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## **The Regulation of Licensed Industries in Small Economies: Limiting the Number of Participants or Encouraging Competition for Better Service Quality**

*Jadranka Mrsik, Marko Andonov, Kimo Cavdar*

### **Abstract**

*The regulation of professions that provide services to the public is necessary to ensure the quality of their services and to protect the interests of their users. However, it can have some adverse effects such as eliminating or restricting competition and reducing transparency. Therefore, establishing a balance between the interest that is supposed to be achieved by regulation and the need to allow competition is becoming more obvious. This is particularly evident when applying regulatory standards in small economies. While the main principles of competition and regulation as developed in major economies are suitable for small economies, their application should be different due to the characteristics of small and limited markets. This chapter will cover three professions - lawyers, accountants and architects, as the most numerous and longest present in the Macedonian market. In the review of the regulation of these professions in Macedonia, a comparison is made with those of the ten new member countries from Central and Eastern Europe (CEE-10). The purpose of this chapter is based on the comparison and experience of the operation of the regulated professions and industries in Macedonia, and to make recommendations for establishing regulatory systems that will enable protection of the public interests and development of these industries.*

*Keywords: regulation, licensed industry, licensed profession, self-regulated organizations, competition, small economies.*

## Introduction

People rely on the ethical integrity of professionals because they provide intangible services and customers have to believe that the services that they receive are of a good quality. This explains the need for governments or governmental bodies to regulate these professions, or transfer regulatory processes to self-regulated organizations with delegated regulatory power.

The first aim of this chapter is to review the professions in Macedonia in terms of their regulation as well as the impact regulation may have on competition within these professions. The second aim is to provide suggestions for the future direction of the regulations which apply to these professions. As such, this chapter will focus on regulations for lawyers, accountants and architects, and the conclusions can be applied to similar professions as well (such as notaries, engineers, tax advisors, and auditors). Then a comparison of data will be made with the ten countries of Central and Eastern Europe, which are members of the European Union.

When adopting the conclusions and proposals for regulation and their competition in the professional occupations in the small markets we must take into account the regulated industries such as the capital market, pension funds, and university education in Macedonia. The experience taken from their regulation is useful with regard to the large number of service users and the consequences on public opinion and trust in these industries when the service providers fail. Furthermore, these industries are sensitive because of the high requirements and conditions for providing adequate and costly capacities and technical conditions. The regulation of the notary profession imposes quantitative entry restrictions but for the other professions entry is open to all who meet the requirements of these service provisions.

In these circumstances, it is questionable whether the regulation of professions and industries, particularly of the small markets, is necessarily in the interest of their users. The reason for this dilemma is the non-methodical issuing of approvals for such works to all who meet the required conditions. Because of the collapse of the large state companies, during the transition process, some former employees such as lawyers and accountants became the new providers of professional services. The increased number of professional service providers has resulted in a lowering of charges for their services and in turn a lowering in the quality of the services that they provide. Such behavior is very notable among the accountants and the brokerage houses (offering service with 0% commission). The above mentioned can disrupt the entire

market of these services by violating trust in all the service providers, or jeopardizing the cost-effectiveness of the service providers.

In recent years, the regulated professions in Macedonia clearly demonstrate examples of the negative outcome of an unrestricted entry of participants onto the capital market and the high entry requirements on the pension market. During the Macedonian stock exchange boom in 2007, caused by the global trend and extreme optimism in share price growth, the number of brokerage houses in Macedonia increased from 17 in 2006 to 29 in 2008. As a result of the sharp decline in stock prices and trade, most of the new brokerage houses have been facing financial problems, thereby causing a reverse process of reducing their number down to 13 in 2013. Only two licenses for establishing pension companies have been issued which in the absence of limitations on legal fees have introduced an extremely high entry fee of 9.9%. Regarding the negative consequences from restricting the entry of more participants in 2010, market liberalization and the legal determination of commission was introduced. The strict conditions for market entry and the small number of eligible companies do not create favorable conditions for opening new pension companies.

The selected service providers referred to in this chapter have strict requirements for establishing and operating companies which include: the limitation of those who can become a founder, a substantial initial capital, high technical requirements, a minimum number of licensed personnel, regulatory body fees and the large number of service users. The non-existence of limitations to entry of the service providers can produce the closure of a number of companies due to their inability to cover the high cost of their operations, in turn causing adverse consequences to the reputations of all members in these industries. In terms of the limited demand for such services, and the planning of individual services on offer which is required in order to offer services that are in the interest of the development of these industries, in order to protect the interests of the service users and to encourage the growth of these industries.

### **The Regulation of Industries and Professions, and Competition**

We depend on professionals to maintain our health, handle our legal and financial affairs, protect our political interests and manage businesses that provide us with employment and consumer goods (Jennings et al., 1987). Not only are individuals more and more dependent on professionals, but they have

a great importance in society. Nearly every market segment of the modern economy - manufacturing, technology, transportation, or energy - intersects with the professional services industry at multiple levels – whether they are lawyers, accountants, or engineers (Williams and Nersessian, 2007). On the other hand they are a powerful economic force that plays an increasing role in the global economy. According to the European Commission (Boot et al., 2013), there are 800 different activities in the EU: “that are considered to be regulated professions in one or more member state and relate to service providers with specific qualifications”. Professional services accounted for 10.2% of GDP in the EU and 2.4% in the number of employees (The CityUK, 2013). In Macedonia, professional services are not yet fully developed and their share in GDP in 2011 was 2.3%. The share in GDP of legal, accounting, architectural and engineering services in GDP is 1.7%, while the share of the employee in these services in total employment is 2.2% (The State Statistical Office of Republic of Macedonia, 2013).

The activities of the professional service providers are regulated in almost all countries, either directly or by the delegation of the regulatory power to the professional associations. The regulation of these professions may relate, among other things, to the following: the number of participants in the profession, the price professionals can charge, the organizational structure, the ability to advertise and the work that can be performed by the members of that profession. Such restrictions can reduce or eliminate any competition between the service providers and thus reduce the incentive of the professionals for cost- efficient operation, lower prices, higher quality or the supply of service innovation. In the past, there was a growing knowledge in many countries (Schultze, 2007) that the occupational regulation has a direct or indirect effect on reducing competition in the market of professional services.

In efficient markets, competition provides significant benefits for the service users through the possibilities of better selection, lower prices and a better quality of goods and services. However, the markets do not always deliver the best results for the consumers of goods and services, the companies or governments. To resolve this, the governments set legal and institutional frameworks for the operation of markets and companies. This way, the governments intervene to achieve specific goals and to prevent the collapse of markets. The unlimited rule of law of free competition in small markets in certain regulated professions can lead to a violation of public trust,

market failure or the destruction of interest in the participation of new participants.

The criticisms over the limitations on the regulations, the consequences on pricing and the quality of services, and the availability of services to all users are very common. Numerous studies in various professions have been conducted to determine the impact of entry restrictions for prices and services, and the overall results. Most of these studies were conducted in developed countries with highly developed markets of professional services. A comprehensive review of these papers done by Olsen (1999) confirms that restrictions on entry into the profession caused higher prices. The study of OECD (2002) also shows the negative effect of the excessive regulation on service users, such as higher prices and lower quality. Other research (Stephen and Love 1999) shows that the increased number of lawyers does not affect increased competition in terms of cost reduction and a greater range of services. Therefore, Van den Bergh (2006) states that it is difficult to determine a general conclusion about the effect of input constraints on the regulated professions.

### **Methodology**

The review of the regulatory framework of the regulated professions is made on the basis of the relevant literature, laws and websites of professional associations, other online sources and in-depth interviews with individual members of the profession. The survey includes the following occupations:

- Lawyers (legal services),
- Accountants (accounting services) and
- Architects (technical services).

The regulation of these groups of professions is reviewed through the basic limiting regulations:

- Regulation of entry;
- Regulation of price;
- Restriction of advertising and
- Business structure and inter-professional collaboration.

The results that have been gathered in are compared with the report on the regulation of liberal professions in Stocktaking Exercise on Regulation of Professional Services of the European Commission (2004) in ten new EU member states (Estonia, Latvia, Lithuania, Cyprus, Malta, Poland, Slovenia, Slovakia, Hungary and Czech Republic).

## Results

In the countries that have been researched, the requirements for joining the professions are usually high: a certain number of years of university education and professional experience, successfully passing the compulsory exam and mandatory membership of professional associations. All these countries have the strictest conditions for joining the legal profession such as: five years of university education and on average two and a half years of professional experience, passing an expert exam and mandatory membership of professional associations. The accounting services require a minimum period of education (three years), relevant professional experience (for example in Poland it is three years) and successfully passing an exam. The membership of professional associations in these countries is compulsory except in Latvia and in Poland. The process for obtaining a license for architects takes seven to ten years and consists of a five-year of university education, a minimum of three years professional experience (five in Lithuania), successfully passing the professional exam (except in Estonia and Hungary) and with some exceptions, membership of a professional association.

Table1: Countries and professions according licensing regulations

Profession	Level of education	Previous professional experience	Expert exam	Mandatory membership in a professional association
Lawyers	All countries	All countries	All countries	All countries
Accountants	All countries	All countries	All countries	All countries (except Latvia and Poland)
Architects	All countries	All countries	All countries (except Estonia and Hungary)	All countries (except stonia, Lithuania and Latvia)

Source: European Commission (2004). Stocktaking Exercise on the Regulation of Professional Services. The information for Macedonia was provided by the web pages of the regulatory and the professional bodies.

The prices of professional services are less regulated in all the countries examined in this chapter although the regulation for legal services is the strictest. Some countries apply minimal prices for legal services, and others have maximum prices (Latvia), while some countries determine a fixed price (Estonia) or a recommended price (Slovakia and Lithuania). The professional associations in Poland and Hungary do not interfere with the level and structure of the prices of legal professionals. The service prices of the other two professions are significantly less regulated, especially in the case of accountancy, with the exception being the case of Slovakia. In some countries there is a loose regulation of the prices for architectural services in the form of recommended prices (Czech Republic, Hungary, Latvia, Slovakia and Slovenia) or there is no limitation in the other countries.

Table 2: Countries and professions according pricing regulation

	Minimal prices	Maximal prices	Fixed prices	Referent	Recommended prices	Not regulated
Lawyers	Cyprus, Malta, Czech Republic, Slovenia	Latvia	Estonia, Macedonia	Slovakia and Lithuania		Poland and Hungary
Accountants				Slovakia		
Architects					Czech Republic, Hungary, Latvia, Slovakia and Slovenia	All other countries

Source: European Commission (2004). Stocktaking Exercise on the Regulation of Professional Services. The information for Macedonia was provided by the web pages of the regulatory and the professional bodies.

In most of the countries surveyed in this chapter, advertising legal services is not allowed. Whilst there is a general prohibition on advertising in Estonia, Lithuania and Poland, Lawyers in Poland cannot advertise, while legal advisors have a limited freedom of publicity, for example, they can provide information on the scope of activities, areas of legal advice, professional experience and the basis for the calculation of remuneration.). By contrast, in the Czech Republic, Hungary and Slovenia most forms of publicity are allowed, whilst in Latvia, only few. In Slovakia advertising is allowed, but with significant restrictions.

Table 3: Countries and professions according advertizing regulation

Profession	Advertizing prohibited	Limited	No limitation
Lawyers	Estonia, Lithuania, Poland, Macedonia	Slovakia, Check Republic, Hungary, Slovenia and Latvia	
Accountants		Poland	All other countries
Architects			All countries

Source: European Commission (2004). Stocktaking Exercise on the Regulation of Professional Services. The information for Macedonia was provided by the web pages of the regulatory and the professional bodies.

The rules for the structure of these professions are mainly relevant to the opening of branches, and the legal formation of organizations or the opportunity for developing inter-professional associations. These rules include a requirement for liability insurance when carrying out services. Regulations for the location and diversification of performing legal services only exist in Slovenia, whilst in the other countries there is no such regulation for any of the examined professions. The form of work organization is regulated in all the countries for all the professions concerned. Liability insurance is required for all professions and countries subject to review, with few exceptions. Partnership with other professions is not allowed for lawyers in all the countries, whilst for accountants and architects there is no limitation in this regard.



Table 4: Countries and professions according to organizational type of work

Profession	Location and dispersion	Form of legal subject	Mandatory insurance	Partnership with other professions
Lawyers	Slovenia	All countries	All countries except Latvia	All countries
Accountants		All countries	All countries except Latvia	
Architects		All countries	All countries except Estonia and Hungary	

Source: European Commission (2004). Stocktaking Exercise on the Regulation of Professional Services. The information for Macedonia was provided by the web pages of the regulatory and the professional bodies.

The revision of the four points of regulation of the examined regulated professions in Macedonia demonstrates similar characteristics to the corresponding ten countries in the European Commission Report. Notable differences are the relatively late introduction of regulations for accounting services and the absence of any self-regulatory body function in accountancy.

### Conclusions and Recommendations

The increased number of employees engaged in professional services and their contribution to national products make the professional services an important part of the economies in all the countries concerned. Professional services are on the increase in the developing countries, mainly as a result of changes in the economy during the transition process. In recent years the importance of the professional services in Macedonia has been growing and new professions are emerging, such as: notaries, administrators, tax advisers, brokers, investment advisors, accountants, and auditors.

These professions are highly regulated in order to provide protection for the profession and service users. The developing countries in the transitional period, when building a market system, were adopting regulatory standards from the developed countries. But the question is, whether the same regulation is appropriate for small markets? The examples from the practice of the regulated industries in Macedonia provide evidence of a negative impact of inappropriate price regulation and of incentives to join one of these industries. The results of the professions surveyed in this research

project demonstrate that in Macedonia the professions are regulated at the same level as in the other comparable countries, with a few exceptions in the accounting profession.

Regulation is an important factor in determining the possibilities and the prospects of the industries of professional services. Therefore, an effective regulatory system that protects and enables the development of the regulated industries is required. Establishing a regulatory framework in the small markets is crucial for enabling the development and growth of trust in the regulated industries and the newly emerging professions. Based on the survey of these professions and industries, we consider the following suggestions:

- Using a system of revisions for measuring the effects of regulations and making any changes accordingly, when they are deemed necessary.
- Implementing measures to harmonize competition and regulation, and
- Involving service users in the process of regulation.

At the end of the day, the key role of the regulation is to enable fair competition by establishing a “just playing field” for all participants in the regulated markets and by this the service users will gain more trust in the market.

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