



BUREAU OF COMPETITION

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

COMMISSION AUTHORIZED

November 7, 1989

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 Commission¹ is pleased to respond to the invitation of the Legislative Audit Council of the State of South Carolina to comment on the possible restrictive or anticompetitive effects of the statutes and regulations governing eight state agencies.² The analysis below discusses provisions governing three of the agencies that may have anticompetitive effects and thereby injure consumers. Those agencies are the Commissioners of Pilotage for the Port of Charleston, the Auctioneers' Commission, and the Board of Registration for Foresters. Our comments are largely confined to the provisions that your letter identifies as raising possible competitive concerns.

Although the statutes and regulations of the five agencies on which we do not comment may also raise significant competition issues, we do not have the expertise to offer an opinion on their merits. You may wish, however, to consider these provisions in light of the analysis of the published research on the effects of occupational licensing that we submitted to you on January 23, 1989.

I. Interest and Experience of the Staff of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Under this

¹ These comments are the views of the staff of the Federal Trade Commission's Bureau of Competition. They are not necessarily the views of the Commission itself or any individual Commissioner.

² The agencies regulate harbor pilots, polygraph examiners, private detectives and private security agencies, foresters, professional counselors and marital and family therapists, auctioneers, and hearing aid dealers and fitters. Another agency promotes economic development in South Carolina.

statutory mandate, the Commission seeks to identify restrictions that impede competition or increase prices without offering countervailing benefits to consumers. The Commission has sought to improve consumer access to professional services by initiating antitrust enforcement proceedings.³ In addition, the staff of the Commission has studied various facets of the regulation of licensed professions,⁴ and has submitted comments to state legislatures and administrative agencies, including the Legislative Audit Council of South Carolina,⁵ on various issues of professional licensing and regulation.⁶

³ See, e.g., *Massachusetts Board of Registration in Optometry*, 110 F.T.C. 549 (1988); *Rhode Island Board of Accountancy*, 107 F.T.C. 293 (1986) (consent order); *Louisiana State Board of Dentistry*, 106 F.T.C. 65 (1985) (consent order); *American Medical Ass'n*, 94 F.T.C. 701 (1979), *aff'd*, 638 F.2d 443 (2d Cir. 1980), *aff'd mem. by an equally divided court*, 455 U.S. 676 (1982); *American Dental Ass'n*, 94 F.T.C. 403 (1979), *modified*, 100 F.T.C. 448 (1982), 101 F.T.C. 34 (1983) (consent order).

⁴ See, e.g., *Cleveland Regional Office and Bureau of Economics, Federal Trade Commission, Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising* (1984); *Bureaus of Consumer Protection and Economics, Federal Trade Commission, A Comparative Analysis of Cosmetic Lens Fitting by Ophthalmologists, Optometrists, and Opticians* (1983); *Bureau of Economics, Federal Trade Commission, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry* (1980).

⁵ The staff of the Commission has provided comments to the Legislative Audit Council on six prior occasions. In comments filed from February 1987 through March 1989, the staff commented on statutes and regulations governing the state's Board of Optometry and Opticianry, Board of Podiatry Examiners, Board of Occupational Therapy Examiners, Board of Speech and Audiology Examiners, Board of Psychology Examiners, Public Service Commission, Licensing Board for Contractors, Residential Home Building Commission, Real Estate Commission, Board of Certification for Environmental System Operators, Board of Registration for Professional Engineers and Land Surveyors, Manufactured Housing Board, Board of Registration for Landscape Architecture, Board of Architectural Examiners, Board of Funeral Service, Board of Examiners for Registered Sanitarians, Board of Social Work Registration, and Building Code Council.

⁶ See, e.g., *Comments of Staff of Federal Trade Commission on Florida Bar Rules of Professional Conduct* (July 17, 1989); *Comments of Federal Trade Commission Staff on Rules of Idaho State Board of Chiropractic Physicians* (December 7, 1987).

II. Analysis of Statutes and Regulations

A. Commissioners of Pilotage for the Port of Charleston

The statute governing the Commission of Pilotage for the Port of Charleston contains a number of provisions that restrict entry into the business of pilotage. The statute limits the number of pilots in the port of Charleston to fifteen.⁷ To be eligible for a pilot's license, an applicant must be recommended by a majority of the pilots in the port of Charleston.⁸ In addition, all boats commissioned and used for pilotage in Charleston, must be "owned and manned by the group of associated pilots then currently licensed."⁹ Licensed pilots are prohibited from engaging in any business other than pilotage¹⁰ and from discontinuing pilotage services, other than for reasons of health, without the authorization of the commissioners of pilotage.¹¹

The statute also contains provisions governing the price of pilotage services. It authorizes the commissioners of pilotage to fix the rates and fees for pilotage services.¹² The statute requires every vessel entering the harbor pilotage area to accept pilotage services and enforces this requirement by mandating that a vessel pay for the services even if it declines the use of a pilot.¹³ Finally, while the statute requires vessels to use licensed pilots, it limits liability for damages caused by pilots' "errors, omissions, fault, or neglect" to \$5000.¹⁴

Although we do not have expertise in harbor pilotage, and thus cannot predict with certitude the effects of the restrictions outlined above, the effects of price and entry

⁷ S.C. Code Ann. § 54-15-130. See also S.C. Code Ann. § 54-15-120. Similar restrictions are imposed in other ports as well. See S.C. Code Ann. § 54-15-130. For convenience, we address solely the provisions concerning the Port of Charleston.

⁸ S.C. Code Ann. § 54-15-60.

⁹ S.C. Code Ann. § 54-15-180.

¹⁰ S.C. Code Ann. § 54-15-200.

¹¹ S.C. Code Ann. § 54-15-210.

¹² S.C. Code Ann. § 54-15-290.

¹³ S.C. Code Ann. § 54-15-270.

¹⁴ S.C. Code Ann. § 54-15-350.

regulations for harbor pilotage are likely to be similar to those in other markets. It should be emphasized that our analysis is confined to the effects of price and entry regulations and does not address regulations designed to enhance navigational safety. We recognize that safety regulation in the maritime context is necessary to protect not only seafaring vessels but also the public at large, which can suffer great harm from the discharge of various kinds of cargo in navigational mishaps.

Restrictions on entry tend to increase the price of the goods or services provided by a line of business.¹⁵ As a general matter, markets are better equipped than regulators to determine the appropriate level of supply of a service, by adjusting the supply for any service in response to changes in demand. Thus, an increase in the use of Charleston harbor, and hence in the demand for pilotage services, would tend to lead to an increase in the price of pilotage services. Such an increase would, in turn, attract entry into the pilotage business and lead to the stabilization of the price at the competitive level. Conversely, a decline in the demand for pilotage services would tend to result in a decrease in the price for the service and the exit of some pilots from the business, with the price again stabilizing at the competitive level.¹⁶ Absent regulatory restrictions or other barriers or impediments to entry,¹⁷ markets tend to adjust supply quickly to meet demand for a service.

When the number of suppliers is fixed by statute, as it is for pilots in South Carolina, the opportunity for new suppliers to enter into the market is curtailed. As a result, incumbents may charge higher prices than would prevail in a competitive

¹⁵ Please refer to Part II of our January 23, 1989, letter to you for a discussion of the effects of entry restrictions imposed through licensing on the price of professional services.

¹⁶ The increase or decline in demand referred to in the text must be more than temporary to have these effects. Obviously, all businesses will have day-to-day or month-to-month fluctuations in demand for their services.

¹⁷ Barriers to entry are long-run costs that must be incurred by entrants into a business but were not incurred by incumbent firms. Environmental regulations, for example, can be entry barriers. Impediments to entry are conditions that necessarily delay entry into a market for a significant period, such as when new entry is possible only through the construction of a plant that cannot be completed for a number of years. See *B.F. Goodrich Co.*, 110 F.T.C. 207, 295-97 (1988).

market.¹⁸ The statute further deters the entry of suppliers who are likely to be vigorous competitors by conditioning new entry, when the number of licensed pilots falls below fifteen, on the entrant's endorsement by a majority of incumbent license owners. Given an opportunity to veto new entry, incumbents may prevent particularly aggressive competitors or innovative and more efficient suppliers from entering the market. By empowering incumbents to select entrants, the law encourages pilots to act as collaborators, not competitors.

The statute also limits the business practices of pilots in a manner that may reduce the efficiency of service. Thus, the requirement that all boats used for pilotage in Charleston be "owned and manned by the group of associated pilots then currently licensed," coupled with the prohibition on license holders' engaging in businesses other than pilotage, prevents potentially beneficial business arrangements. For example, the restrictions prevent shipping firms that use Charleston harbor from operating pilotage services for their own vessels and may prevent efficient providers of pilotage services from simultaneously operating more than one pilot boat.¹⁹ Together, these restrictions tend to encourage incumbent license holders to operate as a close-knit fraternity of pilots, rather than as businesses that compete vigorously in whatever spheres offer an opportunity for profit.²⁰

South Carolina law also provides for price regulation of pilotage services. Although price regulation may have originated as a means to prevent public utilities, which were thought to be

¹⁸ A study by the Commission's Bureau of Economics concerning restrictions on entry into the taxi market, which appear to be analogous to regulations restricting entry into the pilotage market, is particularly instructive. Among other things, the study concluded that entry restrictions enable incumbent firms to exercise market power. See M. Frankena & P. Pautler, *An Economic Analysis of Taxicab Regulation* (FTC Bureau of Economics 1984).

¹⁹ If each license holder must both own and operate his boat, he is unlikely to operate more than one boat. If, alternatively, the statute mandates that boats be owned and operated collectively by the group of licensed pilots, it would, at a minimum, reduce competition among pilots.

²⁰ The restriction against discontinuing pilotage other than for reasons of health, if it is designed to insure that enough pilots are available at any time, might become unnecessary if entry restrictions were removed and the market were allowed to determine the number of pilots in business.

natural monopolies, from exploiting their market power,²¹ some scholarly studies have questioned whether public utility regulation results in lower prices than would prevail without rate regulation.²² Whatever the effects of price regulation on natural monopolies, in otherwise competitive markets consumers typically benefit from vigorous competition among suppliers that is unimpeded by rate regulation.²³

There is reason to believe that South Carolina's law may not result in the lowest prices possible for the quality of services pilotage customers prefer, in spite of the provision for price regulation.²⁴ As an initial matter, it appears that the pilots' association may exercise some influence over the Commission of Pilotage. Although the statute directs the Commission of Pilotage to establish price regulations, the regulations do not set forth price levels or procedures for determining them. Instead, the Commission's regulations authorize the pilots' association to adopt a "Financial Agreement embodying such details with respect to monetary matters as they feel are necessary to fairly provide for and protect the interests of present and future members as well as retired members."²⁵ Even if incumbent pilots do not exercise influence over the Commission's decisions, incumbent pilots may lack the incentive to innovate and increase the efficiency of their service in the absence of a market-based incentive, such as the opportunity to capture market share by offering a service at a lower price.

²¹ See S. Breyer, *Regulation and Its Reform* 15-18 (1984); Jarrell, *The Demand for State Regulation of the Electric Utility Industry*, 21 J.L. & Econ. 269, 272-76 (1978).

²² See, e.g., Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J.L. & Econ. 1 (1962); Moore, *The Effectiveness of Regulation of Electric Utility Prices*, 36 So. Econ. J. 365 (1970); ; Jordan, *Producer Protection, Prior Market Structure and the Effect of Government Regulation*, 15 J.L. & Econ. 151 (1972).

²³ We have no reason to believe that harbor pilotage is a natural monopoly. For that reason, price regulation likely represents a response to entry restrictions, which may enable incumbent pilots to charge higher than competitive prices.

²⁴ Insofar as price regulation succeeds in maintaining prices at a lower level than would prevail in an unregulated market, it can reduce suppliers' incentive to provide the quantity and quality of the regulated products that consumers desire.

²⁵ Regulations of Commission of Pilotage for the Port of Charleston, § 4 (emphasis added).

Such an incentive is restrained by regulatory barriers to entry and the impediment to competitive operation of multiple pilot boats. Consequently, regulatory restrictions would tend to discourage cost-saving innovations that could lead to lower prices.²⁶

Finally, the statutory limitation on damages resulting from pilots' negligence may reduce the quality of pilotage services. Exposure to liability provides pilots with an incentive to adopt safety measures whose cost is lower than the expected benefit. For example, absent liability limitations, a rational pilot would buy a \$400 device if it can reduce the likelihood of an accident causing \$50,000 in damage from 2 percent to 1 percent.²⁷ But with a \$5,000 damage cap, the pilot would not buy the safety-enhancing device unless its cost was less than \$50. As a result, overall safety is likely to diminish in the long run.

B. Auctioneers' Commission

You have asked us to address two provisions of the South Carolina statute and regulations governing auctioneers. First, the auctioneering statute requires applicants for an apprentice auctioneer license to submit statements by at least two licensed auctioneers attesting to the applicant's moral character.²⁸ We doubt that this provision has a significant effect on competition because South Carolina law also provides for the licensing of auctioneers who have not served as apprentices but have had at least eighty hours of classroom instruction in auctioneering.²⁹ These applicants can satisfy the statutory moral fitness

²⁶ Another possible outcome of price regulation is that prices are lower than they would be under an unregulated monopoly but higher than they would be in an unregulated competitive market. It is thus possible that pilotage prices could be even higher if entry restrictions were not accompanied by price regulation, though not as low as they would be if both entry restrictions and price regulations were removed. For that reason, if the Commission on Pilotage in fact has a functioning system for regulating the price of services rendered, we suggest that any repeal of price regulation should be accompanied by the repeal of entry restrictions.

²⁷ This is because the value of a one percent reduction in the probability of a \$50,000 loss is \$500 (one percent of \$50,000). For simplicity of illustration, we have eliminated the time element from this example and assumed the loss to be immediate.

²⁸ S.C. Code Ann. § 40-6-70.

²⁹ S.C. Code Ann. § 40-6-130.

requirement by submitting the statements of two residents of South Carolina, who need not be auctioneers.³⁰ This provision would tend to prevent incumbent auctioneers from restricting entry into the profession by refusing to certify applicants' moral character. Consequently, the moral fitness requirement would seem to have little adverse impact.³¹

The second provision you have asked us to review is a regulation that prohibits auctioneers from advertising any award, title, or other recognition received from any association or professional organization that has not been approved by the Auctioneers' Commission.³² The regulation establishes a procedure for requesting the Commission's approval of a particular association or organization body for promotional purposes and requires the Commission to grant such approval unless a reference to that body would be misleading.³³

The advertising of awards, titles, or other forms of recognition by professional organizations can help consumers predict the nature and quality of the services available from various practitioners. The quality of professionals within any profession can vary widely, and the recognition of particularly skillful practitioners by bona fide professional organizations can be useful to consumers in differentiating professionals.³⁴ Professional awards and certification may provide a useful means for consumers to overcome a lack of information about the experience, knowledge, and skills of practitioners.

³⁰ *Id.*

³¹ To the extent that qualifying auctioneer classes are not widely available, so that apprenticeship is the principal avenue for entry into the profession, the requirement of attestations by incumbent auctioneers could have some marginal adverse impact on competition. See Part II(C), *infra*.

³² Regulations of the Auctioneers' Commission, § 14-18.

³³ *Id.*

³⁴ The Alabama Supreme Court has observed that "[i]t would be less than realistic for us to take the position that all lawyers, in fact, possess equal experience, knowledge and skills with regard to any area of legal practice." *Ex Parte Howell*, 487 So.2d 848, 851 (1986). The same is likely to be true for auctioneers. The Alabama court held that a total ban on attorneys' truthful representations of professional recognition by certification organizations was unconstitutional, and elected instead to permit advertising only of certification by approved organizations.

Consumers benefit from information concerning professional recognition when that recognition represents an objective measure of a professional's performance that is relevant to the services the professional provides. Absent these conditions, claims of professional recognition may deceive consumers. The public may be misled by claims concerning professional recognition that are not in fact based on the professional's advanced training or experience or the professional's attainments in the profession. Claims of professional recognition may also mislead consumers when a professional is recognized in a field that is not relevant to the services the professional offers. For these reasons, some regulation of professionals' certification claims may be appropriate to prevent or cure any deception.

C. Board of Registration for Foresters

You have asked us to review two provisions of the South Carolina law and regulations governing foresters. The first provision requires applicants for a license as a forester to furnish three references from foresters having personal or professional knowledge of the applicant's forestry experience.³⁵ We are not sufficiently familiar with the structure of the forestry market in South Carolina to predict the effects of this requirement. While any provision that requires entrants to secure the endorsement of incumbents to enter a profession may restrict entry, it will not necessarily have that effect. Many states, for example, require applicants for licenses as attorneys to secure references from incumbents, but this requirement is highly unlikely to inhibit entry. To the extent that entry is deterred, it is by the licensing requirement itself. On the other hand, if the forestry market is not competitive and the number of incumbent licensees is small, the reference requirement could result in restricted entry.

The second provision is a regulation setting forth a code of ethics for foresters.³⁶ Although some codes of ethics may mask anticompetitive restrictions in the guise of ethics,³⁷ codes of ethics can also be beneficial. Provisions in codes of ethics that prohibit conflicts of interest or breaches of confidential relationships, for example, can benefit consumers. We do not

³⁵ S.C. Code Ann. § 48-27-140.

³⁶ Regulations of Forestry Registration Board, § 53-15.

³⁷ See, e.g., *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978).

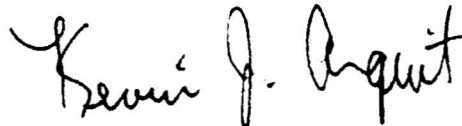
George L. Schroeder
Page 10

find any provisions in the code of ethics adopted by the Foresters' Registration Board that raise competitive concerns.

Conclusion

We are pleased to have this opportunity to present our views on the licensing statutes and regulations that you have submitted for our review. Our analysis suggests that certain provisions governing harbor pilots, auctioneers, and foresters could have anticompetitive effects. We are particularly concerned that provisions restricting entry into the harbor pilotage business could result in higher prices for pilotage services. If the Council has questions concerning provisions not discussed in this letter, we encourage you to contact us for further review.

Sincerely,

A handwritten signature in cursive script that reads "Kevin J. Arquit". The signature is written in black ink and is positioned above the typed name and title.

Kevin J. Arquit
Director