

spotlight

No. 271 – November 17, 2005

GOVERNMENT TRADE RESTRAINTS *How N.C. Hurts Consumers by Restricting Competition*

S U M M A R Y : North Carolina recently filed a lawsuit going after private restraints of trade. But if the state really wants to reduce unfair trade practices and help consumers, it should eliminate or modify its own anti-competitive policies. The certificate of need law, occupational licensing, and other state-imposed restraints of trade hurt consumers and the economic freedom of North Carolinians.

.....

attorney General Roy Cooper recently filed a lawsuit against a gasoline distributor that allegedly was involved in price fixing.¹ If North Carolina is serious about reducing unfair trade practices, however, it should begin by eliminating or modifying existing state laws that severely restrict trade. By eliminating its own anti-competitive policies, the state can truly promote competition and help consumers without the need for lawsuits. This Spotlight will highlight a few² of the many ways that government policies restrict competition and hurt consumers.

General Problems with State Restraints of Trade

Competition benefits consumers and the entire economy. According to the United States Department of Justice:

Competition in a free market benefits American consumers through lower prices, better quality and greater choice. Competition provides businesses the opportunity to compete on price and quality, in an open market and on a level playing field, unhampered by anticompetitive restraints.³

Restraints of trade generally hurt competition. In many instances, both state and federal antitrust laws make it illegal for the private sector to restrain trade. Despite this concern over private restraints, state-imposed trade restraints are prevalent and even worse than private restraints. If a few businesses restrain trade, then the problem may be limited to those businesses in a narrow market. When a state restrains trade, however, an entire industry is affected. Thomas B. Leary, former Commissioner of the Federal Trade

200 W. Morgan, #200
Raleigh, NC 27601
phone: 919-828-3876
fax: 919-821-5117
www.johnlocke.org

The John Locke Foundation is a 501(c)(3) nonprofit, nonpartisan research institute dedicated to improving public policy debate in North Carolina. Viewpoints expressed by authors do not necessarily reflect those of the staff or board of the Locke Foundation.

Commission (FTC), argued that, “In fact, state-imposed restraints of trade may be much more anticompetitive [than private restraints] because they apply across all product lines and to all competitors.”⁴ Furthermore, these restraints are backed by the force of law and therefore aren’t subject to being broken down by emerging market forces.

The Health Care Industry: Certificate of Need

Imagine a health care system in which a hospital must get permission from a government agency to add even a single bed to its facility. Absent government approval, new hospitals cannot be built and existing hospitals cannot expand to meet the needs of local citizens.

Unfortunately, this system is not imaginary — it’s currently the reality in North Carolina. State law mandates that health care providers must obtain a certificate of need (CON) to do such simple things as replace outdated equipment.⁵

The original rationale for the CON laws no longer exists. In 1974, the federal government required states to have a CON program in order to receive federal funding like Medicare.⁶ At that time, government reimbursements to health care providers included coverage of the costs associated with their facilities and equipment. Having the federal government foot the bill provided no incentives for health care providers to limit purchases of new equipment. In 1987, the federal government changed the reimbursement system so that it no longer provided money for new facilities and equipment, basing it instead on a predetermined amount for treatment. For that reason, Congress repealed the CON requirement. Fifteen states have repealed their CON programs since then; North Carolina is among those states that have maintained their CON laws and the bureaucracies that enforce them.⁷

Supporters of the CON law argue that it allows the government to control health care costs by eliminating the duplication of health facilities and equipment.⁸ In other words, the government controls costs by limiting the supply of medical services. A state agency — not consumers and health providers freely making choices in the market — is making subjective decisions as to what are necessary services. This argument also presumes that increased supply leads to higher costs — completely counter to even basic economic principles of supply and demand.

An increase in the supply of health services would keep costs down by giving consumers more options and encouraging health care providers to reduce prices in order to attract consumers. Instead, North Carolina hands existing health care providers their own monopolies in which the state prohibits new competitors from entering the market. Consequentially, as with any monopoly, there are fewer innovations, higher costs, and less incentive to provide quality service.

The United States Department of Justice and Federal Trade Commission (FTC) recently recommended that states with CON laws should “reconsider whether these programs best serve their citizens’ health care needs.” From their report:

The Agencies believe that, on balance, CON programs are not successful in containing health care costs, and that they pose serious anticompetitive risks that usually outweigh their purported economic benefits. Market incumbents can too easily use CON procedures to forestall competitors from entering an incumbent’s market. ... Indeed, there is considerable evidence that CON programs can actually increase prices by fostering anticompetitive barriers to entry.⁹

Education: Caps on Charter Schools

In 1996, North Carolina passed a law allowing for the creation of charter schools.¹⁰ These publicly funded schools are independent of existing public schools and generally afford more flexibility for educators. One of the key purposes for passing the law, as stated within the legislation, was to “provide parents and students with expanded choices in the types of educational opportunities that are available within the public education system.”¹¹

Despite this effort to bring at least some competition to the existing public school establishment, the law capped

the number of charter schools at 100 for the entire state.¹² On August 4, 2005, the cap was reached.¹³ Since then, the door is closed to any qualified applicants who wish to establish a new charter school, even if the proposed charter school would benefit students.

The cap restrains trade by making it impossible for aspiring charter school educators to open new schools. Parents and students, through their selection of schools, are denied sufficient opportunity to determine the success or failure of both charter schools and the established public schools. The concern should be about students and their education, not about protecting established schools from competition with charter schools.

Occupational Licensing and Barbers

North Carolina requires licenses for numerous occupations.¹⁴ State licensing is unnecessary in many instances, however and a less restrictive approach — such as optional certification — would be more appropriate. In an optional system, consumers would be able to choose between certified professionals and others who decided, for whatever reason, not to seek certification. The choice would still be the consumer's; it would not already have been limited by the government.

Barber licensing is one example of an occupational law that should be eliminated. In North Carolina, if you gave a friend a facial for free, and you didn't have a barber's license, you are breaking the law. The barber licensing law is so extreme that it requires almost anyone engaged in "barbering" to have a certificate. The law makes some exceptions for engaging in barbering activities within one's own family (although cousins are not included).¹⁵

To become a registered barber in North Carolina, a person must attend barber school for at least 1,528 hours, complete a one-year apprenticeship, and pass a clinical exam.¹⁶ These excessive requirements make it less likely that qualified individuals will become barbers. Such an anticompetitive law serves only to protect existing barbers from new entrants into the market for haircuts — including the "competitor" who cuts a friend's hair for free. It certainly does not help consumers.

Barbers may find it worthwhile to learn about issues such as sanitation to protect customers. That alone is hardly an argument in favor of an occupational licensing system. A restaurant also requires a sanitary environment, but the state does not license cooks (at least not yet). Nor does the state outlaw "uncertified" friends from cooking dinners for friends, despite there being health issues involved.

Taxicab Regulation

Local governments have the power to regulate the taxicab industry within their jurisdiction. In Winston-Salem, for example, a potential new taxicab driver must obtain a special certificate.¹⁷

Obtaining the certificate is not that easy, especially for a low-income entrepreneur seeking to start what would otherwise be a low-cost business. The city requires a taxicab business to have at least two vehicles, not just one, and the certificate holder has to be accessible by telephone 24 hours a day. These minimum requirements likely prevent many low-income individuals from starting a taxicab business.

Much like hospitals and CON laws, someone seeking a taxicab certificate in Winston-Salem must first prove to the government authorities that "public convenience and necessity" require the operation of the vehicles — that is, they must demonstrate a "need" for a new taxicab company. Furthermore, the city will notify all existing taxicab companies when there will be a public hearing during which an applicant will attempt to persuade the city council to issue him a certificate. One of the factors that the city council must evaluate in deciding whether to issue a taxicab certificate is the adequacy of existing taxicab services.¹⁸

Those barriers to entry certainly help to protect the existing cab companies. Unfortunately, new entrepreneurs who see a chance to get ahead by starting their own businesses are kept from working in their chosen field.

Conclusion

If an individual wants to operate a taxicab business, start a new charter school, build a new wing on a hospital, or engage in any other economically productive activity, it should not be his burden to demonstrate to the satisfaction of government bureaucrats why he should be allowed to do so. The centerpiece of a free enterprise system is not a bureaucracy of economic gatekeepers, but individuals who are free to pursue their entrepreneurial dreams. This freedom is what ultimately leads to the betterment of consumers.

North Carolina, however, is a state that harbors many pernicious legal restraints against trade. For its attorney general to aggressively pursue perceived private restraints of trade is, at the very least, a case of the pot calling the kettle black.

Daren Bakst is Legal and Regulatory Policy Analyst at the John Locke Foundation.

Notes

1. "AG Cooper takes action on gas prices," North Carolina Attorney General Press Release (October 10, 2005), <http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=McLeodOilCompany3.pdf>
2. For another example, see Daren Bakst, "Auto Dealer Protectionism: State Limitations on Dealer Competition Should Be Eliminated," *Spotlight* 265, Sept. 7, 2005, http://www.johnlocke.org/spotlights/display_story.html?id=112
3. See the overview of the United States Department of Justice's Antitrust Division's mission and goals at <http://www.usdoj.gov/atr/overview.html>
4. "State Auto Dealer Regulation: One Man's Preliminary View," text of speech presented by Thomas B. Leary at the International Franchise Association, May 8, 2001, at <http://www.ftc.gov/speeches/leary/learystateautodealer.htm>
5. See the North Carolina Division of Facilities Services, Certificate of Need Section's "Overview of CON Process" at <http://facility-services.state.nc.us/conpage.htm>
6. National Health Planning and Resources Development Act of 1974, P.L. 93-641.
7. Roy Cordato, "Certificate of Need Laws: It's Time for Repeal" (working title), forthcoming John Locke Foundation Policy Report, pp. 9-10, http://www.johnlocke.org/policy_reports
8. *Op. cit.*, note 5.
9. "Improving Health Care: A Dose of Competition," Federal Trade Commission and Department of Justice, July, 2004 at 22 of Executive Summary, <http://www.ftc.gov/reports/healthcare/040723healthcarerpt.pdf>
10. North Carolina Charter Schools Act, N.C. Gen. Stat. §115C-238.29A et seq., <http://www.dpi.state.nc.us/charterschools/policy/legislation>
11. *Ibid.*
12. *Ibid.*
13. "SBE Highlights," North Carolina State Board of Education, August 3-4, 2005 at <http://www.ncpublicschools.org/sbehighlights/2005/08highlights.html>
14. See the list provided by the North Carolina Department of Commerce at <http://www.nccommerce.com/servicenter/blio/redbook/Licenselist.asp?DivID=46>
15. N.C. Gen Stat. § 86A, <http://www.ncga.state.nc.us/gascripts/Statutes/StatutesTOC.pl?Chapter=0086A>, which makes the following exception: "This Chapter shall not prohibit a member of a family from practicing barbering on a member of his or her family. For purposes of this section, 'a member of his or her family' means a spouse, brother, sister, parent, grandparent, child, grandchild, mother-in-law, father-in-law, daughter-in-law, son-in-law, stepparent, or stepchild."
16. *Ibid.*
17. Winston-Salem Code, § 78-1 et. seq., http://library.municode.com/mcc/home.htm?infobase=10054&doc_method=cleardoc
18. *Ibid.*