Competition Policy

And The Self Regulating Professions

The text of a speech by Dr. Sylvia Ostry
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It is a great pleasure for me to be able to address you today on the topic of the Professions and Competition Policy. This is, of course, a subject which is of very great and very immediate interest to myself and my officials, and we have looked forward to this Conference and the opportunity it affords for informed discussion of the issues. At the same time I am very glad to be able to lend my support to the program in law and economics developed by Professor Trebilcock and his colleagues. Experience in the U.S. tells us that the skills and outlook garnered from the study of these two important disciplines can lead to significant new insights on some of the major questions of public policy. I am confident that the program at the University of Toronto will bear this out.

Exactly 200 years ago Adam Smith proferred the following advice:

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices . . . though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary.

Smith was a profound cynic, but the essence of his message that power unchecked is power misused has proved itself over time. We are now beginning to appreciate the relevance of that message as it applies to the self-regulating professions.

The professions have, in some crucial respects, long enjoyed a public policy stance of benign neglect. While for some time there has been concern over individuals' access to professional services, it is only recently that the professions have themselves been put on the examining table and subjected to the kind of careful probing that is familiar to other important participants in the market process. Understandably, a critique of the professions is not something one enters into lightly. As one observer has put it, "The professions operate in an atmosphere of sacerdotal reverence: the stillness of the courtroom, the antiquity of the solicitor's office, the embarrassed silence of the Doctor's surgery. How unseemly to apply economic analysis to all that!"*

These, however are irreverent times. Many have come to accept the wisdom of Shaw's dictum that "all great truths begin as blasphemies": and "unseemly" or not, the task of evaluating the role and structure of the professions, and of putting in place the needed safeguards has begun.

As many of you are no doubt aware, the professions were brought under Combines Law along with other service industries following the recent passage of Bill C-2. As a result of this legislation Canada no longer has the dubious distinction of being one of the only developed countries to exclude the important and rapidly growing service sector from its competition law. What is significant about the amendments in the present context, however, is the opportunity they afford for a response to the special problems of the self-regulating professions. These problems have received some significant attention in recent years; most notable has been the work of the McRuer Commission and the Committee on Healing Arts in Ontario, The Castonguay Commission in Quebec and the select committee on the professions in Alberta, and the Report of the Economic Council on Competition Policy. In the next little while, I would like to describe some of the concerns that my department has in this area, and to try to elaborate on some of the issues that emerge from the decision to extend competition policy to the self-regulating professions.

The argument for extending competition policy to the professions arises out of a recognition of the substantial benefits that are available when market forces are allowed to assert themselves. In other sectors of the economy we have found that performance is considerably improved in an environment that rewards superior productivity, and penalizes waste and inefficiency. We have seen that effective competition encourages the development of new products and improved patterns of production, and generally helps promote the most efficient use of the economy's scarce resources.

Also, we have, I think, come to appreciate the considerable appeal of the simple system of natural justice wherein a free functioning market is the arbiter of who receives what. When economic rewards are affected by restrictions in the system or influenced by administrative decisions, differences in these rewards become less understandable, and often, less acceptable. I must say that I find this in itself to be a compelling argument on behalf of a competitive system.

For those who value the benefits of a market system there is much that is disturbing about the structure and role of the self-governing professions. The very notion of self-regulation is inimical to the concept of a competitive system where the market sets the terms of production and establishes the required discipline. And indeed licensure laws often have an uncanny resemblance to cartel arrangements designed specifically to restrict competition among members of an industry; in this sense licensure can be seen as a way of enlisting the enforcement powers of the state to help in the very difficult task of organizing and policing an agreement to, for example, refrain from price cutting.

I would like to stress that I am not questioning the motives of professional groups; what I am concerned about is the effect of their behaviour and the costs that professional arrangements, however inspired, impose on society. The McRuer Commission noted that 22 self-governing professions and occupations in Ontario had been given "statutory power to license, govern and control those persons engaged in them". Under this and similar authority in other provinces, professional associations have been able to establish training and character requirements for prospective members; to set fee schedules and determine the form of various charges; to prohibit advertising and related competitive practices; and to influence generally the form and manner in which professional services are supplied. It is not clear that all or even most of these restrictions have provided significant positive benefits to the public. What seems more apparent is their substantial effect in reducing competition, impeding innovation and change, and raising costs and prices for many professional services.

Some years ago the British Monopolies Commission looked at the general effect of certain restrictive practices in the professions. They summarized the concerns which arose from their examination of the evidence as follows:

> Collective arrangements which significantly limit the freedom of the parties in the conduct of their business may be expected to result in higher prices, less efficient use of resources, discouragement of new developments and a tendency towards rigidity in the structure and trading methods of those businesses. Such collective restrictions tend to reduce the pressures upon those observing them to increase their efficiency. They may also delay the

introduction of new forms of service and the elimination of inefficient practitioners.*

This puts the problem well, though I think most observers would be inclined to express the latter point more forcefully. As Milton Friedman has pointed out, advances in knowledge and in methods of organization and production often come from the work of "Quacks" and "Crackpots" — from those who are willing to try the new and the unorthodox. A freely functioning market tolerates this sort of diversity and encourages experimentation which is likely to improve upon producers' ability to meet consumer demands. But members of the self-regulating professions are strongly encouraged to conform to the "prevailing orthodoxy", and if they want to remain in good standing, they are often severely limited in the kind of experimentation they can undertake. The result has most certainly been to delay the introduction of new forms of service and to lend support to the inefficient and uninnovative practitioner.

One of the most disturbing effects of market restrictions, as I mentioned, is that it leads to economic differentials, which are difficult to justify. In the case of professional groups, it has proven difficult to get a reliable quantitative reading of this effect; analysts have not been completely successful in disentangling the monopoly profits which are attributable to restrictions, from the higher earnings which represent a legitimate compensation for greater education and training, greater ability, longer hours of work, increased responsibility and other factors. But this is not to say that evidence of excess or monopoly gains in the professions is lacking. The appearance of a long queue of willing entrants in itself suggests that returns to an occupation are more attractive than one would expect in a competitive market, and such queues have, of course, not been uncommon in the case of the most lucrative professions. This is especially the case if we count, as we should, those who meet the minimum standards and would join the queue had they not been deterred from standing in line by the higher effective standards actually used to ration entrants to the major professional schools.

Proponents of licensure laws argue that they are necessary to ensure a certain quality of professional service and to protect the consumer from fraud and incompetence. Certainly there may be a case for supporting the consumer in a market situation where he is likely to be severely disadvantaged by a lack of information and knowledge; or where his decision is likely to have implications for others in society which he would not be willing or able to consider. From my vantage point, I can appreciate this better than most, but how helpful are various licensure laws and restrictions to the consumer? And do the benefits that are available justify the substantial costs which accompany the imposition of professional controls? I would suggest to you that if Federal and Provincial authorities had asked themselves these questions a long time ago, the market for professional services would be very much different from what it is today.

Let us look first at the concept of licensing itself. One might well be suspicious of licensure at the outset due to the fact that the pressure for licensing invariably comes not from the consumers whom it is to protect, but from the trades and professions themselves. Friedman suggests that this may be because the latter groups are more aware than others of how much they exploit the customer and can most clearly see the need for consumer protection. Be that as it may licensing is a considerably less than ideal form of consumer protection, and one need not be experienced in developing consumer legislation to realize this. The fact that a professional met certain standards at the beginning of his career is clearly not much of a guide to his current competence, and while professional associations purport to investigate fraud and incompetence, the evidence would suggest that this activity is pursued with something less than undiluted zeal.

A recent study by the U.S. Federal Trade Commission sheds some revealing light on the question of licensing. The F.T.C. made a comparison of the television repair industry in three separate areas: California, where there is a system of registration and a Bureau of Repair Services to investigate fraud: Louisiana, where there is a system of mandatory licensing by a Board comprised of members of the industry: and the District of Columbia, where there are no controls of any type. The study found that the price of repairs in Louisiana, the state with licensing, was more than 20% higher than in the other two areas. But no fewer instances of fraud were found in Louisiana than in the District of Columbia, the area without controls; and the highest quality of service was evident in California where the Bureau of Repair Services was at work.

Similar results have emerged from studies of regulation in the Canadian Trucking Industry. These studies attempted to compare intraprovincial trucking in provinces where the industry is firmly regulated — specifically British Columbia. Saskatchewan and Manitoba — with that in Alberta where there is no regulation and, in some other provinces where there are lesser degrees of regulation; in Ontario, for example, there is no regulation of rates, while in Quebec where there is also a regulatory authority trucking rates have been de facto not regulated. No evidence was found in this work that carriers in the provinces which required licensing were as a rule safer than those in Alberta. Nor was there any indication that small shippers and small towns in the latter province were suffering from a lack of service. What these studies did find was a quite significant difference in costs and in trucking rates between regulated and unregulated provinces. In the most recent study John Palmer estimated that de facto regulation leads to rates which are about two cents higher per ton mile.*

These studies indicate to me that it is well to remain highly suspicious of the supposed benefits of licensure. Apparently I am not alone in this view. The McRuer Commission, The Castonguay Commission and the Economic Council all saw the need to have the public viewpoint more firmly represented in licensing decisions and accordingly recommended that lay members be appointed to the governing bodies of professional associations. This would certainly be a positive move, and the actions some provinces have already taken in this direction are to be commended. Especially notable in this regard are the steps which have been taken in Quebec — via the enactment of a Professional Code and the establishment of a Professions Board — to ensure public representation in the administration of professional corporations, and to generally help prevent the abuse of power by professional bodies. Developments of this sort should help to reduce the cynicism that often surrounds the activities of professional groups. And with lay representation the decisions of professional bodies should reflect a broader perspective, and, hopefully, an improved understanding of what constitutes the public interest. In practical terms I would hope that the result would be a more careful consideration of such issues as the functions of para-professionals, and the length of professional training — both of which, of course, directly affect the price of professional services as well as the economic return to existing practitioners.

However, notwithstanding improvements of this type licensing can be a very costly market restriction, and this is the case both where licensing is by the industry and where the control is excercised by a government agency or commission, as in trucking. I would suggest to you, therefore, that we must also begin to take a much more critical look at licensure itself. We must recognize that licensing is likely to raise the price of professional services and that its influence

on the quality of professional care could quite possibly be perverse. For example, by imposing sufficiently stringent entry requirements we could ensure that Ontario has the most highly qualified barbers anywhere. But the result would not necessarily be an improvement in the quality of male coiffure in the province. Faced with higher prices and a lack of low cost alternatives some males would probably seek out the haircutting services of their wives; others would just go without a haircut for longer than usual. The effect of the licensing restriction, therefore, could conceivably be to make Ontario males a shabbier looking lot than before.

Too often in the past we have failed to appreciate these sorts of implications. We did not try and tally up the costs of regulation or to look beyond the traditional justifications for licensing. We should now realize that licensing exists in many cases where there are no maior information problems or exceptional risks, and where the consumer is reasonably able to determine his own best interest. We should recognize that in some instances where licensing would seem warranted the costs may not justify it. And we should be aware that there are less restrictive alternatives to licensing, such as registration and certification, and that in many cases these may be more appropriate forms of intervention in the market.

Adopting a more critical stance towards demands for licensing and inserting a public presence on the governing bodies of professional associations are two approaches to the problems arising from self-regulation in the professions. A third response is to focus directly on the activities and rules of professional bodies and to try to ensure that these are in the public interest. This, of course, is the approach underlying the recent amendments to Canada's Combines Law.

Competitive forces have long been important in bringing the public interest to bear in the decisions of groups and individuals. So it is only logical, where there is reason to be concerned about the public interest as it relates to matters of price and efficiency, to begin to look to competition policy for a solution. The immediate question that arises, however, is 'can competition policy be made to apply to the activities of bodies which have received their authority under provincial statute?' I think the answer is: to a considerable extent, yes. The jurisprudence indicates that activities which are expressly authorized by statute are outside the purview of the Combines Act (reference re The Farm Products Marketing Act, (1957) S.C.R. 198). It has similarly been held that the specific powers granted by a legislature and exercised by a board or commission are, for the most part, not subject to the act. I say 'for the most part' because in the Canadian Breweries case (Regina v. Canadian Breweries Limited (1960) O.R. 601), Justice McRuer indicated that an exception could be made where a restriction "operated or is likely to operate, so as to hinder or prevent the Provincial body from effectively exercising the powers given it to protect the public interest". However, and very significantly, it has been held that Combines Law may apply to certain activities of regulated industries. Here again I quote Chief Justice McRuer:

> "There may, however, be areas of competition in the market that are not affected by the exercise of the powers conferred on the Provincial body in which constraints on competition may render the operations of the combine illegal."

We have concluded from this that competition law does indeed have some application to the self-regulating professions. I should point out, however, that there is a good deal of uncertainty in this general area, and it is not always apparent in a given situation whether the Combines Act applies or whether regulation provides immunity. Justice McRuer's decision in the Canadian Breweries Case suggests that a regulatory authority must not only have the power to regulate an activity but the power must be exercised, for that activity to lie outside the Act. There is some doubt where, for example, rates are agreed upon by an industry and merely allowed or disallowed by the regulatory authority, that the latter has effectively exercised its regulatory power. We will be attempting to answer this type of question and to generally clarify the relationship between regulated industries and the Combines Act in the Stage II amendments to competition policy.

I might just briefly mention a related problem which we will be attempting to come to terms with in the forthcoming revision. It sometimes happens that a regulation aimed at achieving a perfectly legitimate objective for which a government agency is responsible lessens competition. While this cannot be avoided in some cases it may be unnecessary in others where both the objectives of the specialized agency and that of competition policy can be met. This would be less likely to occur if regulatory agencies were required to take some account of competition policy in reaching their decisions. I think it's most important that they do so; and I hope that in the near future we can begin to move in this direction and thereby help to reduce the conflict between competition policy and other legitimate government objectives.

At any rate, as the legislation and the jurisprudence now stand, there are important matters in the area of the professions to which competition policy would seem not to apply. I am thinking here, particularly, of the fee setting arrangements emerging out of Provincial programs such as "medicare", and of the practice of setting entry requirements to preserve professional standards. At the same time, however, there is an important range of activities carried out by professional bodies which is not covered by provincial law; here the revised Combines Act applies and has the prospect of becoming an effective instrument for asserting the public interest.

So that my enthusiasm does not mislead you, let me emphasize that there is a good deal of uncertainty regarding the precise implications of Combines law for the professions. The important section 32 of the Bill, which pertains to agreements to lessen competition, only became applicable to the service sector on July 1st of 1976. Therefore, like many of you, we are still awaiting a test of the legislation's strengths and weaknesses in this area.

With the recent revision we have, however, begun seriously to examine a number of professional rules and activities. One of these is the restriction on the professional's right to disseminate information. This is perhaps the most prevalent practice among professional groups. It can also be a particularly pernicious one from the point of view of competition policy, as some recent studies in the U.S. illustrate. Lee Benham, for example, found that, owing to the lack of information and the resulting absence of price competition, prices for eyeglasses were 25% to 40% higher in markets with greater professional control. He noted that these higher prices were "in turn associated with a significant reduction in the proportion of individuals obtaining eyeglasses during a year".* A study of advertising restrictions in the U.S. drug industry came up with similar evidence of a significant loss to consumers. One might reasonably expect that the burden of such losses weighs especially heavily on the shoulders of low-income consumers.

In defense of these restrictions, it is argued that advertising is 'unprofessional', that it could mislead the public and endanger necessary public trust and confidence in the professions. But the advertising of, for example, legal services need not resemble, say, the advertising of toothpaste. Advertising, far from being demeaning, can be a dignified and re-

sponsible method of informing the public about the type of services being offered and their price. In this regard one only has to look at the informative advertising sponsored by various interest groups and trade Associations.

There are to be sure examples from the past of professional advertising of a somewhat startling character. We have, for example, the following which appeared on a huge tablet in the market square of Rome:

> "Telegonius . . . has a positively encyclopaedic knowledge of all Roman edicts, statutes, decrees, proclamations, judicial decisions, etcetera, past, present, operative, dormant or inoperative. At half an hour's notice the most learned and eloquent Telegonius can supply his clients with precise and legally incontrovertible opinions in any judicial matter under the sun . . . No client of Telegonius has ever been known to suffer an adverse verdict in any court — unless his opponent has by chance also drunk from the same fountain of oratorical wisdom and eloquence."*

I have it on good authority that today's lawyers are a much more modest bunch. Whether or not this is the case, professional practice, and public attitudes and expectations are certainly much different from Telegonius' day. There is now as well, of course, important legislation to discourage such rhetorical flights of fancy in advertising. This is not to deny that advertising can be misleading, and, indeed, degrading. This remains a possibility in the professions as elsewhere — notwithstanding existing legislative and other safeguards. However, the dangers in this regard do not provide a justification for the very complete and very firm control many professional groups have imposed over the flow of information.

The approach in Bill C-2 reflects this view and our general concern that, in many cases, restrictions on advertising are incompatible with their relative costs and benefits to the public. Our focus in the legislation is on those restrictive arrangements which unduly lessen competition. Advertising arrangements that are not harmful to competition are specifically exempted (Section 32 (2)). There is also explicit recognition in the Act (Section 32 (6)) that protection of the public may require rules relating to professional "standards of competence and integrity". But where such restrictive agreements cannot be justified as being "reasonably necessary for the protection of the public", and they are likely to unduly lessen competition with respect to price or quality we are very much concerned. A restriction on advertising of this type risks being in violation of section 32 of the Act.

Another practice which concerns us is the attempt to control professional fees. Regulations governing fees are not as widespread as regulations on advertising. And where fee schedules do exist, they are, at times, difficult to enforce. It is not uncommon for a tariff schedule to be set aside, for example, where the professional is selling his services to a large buyer with a substantial degree of bargaining power. But there are important areas where fees are effectively maintained — and at some considerable cost to society.

The issue was put quite well, I think, in a recent U.S. Supreme Court test of price-fixing in the legal profession. It was the important case of Goldfarb v. Virginia. The Prosecuting attorney, Solicitor General Robert Bork, asked why the antitrust laws should not apply to lawyers. "The answer is said to be the ethical responsibilities of the bar", he noted; but "one searches in vain for the connection between professional ethics and price-fixing for professional services."

One does indeed. The argument put forth, that fees must be set to preserve professional standards, is not at all convincing. Where it is desirable to ensure a certain quality of professional service — and let me emphasize that in many cases it is not desirable to deprive the consumer of his choice in this way — where it is desirable, however, there are more effective and less costly approaches. The elimination of price competition has, as I have indicated, major implications for efficiency, for innovation and change, and for costs and prices in the industry. The attempt to impose a given fee structure, moreover, can lead to severe distortions with respect to allocation of time and talent within a profession. The restrictions on price-cutting along with most restrictions on advertising are undesirable of course from the point of view of consumers; one might expect that they are also fairly disagreeable to new entrants to the profession who, by being denied the opportunity to use these competitive devices, are put at a significant disadvantage.

In regard to pricing restrictions, it is again section 32 of the Combines Act which is relevant. The question the courts will have to decide in each case is 'Does the practice of the association with respect to fees constitute an arrangement to unduly limit competition?' The general contention is that by publishing a fee schedule, the professional body is only providing its members with a suggested list of charges. This may be the case, but the facts could indicate that the issuance of such a schedule amounts to much more than a suggestion. Where, for example, there is evidence of attempts having been made to enforce an agreed-upon schedule of fees, I would think it would be quite difficult to conclude that a price-fixing arrangement did not exist. Less direct evidence may point in the same direction. Where, for example, it is clear that most practitioners in an area raised their fees to a newly recommended level in the reasonable expectation that the tariff schedule would be substantially followed, the courts could very well find that the association has entered into an arrangement under the terms of section 32 of the Act.

In this connection, it is instructive to note the decision of the court in the recent Armco case (Regina v. Armco Canada Ltd. (1975) O.R. 521). There was no direct evidence of a price-fixing agreement in this case, and indeed some of the published statements would tend to suggest quite otherwise. There was, however, evidence that after much discussion on the subject the industry had adopted an "open pricing policy", the key to which was publication of a price list by one of the firms and its prompt adoption by the remainder of the accused. The cumulative effect of the evidence indicated to Justice Lerner that there was indeed an arrangement to lessen competition unduly — a conclusion which was substantiated by the evidence of "consistent and remarkable uniformity" in pricing.

My Department is aware that it has been the custom of a number of professional associations to propose, discuss, authorize, and circulate, fee schedules which have been widely adopted by their respective memberships. There appears to be sufficient similarity between the situation in these cases and that in the Armco case to caution the wise and wary against continuation of such practices. The prohibitions in the Combines Investigation Act are criminal law and I cannot help speculating on the ultimate consequences of prosecution of members of a group whose by-laws provide for suspension of a member who has been convicted of an indictable offence.

In our efforts to come to terms with price fixing and with other restrictive practices in the professions, we can benefit from the experience of other countries. The U.S. record of achievement in this area is beginning to look especially impressive. In the recent case of Goldfarb v. Virginia, which I referred to earlier, the U.S. Supreme Court ruled for the first time that price-fixing among professionals can be in violation of federal antitrust laws. This has paved the way for a number of actions: the Justice Department, for example, has recently

challenged the advertising bans of the American Medical Association and American Bar Association: and the pricing restrictions of the Institute of Public Accountants, the Society of Anaesthesiologists, and American Institute of Architects, among others. The British government has also become increasingly concerned about the practices of professionals, and it is now waiting to hear what the Monopolies Commission will have to say following its examination of specific professional groups.

I think that what we are seeing quite generally is a significant change in the public attitude towards self-regulation. To a greater extent than ever before, people are making invidious comparisons, and questioning whether it is necessary and desirable to endow some groups with special powers. The decision in Canada's case to extend competition policy to the self-regulating professions represents, I think, a positive and significant response to public concern on this issue.

At the same time, however, we should fully recognize the substantial barriers against competition in the professions. In many cases it is not merely a problem of anticompetitive rules — important as these are. The more general problem often is that the members of professional groups are led to think of each other not as competitors but as colleagues, or, to use Reuben Kessel's terminology fellow members of an "in-group". One just does not question the work of one's colleagues: never mind that such openness could lead to more effective decision-making by consumers and contribute to an improvement in professional standards. Clearly, this perspective is not something that can be changed easily or quickly. It will require the co-operation of federal and provincial authorities and a commitment by both to strengthen the role of competitive forces in this important area of the economy. Undertakings to provide such a commitment would, I think, constitute a most fitting tribute to Adam Smith on this bicentennial of the Wealth of Nations.

*D.S. Lees, **Ec. Consequences of the Professions,** The Institute of Economic Affairs, London, 1966, pg. 4.

*The Monopolies Commission, **Part I; The Report,** H.M.S.O., London, 1970, pg. 69.

*John Palmer, "A further Analysis of Provincial Trucking Regulation." **The Bell Journal of Economics and Management Science,** Vol. 4, No. 2 (Autumn 1973), pp. 655-664.

*Lee and Alexander Benham, "Regulating Through the Professions: A perspective on Information Control." **The Journal of Law and Economics,** Vol. XVIII, October 1975, pp. 421-44.

*Quoted in Lees, op. cit. p. 25.