both improving new legislation and simplifying existing regulation along with reviewing or abolishing obsolete rules. A good regulatory system should look to preserve and, where possible, extend the competitiveness of the sector as well as be flexible enough to accommodate new market and regulatory developments going forward.

## VIII. REGULATORY REFORM IN GREECE

The recent package of deregulation measures in professional services in Greece is a very positive development. The elimination of certain serious restrictions to competition in a range of professions, including imposed minimum tariffs and certain business structure restrictions, is a positive response to calls to reform professional services.

However the new law, despite the optimistic announcements in its preamble, seems rather inadequate to achieve its goals. The proposed law reform has already been fiercely criticized due to the fact that the motivation behind this process has had a general political rather than a competition policy character, in so far as Greece's compliance with the requirements imposed by European Union, European Central Bank, and International Monetary Fund was the declared target and possible economic effects and consequences were taken into consideration only partially.

In summary, the proposed law reform:

- a) does not contain clear criteria to ascertain the conditions under which regulation is needed and, consequently, the professional activities which should be publicly regulated;
- b) does not change regulation of entry;
- c) does not rule out the possibility of creating new licensed activities;

- d) makes only minor improvements with regard to the determination of fees and business structure restrictions;
- e) does not eliminate the prohibition against advertising;
- f) does not provide counter-measures to tackle problems that may arise from the free price competition in the service market; and, lastly but most importantly,
- g) does not achieve social consensus. As a result, the majority of professionals as well as the professional bodies of the relevant professions appear to be defensive in regards to liberalization of professional services.

These important legal deficiencies, in conjunction with Greece's problematic current financial situation and the unwillingness of most professionals to collaborate to achieve a positive result, make the enforcement of this law uncertain.

## **IX. CONCLUSIONS**

The important role of the services sector in both the Greek economy and in consumers' welfare demonstrates the necessity of liberalization. Lots of discussions have taken place on the matter of regulating liberal professions, ways of liberalization, and opening of such sectors to competition. However, eliminating regulatory restrictions governing liberal professions requires a thorough analysis and a careful consideration as to the type and characteristics of the market for each individual professional service, because each single professional activity has unique features that necessarily affect the required level of regulation.

Hence, in the author's view, Greece should begin by taking small steps forward instead of trying to change, overnight, a whole regulatory framework which has defined for many years the rights and obligations of Greek professionals and consumers.

Time will tell whether Greece has made a step towards the desirable reform of professional services' sector or the whole reform was just another "collateral" for the repayment of Greece's loan.