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FEDERAL TRADE COMMISSION  
WASHINGTON, D. C. 20580

COMMISSION AUTHORIZED

BUREAU OF ECONOMICS

January 15, 1987

George L. Schroeder, Director  
Legislative Audit Council  
State of South Carolina  
620 NCNB Tower  
Columbia, South Carolina 29201

Dear Mr. Schroeder,

The staff of the Federal Trade Commission<sup>1</sup> is pleased to respond to the invitation of the Legislative Audit Council<sup>2</sup> of the State of South Carolina for comments on possible restrictive or anticompetitive practices in the state statutes and regulations of the following agencies:

Licensing Board for Contractors  
Residential Home Builders Commission  
Real Estate Commission  
Board of Certification of Environmental System Operators  
Board of Registration for Professional Engineers and Land  
Surveyors  
Manufactured Housing Board.<sup>3</sup>

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<sup>1</sup> These comments represent the views of the Bureaus of Competition, Consumer Protection, and Economics of the Federal Trade Commission, and do not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize the submission of these comments, with Commissioner Bailey dissenting.

<sup>2</sup> FTC staff provided comments to the Legislative Audit Council of South Carolina on three earlier occasions. On February 19, 1987, FTC staff commented on the sunset audit of the Boards of Optometry and Opticianry. On April 23, 1987, FTC staff commented on the sunset audit of the Boards of Podiatry Examiners, Occupational Therapy Examiners, Speech and Audiology Examiners, and Psychology Examiners. On September 29, 1987, FTC staff commented on the statutes concerning the South Carolina Public Service Commission.

<sup>3</sup> Letter from George L. Schroeder, Director of the Legislative Audit Council of the State of South Carolina, June 10, 1987.

Our analysis and our experience in related matters lead us to conclude that a number of provisions in the statutes and regulations governing real estate professionals, land surveyors and engineers could have anticompetitive effects.<sup>4</sup> You may wish to weigh the possible costs of these anticompetitive effects against any quality enhancing benefits.

Section I of this comment reviews the interest and experience of the Federal Trade Commission staff in the area of occupational regulation. Section II discusses the economic rationale for such regulation. Section III examines particular sections in the statutes and regulations that appear to increase quality, but also have the potential for producing anticompetitive effects. Section IV sets out our conclusions.

I. The Federal Trade Commission's Interest and Experience in Occupational Regulation

Under the Federal Trade Commission Act, 15 U.S.C. § 41 et seq., the Commission is charged with preventing unfair methods of competition and unfair or deceptive acts or practices. In addition to our enforcement work directed toward these goals, we encourage legislatures and regulatory bodies to consider competition policy and consumer welfare as important elements in their deliberations on various regulatory issues.

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<sup>4</sup> The staff has reviewed the statutes and regulations of the six building-related trades for possible anticompetitive or restrictive provisions. Taking into consideration the number of statutes and regulations involved, however, it is possible that some potentially anticompetitive provisions have escaped our attention. If the Legislative Audit Council has any questions regarding statutes or regulations not discussed in our letter, we encourage you to contact us for further review of these practices.

For several years, the Commission has maintained a program relating to the competitive effects of various restrictions on state-licensed professionals, including optometrists, dentists, and lawyers.<sup>5</sup> In addition, the Commission staff has extensively studied the nature of competition in the real estate industry.<sup>6</sup> In one study of the residential real estate industry, the Commission's Los Angeles Regional Office concluded that certain provisions in state regulations of the industry often tend to dampen competition.<sup>7</sup> Our goal throughout has been to help policy makers identify regulatory restrictions that decrease competition and increase costs without providing offsetting benefits.

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<sup>5</sup> Staff economists have examined such restrictions. Liang and Oger, Restrictions on Dental Auxiliaries, Washington, D.C.: Federal Trade Commission, 1987; Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising, Washington, D.C.: Federal Trade Commission, 1984; Bond, Kwoka, Phelan, and Whitten, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry, Washington, D.C.: Federal Trade Commission, 1980.

<sup>6</sup> Florence Multiple Listing Service Inc. of Florence, S.C., 861-0081 (December 30, 1987) (tentatively approved consent order) (Settling charges that it has restrained competition by restricting membership); Multiple Listing Service Mid County Inc. of Brooklyn, N.Y., 851-0108 (December 30, 1987) (tentatively approved consent order) (Ending practices that have allegedly restrained price and service competition among residential real estate brokers); Multiple Listing Service of Greater Michigan City Area, Inc., 106 F.T.C. 95 (1985); Orange County Board of Realtors, Inc., 106 F.T.C. 88 (1985); Brief for the Federal Trade Commission as Amicus Curiae, Coldwell Banker Residential Real Estate Services of Illinois, Inc. v. Clayton, 105 Ill. 2d 289, 475 N.E. 2d 536 (1985); The Residential Real Estate Brokerage Industry, Washington, D.C.: Los Angeles Regional Office (LARO) of the Federal Trade Commission, 1983; Butters, Consumers' Experiences with Real Estate Brokers: A Report on the Consumer Survey of the Federal Trade Commission's Residential Real Estate Brokerage Investigation, Washington, D.C.: Federal Trade Commission, 1983.

<sup>7</sup> The Residential Real Estate Brokerage Industry, Washington, D.C.: Los Angeles Regional Office (LARO) of the Federal Trade Commission, 1983, p. 188-190.

## II. The Economic Rationale for Occupational Regulation

It is sometimes difficult for consumers to determine the quality of a service they desire to purchase. In some cases, the quality of a service cannot be evaluated even after a purchase. For example, the plaintiff in an unsuccessful medical malpractice case may be unable to determine if his case failed due to its lack of merit or due to his lawyer's incompetence. Because consumers may base their willingness to pay for a particular service on the "average"<sup>8</sup> quality they expect to receive, there could be an incentive for any one professional to allow the quality of his service to deteriorate. If professionals cannot capture the gains associated with difficult-to-detect, higher quality service, the market may be flooded with low quality service. This is one example of market failure in the occupational area, and is frequently cited as the main justification for occupational regulation designed to increase the quality of service.<sup>9</sup>

Another type of market failure might occur when professionals or consumers do not take into account the effect of their sales or purchase decisions on parties not directly involved in a transaction. For example, an individual consumer may prefer a mobile home with a minimum of safety features. Frequently, however, mobile home sites are densely clustered, and the mobile home with minimum safety features may therefore pose a

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<sup>8</sup> If, for example, a consumer is unable to evaluate the quality of any particular dentist's services, he may base his decision on what he perceives to be the average quality of dentists' services.

<sup>9</sup> Young, The Rule of Experts: Occupational Licensing in America, Washington, D.C.: Cato Institute, (1987) p. 15; Rottenberg, Occupational Licensing and Regulation, Washington, D.C.: American Enterprise Institute, 1980, p. 7; Consumer Information Remedies Policy Session, Washington, D.C.: Federal Trade Commission, 1979, p. 36.

significant health and safety risk to other mobile homes in the area. To the extent that the consumer does not take into account the effect of his safety choice on the safety of others, he may choose less than the socially optimal amount of safety equipment for his mobile home.<sup>10</sup> In this type of situation, policy makers may wish to take action to insure that a proper amount of safety equipment or quality is present.

The rationale for occupational regulation has typically been to guarantee a minimum quality standard in order to (a) reduce the uncertainty about quality that consumers face when purchasing professional services; and (b) prevent costs to society which might occur in a market without minimum quality assurance. Although a few studies have indicated that higher quality levels result from licensing,<sup>11</sup> a majority of the work to date has found quality to be unaffected by licensing or other restrictions associated with licensing.<sup>12</sup>

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<sup>10</sup> The socially optimal amount of safety equipment occurs when the expected cost of additional equipment is equal to the expected benefit--where cost and benefit measures reflect not only the effect of an individual's safety choice on his own welfare, but also on the welfare of persons affected by the decision.

<sup>11</sup> Begun and Feldman, "The Welfare Cost of Quality Changes Due to Professional Regulation," Journal of Industrial Economics 34 (1985), p. 17; Holen, "The Economics of Dental Licensing," Washington, D.C.: Public Research Institute, Center for Naval Analysis, 1978. A few studies have found licensing to be associated with lower quality: Kwoka, "Advertising and the Price and Quality of Optometric Services," American Economic Review 74 (1984), p. 211; Carrol and Gaston, "Occupational Restrictions and the Quality of Service Received: Some Evidence," Southern Economic Journal 47 (1981), p. 959.

<sup>12</sup> Martin, "An Examination of the Economic Side Effects of the State Licensing of Pharmacists." Doctoral Dissertation, University of Tennessee, 1982; Paul, "Competition in the Medical Profession: An Application of the Economic Theory of Regulation," Southern Economic Journal 48 (1982), p. 559; Bond, Kwoka, Phelan, and Whitten, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry, Washington, D.C.: Federal Trade Commission, 1980; Muris and

In contrast, the costs associated with licensing have been well documented. Numerous studies have shown that licensing and associated restrictions often result in higher prices.<sup>13</sup>

Thus, in considering any licensing proposal, it is important to weigh carefully the likely costs against the prospective benefits. Restrictions that tend to increase quality should be examined to determine whether the expected benefits of increased quality outweigh any anticompetitive costs.

The benefits of licensing may outweigh the costs when consumers make a "once in a lifetime purchase," or when they are otherwise unable accurately to assess the quality of a professional's service. Licensing is especially likely to be beneficial when there are, in addition, significant health or safety risks. For example, persons needing brain surgery and emergency health care are likely to benefit from licensing requirements. In these situations, consumers are unable to evaluate the quality of service, and the expected costs associated with low quality service are high.

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McChesney, "Advertising, Consumer Welfare, and the Quality of Legal Services: The Case of Legal Clinics," Law and Economics Center, University of Miami, Working Paper 78-5, 1978; Healey, "The Effect of Licensure on Clinical Laboratory Effectiveness," Doctoral Dissertation, University of California, Los Angeles, 1973. The fact that authors disagree on quality effects may partly stem from the necessity to choose a particular variable used as a proxy for quality. Whereas "price" is unidimensional, "quality" is multidimensional; i.e., many aspects of quality could be chosen to proxy the "quality" of a particular professional service. Thus, any quality proxy in these studies may not capture all of the relevant dimensions of quality.

<sup>13</sup> Liang and Ogur, Restrictions on Dental Auxiliaries, Washington, D.C.: Federal Trade Commission, 1987; Conrad, and Sheldon, "The Effects of Legal Constraints on Dental Care Prices," Inquiry 19 (1982), p. 51; Shepard, "Licensing Restrictions and the Cost of Dental Care," Journal of Law and Economics 21 (1978), p. 187. Licensing restrictions have also been found to increase the incomes of those within the regulated profession.

In contrast, regulation is less likely to be beneficial if reputations for quality can be accurately established within a community at relatively low cost. Consumers may learn of a professional's reputation from friends, family, other professionals, advertisements, or trade names. To the extent that reputation is an effective signal of quality, consumers will be less apt to make inaccurate quality assessments and incur costs associated with an inaccurate assessment.

We now turn to a discussion of the specific provisions that the Legislative Audit Council may wish to reconsider.

### III. Analysis of Statutes and Regulations

#### A. Advertising by Real Estate Schools

Section 105-200 of the regulations of the Real Estate Commission concerns the advertising of real estate schools and provides that "[s]chool advertisements shall not appear under the real estate sales or help wanted columns of newspapers or directories." Limiting where advertisements can appear may increase the cost of advertising to potential real estate professionals. For example, schools may be able to inform more potential students with one advertisement in the real estate sales section than with two or more advertisements in another section of the paper.

The FTC has documented the adverse effects on consumers and competition of restrictions on advertising in the legal profession. A study by the Commission's staff concluded that fees for a number of routine legal services were higher in cities that imposed time, place and manner

restrictions on advertising.<sup>14</sup> Although we recognize that South Carolina may have concerns which justify this regulation, you might want to reevaluate the advertising restriction in light of the possible cost it could impose on consumers.

B. Nonresident Real Estate Professionals

Section 105-11 of the regulations of the Real Estate Commission states that the "Commission is authorized to license nonresident brokers and salesmen by reciprocity where the other state offers similar privileges to South Carolina real estate brokers and salesmen" (emphasis added). Section 40-57-140 of the South Carolina Code of Laws requires nonresidents who seek a South Carolina license, in addition, to "meet the statutory qualifications and standards required of residents." Thus, qualified out-of-state residents are allowed to compete in South Carolina only if South Carolina residents are also allowed to compete in the other state. While this restriction is favorable to South Carolina real estate professionals, because it insulates them from some sources of competition, it may not benefit consumers in South Carolina. The restriction might tend to benefit consumers in neighboring states, by encouraging these states to adopt reciprocity arrangements with South Carolina. In other professions, however,

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<sup>14</sup> Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising, Washington, D.C.: Federal Trade Commission's Cleveland Regional Office and Bureau of Economics, 1984.



restrictions on mobility have been found to increase both incumbents' incomes and the prices of services to consumers.<sup>15</sup>

### C. Real Estate Salesmen/Brokers

Section 105-17 of the regulations of the Real Estate Commission states that a broker shall not employ a salesman whose residence is located more than 25 miles from the broker's office. This restriction could reduce competition among real estate professionals and increase prices for real estate professionals' services. Although salesmen who live within 25 miles of the office may have a greater knowledge of the locality and thus provide higher quality services within that area,<sup>16</sup> salesmen may have a good knowledge of the area without currently residing in it. For example, a salesman may have lived in the area most of his life and recently moved to an adjoining neighborhood. The place of residency may not necessarily be related to quality of service.

The 25 mile limit rule appears to be arbitrary and is probably unnecessary, because the market should work to insure that brokers employ salesmen with a good knowledge of the locality. Although this restriction may have quality enhancing benefits, these benefits may be minor compared

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<sup>15</sup> Boulier, "Influence of Licensure on Dentists," In Occupational Licensure and Regulation. Edited by Simon Rottenberg. Washington, D.C.: A.E.I., 1980; Pashigian, "Occupational Licensing and the Interstate Mobility of Professionals," Journal of Law and Economics 22 (1979), p. 1.

<sup>16</sup> The Residential Real Estate Brokerage Industry, Washington, D.C.: Los Angeles Regional Office (LARO) of the Federal Trade Commission, 1983, p. 35 ("The geographic markets within which individual brokers operate are relatively small areas, and intense knowledge of the local market often represents the individual broker's most valuable expertise.")

to the potential costs that limited entry could impose on South Carolina consumers.

D. Engineers and Land Surveyors Paving Commissions

Section 49-17 of the regulations of the State Board of Engineering Examiners states:

The Engineer or Land Surveyor shall not offer to pay, either directly or indirectly, any commission, political contribution, or a gift, or other consideration in order to secure work, exclusive of securing salaried positions through employment agencies.

Although this regulation may be aimed primarily at deterring bribes and corruption, as currently stated, it may also deter some desirable behavior. The use of commissions to secure work may actually promote efficient outcomes to the extent that such payments encourage referrals which would likely benefit consumers. For example, referrals to a surveyor or engineer with particular expertise, even if based in part on the financial interest of the referring party, may serve the customer's interest better than retention of the matter by the less ideally skilled practitioner. To the extent that the above regulation discourages efficient referrals, it imposes costs on consumers. Although we recognize the possible benefits of this restriction, South Carolina policy makers might wish to consider, as well, the costs that this provision may impose on consumers.

#### E. Engineers and Land Surveyors Receiving Payments

Section 49-16 of the regulations of the State Board of Engineering Examiners states that engineers and land surveyors "shall not solicit or accept financial or other valuable consideration from material or equipment suppliers for specifying their products." While this regulation would prevent clearly fraudulent "kickbacks" that would harm consumers, it might also inhibit potentially beneficial outcomes. For example, engineers and surveyors may have insufficient incentive to provide valuable information to customers about the most desirable material or equipment supplier. To the extent that professionals provide less information to customers under this provision, a cost is imposed on consumers. South Carolina policy makers may want to consider this potential cost in their evaluation of the desirability of this regulation.

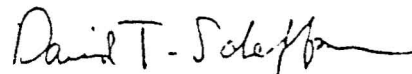
#### IV. Conclusion

Our analysis and experience lead us to conclude that several provisions of South Carolina's statutes and regulations governing real estate professionals, land surveyors and engineers may have anticompetitive effects. Although we recognize that South Carolina policy makers may have concerns which justify the imposition of the regulations mentioned above, you may benefit from a reconsideration of these restrictions in light of their costs.

We appreciate this opportunity to present our views. Please contact

staff economist Carolyn A. Woj at (202) 326-3434 should you have any questions regarding our comments.

Sincerely,

A handwritten signature in cursive script that reads "David T. Scheffman".

David T. Scheffman, Director

Bureau of Economics