Department of Justice

REGULATORY REFORM: A PROGRAM FOR THE STATES

Remarks by

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Today I would like to address a topic that can best be discussed in state capitals, like Richmond, all across the Nation. That subject is state and local government regulation, its costs and benefits.

Regulation at these levels of government is a huge enterprise. There are many more state regulators than federal--the states regulate things the federal government has not even heard of. One small sector of state regulation, occupational licensing, involves more regulation (in terms of the number of people involved and in economic impact) than all of the federal economic regulatory programs put together. States regulate other vital sectors at the core of the economy--banking, insurance, public utility services, communications and transportation. Also, state policies ostensibly directed at public health and safety concerns have important economic effects. In total, billions of dollars of commerce are directly affected by state regulatory decisions.

The diversity and significance of state and local regulation are illustrated by its effect on basic personal needs. How much your housing costs and its quality are influenced by zoning laws, building and housing codes, and rent control laws. The cost of health care has been boosted by the regulation of practitioners, certification of hospitals and

nursing homes, and the regulation of health insurance. State agricultural regulations have much to do with the quality and price of food. In short, as citizens and consumers, we all have an enormous and immediate stake in the quality and effectiveness of state and local regulation.

As the public has become aware of the scope of state regulation, it has also paid increasing attention to its costs and benefits. Because of this new sensitivity to the costs of regulation, we are in the midst of a historic reexamination of the role of regulation in the economy. This new look is occurring in Washington and in state and local governments throughout the country.

The causes of this reexamination, and the progress that has been made at all levels of government are important to an understanding of this critical public policy issue.

I am also, today, going to outline an agenda for action by this and similar audiences, to make a proposal for future federal-state cooperation so that the federal government and the states can constructively, cooperatively and systematically build on the initiatives already undertaken.

Let's begin our reexamination with regulation of the trades and professions. As of 1969, something like 10 percent of national income originated in occupationally licensed labor markets. 1/ Regulation of the professions is defended

as protection for the public against inferior, fraudulent, or dangerous services and products that practitioners, left to their own devices would too often inevitably provide. 2/ Under this rubric, regulation has been extended to occupations that, at the most, only minimally affect public health and safety. States license cosmetologists, auctioneers, weather control practitioners, taxidermists, junkyard operators, and weather vane installers, among others.

Moreover, studies show that delegation of regulatory powers to the affected occupational group itself and alone, a common practice, can lead to restrictions without discernible relationship to public protection. What are we to think of a rule preventing a professional from having his office in his home, as is the case with real estate sales regulation in some states? Or of another rule requiring hundreds of hours of meaningless and irrelevant instruction? Whatever else can be said, there is no denying that these and thousands of other similar restrictions substantially limit competition within the regulated industry. As a result, regulation may fail to achieve--may even defeat--the purposes it ostensibly serves. The Federal Trade Commission, for example, has studied prices and the incidence of fraud in the television repair business. The study found that the rate of fraud was not lower in a state (Louisiana) that licensed repairmen.

Prices for repairs in that state, however, were 20 percent higher than in two jurisdictions (California and the District of Columbia) that had no licensing scheme. 3/

A recent study of the effects of state regulatory programs suggested that even if licensing improves the quality of services sold in the marketplace somewhat, the corresponding increase in price may cause some buyers to do without the service altogether, or attempt do-it-yourself remedies, thereby reducing the overall quality of service. 4/ They found, for example, that strict licensing of electricians was correlated with greater numbers of accidental deaths of electrocution; that strict licensing of veterinarians was correlated with the underdiscovery of animal diseases, with a resulting increase in risk of infection to healthy animals and people; and that strict licensing of real estate brokers resulted in a longer period of vacancy in houses before sale. They also found that test pass rates were lower when brokers' incomes were higher, suggesting a direct relationship between restrictive licensing and higher prices. Moreover, the study showed that state regulators tended to manipulate the pass rate on licensing examinations to match the demand for services with a profitably limited number of new entrants.

None of this should surprise us at all. Comparable statistics from the federal experience show that similar

federal regulation is devastatingly costly. Before the CAB and then Congress loosened the federal regulatory grip, a study pegged the cost of air transport regulation at almost $2 billion annually. ICC regulation of trucking inflates prices somewhere between 5 to 20 percent, or perhaps as much as tens of billions of dollars a year. Ocean shipping regulation may have increased rates as much as 45 percent. The federal milk marketing order system, only one small part of farm regulation, costs consumers hundreds of millions of dollars, and costs some categories of farmers equally large sums in order to benefit other farmers. 5/

A growing consensus has developed that we can no longer afford the luxury of these regulatory costs. We now recognize that limitations on our natural resources require a national commitment to efficient use. We also now realize that persistent inflation is not entirely an economy-wide problem. It is also associated with individual problems in particular industries arising in part from the costs of regulation.

All of this evidence on the costs of regulation is leading us back to our economic "roots"--reliance on the competitive system. The old saw that competitive markets maximize consumer welfare by offering the greatest incentive for innovation and increased productivity is proving once again to work in real life, just as in the economic textbooks.

In 1975, the system of fixed brokerage commissions for stock transactions ended. As a result, institutional brokerage rates dropped more than 45 percent and individual rates fell some 15 percent. By the fall of 1976 the investing public had already saved about $700 million. 6/

The experience with air transportation deregulation has been equally gratifying. Deregulation of air cargo service has resulted in a wide spread of cost-based rates, and expanded service with a multitude of price-service options. Even more dramatic results occurred in the air passenger sector of the market. Increased flexibility with respect to fares and routes has led to a combination of lower prices, record numbers of passengers and quite healthy profits for the industry. The early returns also show that even for smaller communities, the level of service has actually increased. 7/ These results have led to intensive reviews for other federally regulated industries such as trucking, communications and ocean shipping. The Department of Justice is closely involved as a major participant in each of these efforts.

In addition to these efforts in specific industries, broader cross-cutting regulatory reform initiatives are being undertaken. Just last year, President Carter issued an executive order that required executive agencies to attempt to measure the costs and benefits of proposed actions. 8/

Now the President has introduced comprehensive legislation that would streamline the regulatory process. It would require agencies to establish priorities and deadlines for completing proceedings. Agencies would also be required to analyze carefully the benefits and burdens of proposed decisions with an eye toward selecting the most efficient regulatory solution. Legislation has also been introduced that would require focused consideration of the competitive impact of the most potentially disruptive types of agency action.

The states have not remained in the background of this steady stream of regulatory reform efforts. In fact, in many important instances, the states have been first, have been the most innovative, have provided, in effect extremely useful guidance to federal regulators and deregulators. Long before airline reform occurred at the federal level, California and Texas had adopted competitive regulatory approaches for their respective intrastate markets, resulting in inexpensive, efficient service for intrastate passengers and showing that competition could work in the industry. That experience proved to be persuasive to federal regulators and legislators when proposals for change were pending in Washington. The success of more competitive regulatory treatment of the trucking industries in New Jersey and Maryland has also helped spur reform at the federal level.

Several states have also led the way in procedural regulatory reform efforts. For instance, Florida has enacted an impressive bundle of statutes requiring reasoned and efficient regulatory decision-making. Its Administrative Procedure Act requires regulators to develop economic impact statements, assessing the costs and benefits of a proposed regulation, and paying particular attention to competition policy issues. The Florida legislature has also established mechanisms for systematic legislative review of all regulatory programs, with specific standards prescribed. In looking at regulatory programs, it is to look for unreasonably adverse effects on the competitive marketplace and it must seek to remove these impediments on competition.

Virginia is responsible for another innovative solution to the professional licensure problem. Since 1974 it has had a mechanism for systematically reviewing proposals to regulate professions. Before recommending any new regulation, the Board of Commerce must consider as less restrictive alternatives changes in law, for instance, the granting of inspection and injunction procedures. Only if these approaches are thought inadequate does the Board then consider mandatory licensing. In determining the proper degree of regulation the Board looks at such factors as:

(1) Whether the practitioner performs a service involving a hazard to the public health, safety or welfare, if unregulated.

(2) The views of those who do not practice the particular occupation.

(3) The number of states that have regulatory provisions similar to those proposed.

(4) Whether the profession, trade, or occupation requires such skill that the public generally is not qualified to select a competent practitioner without some assurance that he has met minimum qualifications.

(5) Whether current laws pertaining to public health and safety generally are ineffective.

(6) Whether the characteristics of the profession, trade, or occupation make it impractical or impossible to prohibit those practices of the profession which are detrimental to the public health, safety and welfare. The Board of Commerce then makes a detailed recommendation to the legislature.

Since the screening approach was initiated in Virginia, 17 groups have filed formal applications. Only two have ultimately received legislative approval. Each year since 1974, fewer and fewer groups have managed to get through the screening process. In 1977 not a single group was recommended for licensure.

State regulatory reform has also been given a boost by a cooperative federal-state program. In 1976, Congress established a limited three-year program for giving grants to the states for antitrust enforcement activities. Fifteen

state attorneys general have used some of these funds for competition advocacy activities. In these states the state attorneys general are playing a role like that of the Justice Department at the federal level--as a voice speaking up for competition and the free enterprise system in regulatory proceedings. For example, under this program the West Virginia Attorney General, Chauncey Browning, worked with all 32 occupational licensing boards in his state to add more competition to the regulatory process. Nine boards were told they had rules that conflicted with the antitrust laws. These rules are now being repealed. The Minnesota Attorney General's office has also undertaken a similar program. It persuaded its State Board of Cosmetology to delete a minimum fee schedule. Filings were also made with the State Denistry and Accountancy Boards and now a complete review of all state agency rules is under way with an eye toward eliminating unnecessarily anticompetitive regulations.

What do the voters think of all of these regulatory efforts? Oregon provides a good example. There the voters, by a 700,000 to 200,000 margin, ended the monopoly dentists had over the fitting of dentures. The referendum established a new category of dental health care professional licensed to sell, fit and manufacture dentures. The evidence shows the Oregon voters made a wise choice. Before the vote

Oregon dentists charged about $600-700 for dentures while paying dental technicians some $120 to $130 to manufacture the item. Dental technicians are now expected to fit dentures as well as manufacture them. In Canada where the dentists' monopoly was eliminated 20 years ago, prices are about one-half as high as United States prices. Prices to the Oregon consumer are now expected to fall to this level.

Of course not all of the regulatory reform efforts at the state level have been voluntary. In recent years through litigation the Parker v. Brown 9/ shield that sheltered private conduct with state involvement or state conduct from antitrust scrutiny, has been significantly reduced. In the famous Goldfarb 10/ case, a case we are all exceedingly familiar with in one capacity or another, the Supreme Court held that: "It is not enough that . . . anticompetitive conduct is prompted by state action; rather, anticompetitive activities must be compelled by direction of the state acting as sovereign."

Then in Cantor 11/ the Court held that a utility tariff that had been approved by a state public utility commission was not insulated from antitrust attack. In a third state action case, City of Lafayette, 12/ the Court held that municipalities could claim the protection of the state action exemption only to the extent that the state had expressly

delegated the authority to undertake the particular kind of action challenged.

An important additional decision was handed down recently by the Fifth Circuit. The Antitrust Division challenged a rule of the Texas State Board of Public Accountancy that prohibited accountants licensed to practice in Texas from engaging in competitive bidding. In that case, it was the State Board itself that was the defendant. The Board consists of nine full-time practicing accountants appointed by the Governor and approved by the state Senate.

The Board defended its no bidding rules on the grounds that it was a state agency, authorized by the state legislature to regulate accountants under a broad but vague statutory mandate. The Board reasoned, it was immune from federal antitrust attack, under Parker.

The Board lost. The court held that the rule prohibiting competitive bidding was a clear antitrust violation, and that the state action immunity simply wasn't applicable. This will mean that, where state agencies that are actually self-regulatory bodies have seized upon general authorizing language of the state legislature to promulgate regulations, those regulations must stand the test of antitrust attack on the merits.

As a direct result of another Supreme Court opinion, the NSPE case, most of those regulations will be suspect.

In NSPE we challenged a rule prohibiting competitive bidding contained in the code of ethics of the National Society of Professional Engineers. NSPE argued that its rule was not an antitrust violation because it was sound policy, for a number of health and safety related reasons--essentially, that if engineers had to compete on price, buildings would fall down as the result of the shoddy work resulting from price competition.

The Supreme Court unanimously rejected this defense. It emphatically rejected the notion that certain occupations or professions might be able to defend clearly anticompetitive arrangements on the ground that, in that occupation or profession, competition was simply not a good idea.

This collection of decisions by the Court has opened up the whole area of state and local regulation of economic activity, including occupational licensing, to close scrutiny under the federal antitrust laws. And it is important to remember that these newly sharpened tools can be utilized not only by the Antitrust Division but also by private parties--individuals and companies--that feel themselves damaged in some way by a state or local regulatory scheme.

In sum, ethical and other restrictions on the conduct of professionals and other occupations, if not truly the act of the state as sovereign, acting through independent state officials, cannot be defended against antitrust attack on

the grounds that competition is unreasonable. Health and safety, public ignorance, or other problems are not adequate reasons to defend anticompetitive conduct. The net effect is to bring the application of the antitrust laws to these kinds of restraints much more in line with similar restraints in other fields, and again to increase the pressure for a reexamination of both state regulation and self-regulation by occupations and professions and in other fields as well.

Where does this spate of legislation, litigation and competition advocacy activities leave us? I think the states as well as the federal government are at a significant crossroads. At both levels new efforts to mandate competition must continue. Antitrust and competition policy must now become familiar matters to state and local agencies. This will make these agencies' lives more difficult--more complicated--but in the end, it will help make their decisions sharper and more focused, and more likely to truly serve the public interest.

The job of reevaluating state and local regulation is in midstream. But several important tasks need completing. States must continue to undertake an industry-by-industry reexamination of regulatory schemes. I recently served as the chairman of a presidential commission that developed a catalogue of three analytical questions that states should ask when looking at regulatory departures from competition.

First, the study of a particular regulatory system should begin by considering the historical and economic context in which the system was created. What problem did the policy-makers believe they were solving when the system was created? Second, compared to the original assumptions, what have the results been? Have conditions changed? Were the original expectations for regulation correct? Third, what costs and benefits have been associated with the regulatory scheme? The answer to this question involves several specific inquiries. Are innovators being excluded from the marketplace? Can we compare the performance in the regulated industry to that in some unregulated market? Are customers of the industry working to escape or eliminate the regulations? In many cases answers to these questions will indicate that all regulation should be eliminated. In other cases regulation may continue to be necessary. Regulation, however, is not an all-or-nothing proposition. In many instances competition is a vital part of an overall regulatory solution. The goal should be to achieve the necessary regulatory goal in the least anticompetitive manner. This will reduce the costs of regulation without unduly hindering important social goals.

The second major remaining task is completing reform of the process of regulation. In each state, mechanisms need to be established to focus attention during the regulatory process

on the cost and benefits of regulation and the effects of regulation on competition. More members of the public need to become aware of regulation and the regulatory process. Membership on regulatory boards can no longer be limited to members of the affected industry and industry experts. More states need to adopt a law like California's Public Member Act, which provides for a majority of public members on all boards except the health-related and accountancy boards where the ratio is one-third public membership to two-thirds licensee membership. All these types of regulatory reforms will enable state and local governments to decide whether any regulation should be adopted, and if so, to adopt a statute that is fair to both consumers and practitioners. Such reforms will also promote accountability and public confidence in administrative structure.

We in the Antitrust Division have had 10 years' experience in the regulatory reform business. We have participated in legislative efforts at the federal and state levels and have appeared before numerous federal and state regulatory agencies. Our experience has taught us some lessons. The beneficiaries of anticompetitive regulation generally are well organized and intensely supportive of existing protections while in the past the beneficiaries of competition--the public at large--were less knowledgeable and less involved. I sense

this is changing. Long ago Bernard Shaw claimed: "Every profession is a conspiracy against the laity."

The laity is beginning to agree--and because of this belief regulatory reform is not only good public policy, it is good politics. In a time of swiftly rising prices and inflation, it is also good economics. The Antitrust Division will be paying increasing attention to these issues at the state and local level. I take this occasion to offer our services in an effort to help keep the reform momentum flowing. Some 120 lawyers and 40 professional economists work on regulatory reform issues in the Division. These resources will be applied, with the help of state and local governments and the public at large, to help in the continuing effort to make state and local regulation more efficient and effective. We rate this program one of our new top priorities in the Division. I see no other task more important facing state and local government. With the momentum that has already been generated, with the joint efforts of federal, state and local authorities, and with the high priority that the public will assign the regulatory reform agenda, real dollars-and-cents progress across a broad front is well within reach.

FOOTNOTES

1/ Carroll and Gaston, Occupational Licensing, at 2 (1977).

2/ See, e.g., Shimberg and Roederer, Occupational Licensing: Questions A Legislature Should Ask (1978) for a summary of the arguments made by those seeking regulation.

3/ This study is described in Staff Paper on the State Action Immunity to the National Commission for the Review of Antitrust Laws and Procedures, p. 3 (1979).

4/ Carroll and Gaston, supra n. 1.

5/ See Report of the National Commission for the Review of Antitrust Laws and Procedures, at 181-82 (1979).

6/ Id. at 182.

7/ Id. at 185.

8/ Executive Order 12044, 43 F.R. 12661 (1978).

9/ 317 U.S. 341 (1943).

10/ Goldfarb v. State Bar of Virginia, 421 U.S. 773 (1975).

11/ Cantor v. Detroit Edison, 428 U.S. 579 (1976).

12/ City of Lafayette v. Louisiana Light and Power Co., 435 U.S. 389 (1978).