

The *Allen Consulting* Group

A framework for considering the use of occupational licensing

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Report to Consumer Affairs Victoria

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Chapter 1

Introduction

In the 2006-07 Victorian Budget, the Treasurer announced the Reducing the Regulatory Burden initiative, which commits the Government to a range of measures to reduce the regulatory burden on business and not-for-profit organisations.

In support of Consumer Affairs Victoria's (CAV's) initiatives to meet this commitment, CAV engaged the Allen Consulting Group to prepare a report that:

- clarifies the circumstances where occupational licensing is the appropriate regulatory tool;
- develops a framework to help decide when to use occupational licensing and what licensing should entail; and
- determines the steps associated with good practice generic licensing processes.

These tasks have been completed and this report presents the generic framework and processes for choosing and using occupational licensing as a policy tool.

While the framework was prepared for CAV to assist with their consideration of reforms to reduce regulatory burden, the framework and processes are sufficiently generic to be applicable to all areas of government where occupational licensing is used or is being contemplated.

Chapter 2

Framework for the use of occupational licensing

2.1 Overview

The use of occupational licensing is extensive throughout developed countries, including Australia. Given its prevalence, it is not surprising that occupational licensing is viewed as one of the primary regulatory tools to address policy issues relating to trades and professions. From a policy perspective, the decision to use occupational licensing typically follows a two-step process of asking whether or not there is a role for government to resolve an issue, and if so, what type of licensing requirements will best achieve the desired policy objectives.

To ensure optimal outcomes, occupational licensing requires careful consideration, particularly since there are countless studies that have examined the potential for occupational licensing to cost more in terms of higher prices, reduced competition, and poorer consumer choice and options than the schemes actually resolve in terms of protecting consumers and addressing market failures.¹

The proposed framework therefore, is to aid policy makers with their consideration of the use of occupational licensing so as to minimise the potential for anti-competitive outcomes while at the same time best targeting the policy issues of concern.²

With these points in mind, the framework requires a ‘yes’ answer to the following five questions:

- Is there a role for government?
- Is occupational regulation (such as licensing) an option?
- What form of occupational regulation is appropriate?
- What are the specific licensing requirements that best target the problem?
- Is licensing the best approach?

Underlying these steps is a principle that occupational licensing should be used only when absolutely necessary — in fact, almost as a last resort, given the potential for anti-competitive outcomes — and only to the extent necessary to achieve the objectives.

¹ M. Kleiner 2006, op. cit. is the most recent comprehensive study on this matter although the issues of anti-competitive occupational licensing have been the subject of consideration by Nobel laureates such as Friedman, Stigler and Akerlof and was a core element to NCP reform in the late 1990s.

² Targeting of regulatory policy is an often-stated principle. In the economic literature this is known as the application of the assignment rule or the adoption of the theory of third best. The theory of third best flows from the practical limitations of the theory of second best. The theory of second best says that if some of the preconditions for competition or efficiency improvements are absent then the second best outcome is for government intervention which regulates all aspects of the market, e.g. price, quantity, quality, etc. The problem with this however, is that government rarely, if ever, knows the optimal level of price, quantity, quality etc. The response to this therefore is to target the problem with the most direct policy option, thereby minimising the potential for regulatory failure whilst maximising the potential of addressing the particular market failure. For further information see Y.K. Ng 1977, ‘Towards a theory of third-best’, *Public Finance*, vol. 32, pp. 1–15.

The remainder of this chapter provides guidance on the perspective from which these questions should be viewed, on the matters that need to be taken into account to answer the questions, and what is the implication of a yes or no answer.

2.2 Is there a role for government?

The first step in any decision to regulate is assessing whether or not there is a role for government intervention. While this might seem self-evident to many, the question is critical to ensuring that government only regulates when it must and ensuring that the specific problem that requires regulation is identified. This latter point allows for the best targeting of policy solutions to the regulatory problem — in fact, this is a subsequent step in the framework.

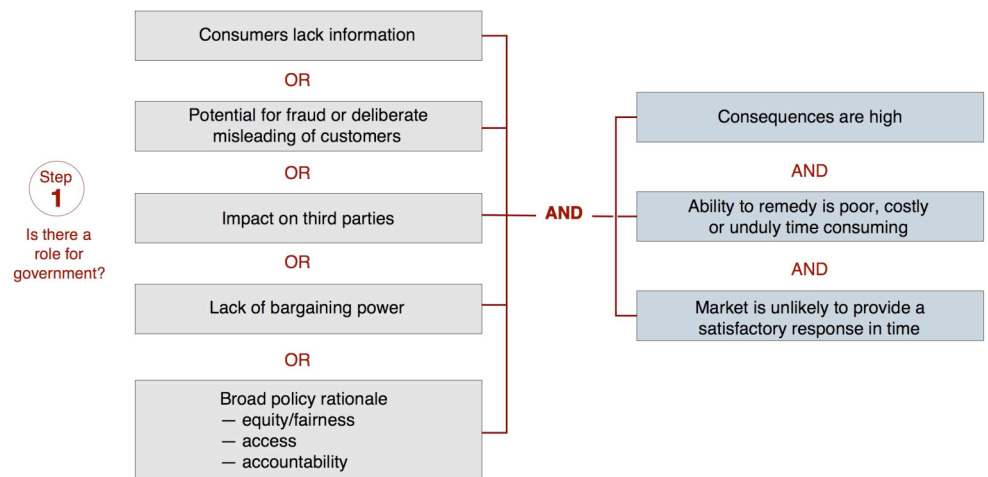
In answering the question of whether there is a role for government, there are two conditions that must be satisfied.

- First, there must be some form of market failure or over-arching policy rationale for government intervention, such as social welfare objectives.
- Second, the consequence of that problem must be high, the potential to remedy the problem once it occurs must be poor, and there must be limited potential for the market or consumers to resolve the issue over time of their own accord.

This two-stage test is depicted in Figure 2.1.

Figure 2.1

IS THERE A ROLE FOR GOVERNMENT?



In a more technical sense, the first set of conditions for government intervention which are set out on the left-hand side of Figure 2.1 — such as market failure or broad policy reason — are only necessary conditions. Of themselves, they are not enough to justify government intervention. In fact, market failures are an everyday event; buyers are rarely as informed as sellers, and most transactions have consequences for third parties. For example, the Productivity Commission has noted that:

The need for government regulatory intervention does not immediately follow from the identification of information deficiencies: information deficiencies are pervasive yet most markets continue to function reasonably efficiently. ... it is not generally efficient to eliminate all negative externalities or promote infinitely large quantities of positive externalities. In many cases, externalities do not create significant problems.³

The second stage of Step 1 involves a set of sufficient conditions for government intervention and together with the necessary conditions they represent a combined test. In other words, if there is to be a role for government, then, for example:

- consumers must lack information about a service or a product and the consequences of a poor consumer choice as a result of the poor information must be high, the potential to remedy the problem must be poor or too costly, and the market must not be able to resolve the issue over time;
- alternatively, the impact on third parties must be high, with limited ability to remedy and no scope for a market solution;
- alternatively, a broad policy rationale with significant consequences in the absence of government intervention, ability to remedy the issue is poor, and no scope for a market solution; and so on.

While for many readers the above conditions will be well understood, for completeness sake the following briefly discusses each of these conditions.

First necessary condition — consumers lack information

It is rare for consumers to know everything about the quality of a product or service prior to choosing to purchase. The problem associated with making decisions based on imperfect information, particularly if one party to the transaction has more information than the other, is that consumer decisions may be sub-optimal compared to the case if all information had been known at the time of the decision. In economic parlance, this market failure is known as *information asymmetries* and can result in an inefficient allocation of resources, and for individual consumers, the purchase of ‘dud’ services.

For many services, it is hard to assess in advance of purchase whether or not the service is of high quality — and in some instances, even after the fact, consumers may not be able to easily assess whether the service was high quality or not.

³ Productivity Commission 2000, *Inquiry Report: Review of Legislation Regulating the Architectural Profession*, AusInfo, Canberra, pp. 64, 76.

If it were easy to assess quality before the purchase then this would not be much of an issue, as the price for low quality service providers would reflect their lower quality or they may even be competed out of the market. But because sometimes quality is hard to assess ahead of time, this creates difficulties for consumers and the potential for lower quality service providers to pass themselves off as high quality service providers.

If consumers cannot evaluate the quality of the services provided by a particular occupation, but can only observe price, then those occupations have reduced incentives to provide high quality services. After all, they cannot signal relative differences in the quality of their services compared to their competitors — so why try?

While this type of logic is somewhat simplistic, it highlights a key issue of concern about occupational services. That is, assessing quality is sometimes hard and this has consequences. One way to think about this is to consider services in terms of the ability or ease of assessing quality.⁴ In this regard, occupational services can be considered to be either:

- *search* services — are those services for which consumers can assess quality and service characteristics before purchasing;
- *experience* services — these services must be purchased and consumed before quality can be evaluated;⁵ and
- *credence* services — these services are those for which the consumer is obliged to take the quality of the service on trust since he or she may not possess the expertise to determine whether the service has been appropriately supplied.⁶

Classifying occupational services or component elements of occupational services in these terms will assist with the identification of the best policy solution, presuming a case for regulation exists.

At this stage of the framework though, it should be acknowledged that there is limited rationale for the regulation of *search* services, as consumers should reasonably be able to assess quality and service providers are unable to engage in misleading behaviour with respect to these characteristics.⁷ Moreover, occupational services tend to be *experience* or *credence* services, and as such, these services are more likely to satisfy the sufficient conditions for government regulation.⁸

While understanding the characteristics of the occupational service is important for matching subsequent policy options, it is noted that there are other problems associated with lack of information that may represent a sufficient condition for government intervention.

⁴ See E. Golan et al 2001, *Economics of Food Labeling*, Agricultural Economic Report No. 793, US Department of Agriculture, p. 7; L. Aldrich 1999, *Consumer Use of Information: Implications for Food Policy*, Agricultural Handbook No. 715, US Department of Agriculture, p. 2.

⁵ See P. Nelson 1970, 'Information and Consumer Behavior', *Journal of Political Economy*, 311; and P. Nelson 1974, 'Advertising as Information', *Journal of Political Economy*, 729.

⁶ See M.R. Darby and E. Karni 1973, 'Free Competition and the Optimal Amount of Fraud', *Journal of Law and Economics*, Vol. 16, No. 1, pp. 67–88; and L. Aldrich 1999, op. cit.

⁷ R. Schmalensee 1978, 'A Model of Advertising and Product Quality', *Journal of Political Economy*, Vol. 86, No. 3, pp. 485–503.

⁸ J.A.H. Moks and N.J. Philipsen 2005, 'An economic analysis of the regulation of professions' in E. Crals and L. Vereeck (Eds.), *Regulation of architects in Belgium and the Netherlands*, Leuven, p. 2.

- *Information deficiencies* — where all parties to a transaction may lack sufficient information to make optimal decisions, e.g. employers and employees may be unaware of the risk of using certain equipment or processes.⁹
- *Information biases* — where the parties to a transaction have flawed information, including incorrect risk perceptions, called *information biases*.¹⁰
- *Principal-agent problems* — where the interests and incentives of agents and the principals that represent them are not necessarily aligned yet information about the extent to which this is an issue cannot be observed until after a problem arises.¹¹

Second necessary condition — fraud and deliberate misleading of consumers

Related to the problems of lack of information are the problems associated with fraud or deliberate false and deceptive behaviour.¹² The above discussion assumes an environment where people are operating in good faith. While similar consequences can occur if people deliberately seek to mislead or engage in fraud, it is impossible — at least ahead of time — to assess whether this is due to lack of information or misinformation.¹³ Notwithstanding, and as will be seen later, policy solutions for lack of information and fraud differ and it is important to identify the cause of the concern, even if after the fact, so that future policy initiatives target the problem.

Third necessary condition — Impact on third parties

An activity or the consumption of an occupational service may impose costs — for which people are not compensated — or generate benefits — for which people are not paid — on parties not directly involved in the activity or service. For example, without laws relating to planning approvals, concerns of neighbours would not necessarily be taken into account by builders and property owners, yet clearly overshadowing and privacy impact on more than just the parties to the building contract. These impacts on third parties are termed *externalities* and their presence may result in too much (where costs arises) or too little (where a benefits arises) of a service being produced or consumed from society's point of view.¹⁴

⁹ If consumers knew their preferences, as well as the prices, performance and availability of all goods and services capable of satisfying those preferences, the process of consumption would be straightforward. In reality however, consumers lack a range of information about their own preferences as well as the prices, performance and availability of goods and services.

¹⁰ According to the extensive body of academic literature on behavioural economics, even if an individual did have perfect knowledge of their preferences and the goods and services available to satisfy those preferences, a range of psychological behavioural characteristics may influence the way that individuals process information. Individuals may not process information, and particularly risk information, in the rational manner than economic theory assumes — individuals may make judgements intuitively, be optimistic, make risk judgements based on whether exposure is voluntary or not, focus on the consequence of the outcome rather than probability, be overconfident in relation to their skill level, overestimate risks that have received publicity and ignore risks to avoid conflicts with established beliefs. For further reading, see C. Camerer, G. Lowenstein and M. Rabin (eds) 2004, *Advances in Behavioural Economics*, Princeton University Press, Princeton.

¹¹ J.A.H. Maks and N.J. Philipsen 2005, op. cit.

¹² W. Gellhorn 1976, op. cit.

¹³ T. Moore 1961, 'The Purpose of Licensing', *Journal of Law and Economics*, Vol. 4, p. 104.

¹⁴ Much of the body of economics literature is based on the existence of externalities and their treatment. For an introductory discussion on externalities as an argument for licensing, see J.A.H. Maks and N.J. Philipsen 2005, op. cit., pp. 8–9.

The most often quoted example for occupational services is that originally raised by Milton Friedman for doctors. If an ‘incompetent’ physician misdiagnoses a patient’s illness, then this could cause an epidemic, which will cause harm to many external or third parties who are not involved in the original doctor’s consultation. In such a case, everybody, including even the patient and physician, would prefer the regulation of medical professionals in order to prevent such epidemics from occurring.¹⁵

While use of occupational licensing is often used to address externalities, it should be acknowledged there are many other instruments — such as creating new property rights, imposing standards, taxes and subsidies — which could perhaps better target these concerns and that licensing needs to be considered in that context. In fact, this is the focus of subsequent stages of the framework.

Fourth necessary condition — lack of bargaining power

A major cause of market failure is the existence of market power, which may arise from uncompetitive market structures (e.g. a monopoly or a small number of market participants) or from anti-competitive conduct (e.g. collusion). In these circumstances, prices may be higher or output lower than they should be, and too few resources are allocated to the production of particular goods and services. In other words, the market does not produce enough of what best meets society’s needs. Regulation may be required to ensure that this market power is not exploited to the detriment of consumers.¹⁶

An aspect of market power that underlies a number of occupational licensing schemes — even if it is not formally acknowledged in these terms — is the issue that arises with unequal bargaining power between suppliers and purchasers of services. The greater the degree of disparity between bargaining power, the greater the potential for people to enter into contracts for service under duress or at least not to make what some might consider a ‘rational’ decision.

The extent to which this occurs, and subject to the consequences, remedy, and market solution test of this step, then there could be justification for government intervention to redress bargaining power, to regulate behaviour of occupations to reduce or prohibit the behaviour all together.¹⁷

Fifth necessary condition — government policy objectives

According to *The Victorian Guide to Regulation*, government intervention can be justified in the pursuit of social and equity objectives. Such objectives include the redistribution of income to achieve equity goals, measures to promote public health and safety, establishing law and order, cultural objectives, and preserving and protecting environmental resources.¹⁸

¹⁵ M. Friedman 1962, *Capitalism and Freedom*, University of Chicago Press, Chicago, p. 147.

¹⁶ Department of Treasury and Finance 2005, *Victorian Guide to Regulation: Incorporating Guidelines made under the Subordinate Legislation Act 1994*, Melbourne, February, p. 2-1.

¹⁷ S. Breyer 1982, *Regulation and its Reform*, Harvard University Press, pp. 15–35.

¹⁸ Department of Treasury and Finance 2005, *Victorian Guide to Regulation: Incorporating Guidelines made under the Subordinate Legislation Act 1994*, Melbourne, February, p. 2-2.

A prominent example of such objectives can be found in the Victorian Government's economic, social, environmental and civic objectives for the state set out in *Growing Victoria Together* (see Box 2.1). While many of these areas support the efficient operation of markets and some can easily be re-couched in terms of addressing market failures, they are in the main broad policy objectives.

For example, the 2006–07 Victorian Budget which linked consumer protection activities to the Victorian Government's objectives of building friendly, confident and safe communities; more quality jobs and thriving, innovative industries across Victoria and a fairer society that reduces disadvantage and respects diversity.¹⁹

Box 2.1

TEN GOALS FOR VICTORIA'S FUTURE

By 2010, Victoria will have further strengthened its performance in the following areas:

Thriving economy

1. More quality jobs and thriving, innovative industries across Victoria
2. Growing and linking all of Victoria

Quality health and education

3. High quality, accessible health and community services
4. High quality education and training for lifelong learning

Healthy environment

5. Protecting the environment for future generations
6. Efficient use of natural resources

Caring communities

7. Building friendly, confident and safe communities
8. A fairer society that reduces disadvantage and respects diversity

Vibrant democracy

9. Greater public participation and more accountable government
10. Sound financial management

Source: The Hon. Steve Bracks 2005, *A Vision for Victoria to 2010 and Beyond: Growing Victoria Together*, Victorian Government, Melbourne, p. 2

According to the Productivity Commission there is a widely held view that close attention should be given to assisting disadvantaged or otherwise vulnerable consumers to participate effectively in markets, and ensuring that they do not fall victim to scams and inappropriate trading practices.²⁰ Consumer Affairs Victoria has provided definitions of 'vulnerable', 'disadvantaged consumer' and 'detriment':

Consumer vulnerability is exposure to a risk of detriment consumption due to the interaction of market, product and supply characteristics and personal attributes and circumstances. The main cause of vulnerability is this interaction resulting in inadequate information, poor access to information and/or ineffective use of information by a consumer or in the deterrence of complaint or the pursuit redress by a consumer.

Consumer detriment includes, in addition to physical harm and monetary loss, a level of satisfaction less than was reasonably expected from a purchase and the denial of a transaction sought by a consumer.

¹⁹ Department of Treasury and Finance, *2006-07 Budget Paper 3 – Chapter 3: Department of Justice*, Melbourne, p. 187.

²⁰ Productivity Commission 2007, *Consumer Policy Framework – Issues Paper*, January, pp. 13, 18.

Not all vulnerable consumers are disadvantaged consumers. Some consumers will be vulnerable only because of either temporary personal circumstances that adversely affect them in consumption; or adverse market, product or transaction characteristics specific to a particular purchase, rather than their purchases generally.²¹

First sufficient condition — consequences are high

Competitive markets have devised a range of instruments to accommodate the absence of perfect competition, such as through the provision of insurance and futures markets, where it is important to allow for risk and uncertainty. But problems of particular relevance to occupations can still arise in relation to:

- direct consequences — where the significant consequence of a poor consumption decision is borne by the consumer. For example, choosing a poorly qualified medical practitioner could have significant health implications, which may not be reversible. In this case, financial reparations do little to compensate the consumer when health or other transactions are concerned; or
- indirect consequences — where significant consequences of consumption decision are incurred by others — for example, if poor engineering work leads to a building collapsing then this will have consequences for people other than the engineer and the building owner.²²

The extent to which a consequence is significant is somewhat subjective. While many may believe that this can be reduced to a dollar figure — for example, insurance payouts put a dollar figure on the value of life — the reality though is that ‘significance’ is relative and needs to be considered on a case-by-case basis.

To provide guidance on this matter, and in support of the view expressed by the BLA that ‘community concern’ is a legitimate basis for regulation, it is worth considering the views articulated in the ‘Sandman principle’.²³

While drawn from the literature relating to the regulation of environmental and safety issues, the ‘Sandman principle’ postulates that the public’s perception of risk — and therefore the need for regulation — takes into account the potential hazards (that is the scientific risk) as well as qualitative attributes, called ‘outrage’, associated with that risk. Risk therefore is equal to the hazard plus the outrage. Outrage is likely to be higher where risk is:

- coerced rather than voluntary;
- industrial rather than natural;
- exotic rather than familiar;
- memorable rather than not memorable;
- dreaded rather than not dreaded;
- catastrophic rather than chronic;
- not knowable rather than knowable;

²¹ Consumer Affairs Victoria 2004, *What do we mean by ‘vulnerable’ and ‘disadvantaged’ consumers*, Discussion Paper, p. 3.

²² Council of Australian Governments Committee on Regulatory Reform 1999, *Guidelines for the Review of the Professions Under National Competition Policy*, p. 49.

²³ P. Sandman 1997, *Responding to Community Outrage: Strategies for Effective Risk Communication*, American Industrial Hygiene Association, Virginia.

- controlled by others rather than controlled by the individual;
- unfair rather than fair;
- morally relevant rather than morally irrelevant;
- no trust rather than trust; and
- unresponsive process rather than responsive process.

Second sufficient condition — ability to remedy is poor, costly or time consuming

Consumer protection is a trade-off — the more protection government provides, the less effort consumers need to make to protect their own interests, but the greater the compliance and administrative costs.²⁴ To avoid unnecessary costs on business and government, it is critical to assess the extent to which the problem can be remedied, the cost of seeking redress, and the time involved.

The less capacity there is to remedy, the greater the rationale for intervention. In fact, in some circumstances there may be no capacity to remedy if specific performance is what is being sought, such as in the event of two parties claiming to own a house (perhaps due to fraud or misrepresentations by an agent or conveyancer) but only one legal owner. Also, the more costly and time-consuming the remedy, the greater the rationale for government intervention — particularly if government intervention is cheaper or quicker.

According to Duggan, if consumers are overly discouraged from seeking redress, there are two likely consequences:

- some disputes that should have been resolved will not be resolved at all and other disputes will be resolved by less efficient methods; and
- there will be an ‘undersupply of deterrence’; in other words, some disputes will occur that could otherwise have been avoided.²⁵

To avoid this, it is necessary to consider government intervention in terms of, or as part of, a transaction or administrative cost assessment. Litigation, for example, can be particularly costly; it imposes direct and indirect costs on litigants. Fostering the development of effective, low cost ways for consumers to resolve disputes and obtain monetary compensation for losses sustained is an important and justified consumer policy objective.²⁶

²⁴ National Competition Council 2002, *Assessment of Governments’ Progress in Implementing the National Competition Policy and Related Reforms, Volume One: Assessment*, AusInfo, Melbourne, p. 11.2.

²⁵ A. Duggan 2003, ‘Consumer access to justice in common law countries: a survey of the issues from a law and economics perspective’, *International Perspectives on Consumers’ Access to Justice*, Cambridge University Press, Cambridge, p. 47.

²⁶ Organisation for Economic Co-operation and Development 2005, *Background Report*, OECD Workshop On Consumer Dispute Resolution And Redress in the Global Marketplace, Washington DC, 19-20 April 2005.

Third sufficient condition — market is unable to provide a satisfactory response

If the market is unable to provide a satisfactory response then this adds to the case for potential government intervention.²⁷ Market solutions to lack of information (e.g. producer warranties) may emerge over time without the need for government action. Secondary markets in information may also emerge (e.g. certification of services by third parties, agents, insurers, consumer ratings in magazines) which facilitate consumer learning and directly address the issue of concern.

It should be remembered throughout that the incentive for the market to respond tends to be much lower in cases where most of the external costs or benefits are borne by other sections of the community. In these cases, there is little incentive for firms to group together to internalise costs.²⁸ On the other hand, it should not be presumed that the market will always fail to provide a socially optimal output level in the presence of impacts on third parties.

2.3 Determine whether occupational regulation is an option

Having decided there is a role for government, the next step in the framework is to determine whether occupational regulation is an option. This is not to say that the outcome of this step is that licensing is the preferred approach, but rather this step takes the approach that occupational licensing is a last resort rather than a first resort and therefore considers whether or not other approaches would be more suitable.²⁹

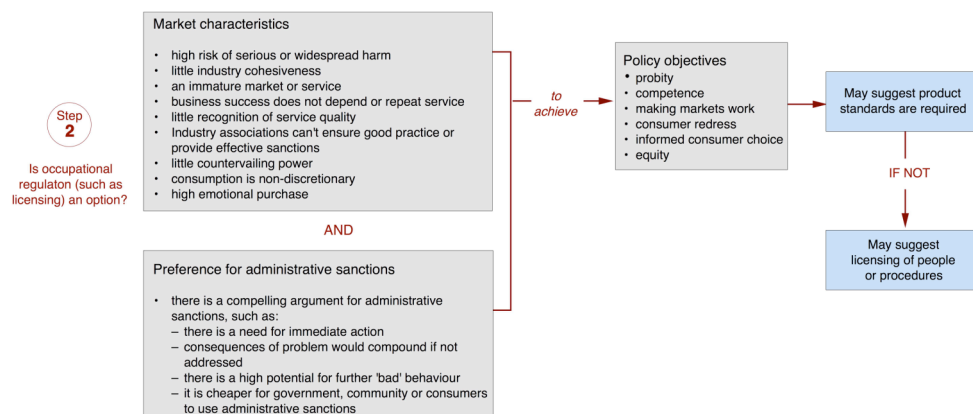
Step 2 in the framework says that the occupation or market must exhibit certain characteristics and that government must have a preference for administrative sanctions in order to achieve its policy objectives. A diagrammatical representation of this part of the framework is shown at Figure 2.2.

²⁷ National Competition Council 2001, *Reforming the Regulation of the Professions*, Staff Discussion Paper, AusInfo, Canberra, p. 16.

²⁸ Tasman Asia-Pacific 2000, *Analysis of market circumstances where industry self-regulation is likely to be most and least effective*, p. 18.

²⁹ As with other forms of licensing, occupational licensing creates a barrier to entry that restricts competition and raises prices within the licensed service market. Kleiner (2006, op. cit., p. 59) estimates the impact of licensing-related practices on prices to range between 4–35 per cent. Given these adverse consequences, which have the potential to outweigh any benefits that licensing may cause, it is prudent to first consider other alternatives that impose a lesser barrier to entry, before contemplating licensing.

Figure 2.2

IS OCCUPATIONAL REGISTRATION AN OPTION?**Market characteristics**

Step 2 sets out the occupation or industry characteristics that suggest that licensing may be an option. While there is some overlap between these characteristics and the sufficient conditions discussed above, it is important to separate out those elements that can be observed from the industry — such as the characteristics set out in the figure above — and the impact of the problem which is the primary reason for listing the 'sufficient' conditions.

Drawing on the language already used in this report, the market or industry characteristics relevant for Step 2 relate to:

- the extent of the problem and the consequences for consumers — such as *high risk of serious or widespread harm* or *high emotional purchase* or *consumption is non-discretionary*;
- the occupation's ability to resolve the concerns directly such as *little industry cohesion* or *industry associations can't ensure good practice or provide effective sanctions*;
- consumers who use the occupational services such as *an immature market or service* or *little countervailing power*; or
- the occupation's incentives to provide high quality service once engaged such as *business success does not depend on repeat service* or *little recognition of service quality* or *little recognition of service quality*.

These characteristics highlight the types of occupations and occupational services that potentially lend themselves to licensing. If these characteristics are not present then, given a conclusion from Step 1 that government regulation is necessary, then some other form of regulation should be pursued and that is an issue beyond the scope of this report.

Preference for administrative sanctions

Along with the industry characteristics, government must have a preference for administrative sanctions over other remedies.

At its essence, occupational licensing is a series of requirements and obligations imposed on an occupation and enforced with the potential threat of various administrative sanctions — ranging from warnings all the way through to revocation of the licence — in the event that those obligations and requirements are not met.

Non-administrative sanctions, such as civil or criminal procedures focus on after the fact behaviour. For those remedies to be successful, the threat of action or persecution needs to be sufficient to prevent harm.³⁰ Yet once harm occurs, at least one consumer will be adversely affected and the cost and difficulty they face in seeking redress may act as a disincentive to pursuing such redress.

The question of preference for administrative sanctions can hinge on the ease of administration or a cost consideration. In this regard, use of occupational licensing is more likely to be appropriate if:

- there is a need for immediate action;
- the problems are likely to compound;
- there is a high potential for further ‘bad’ behaviour; or
- it is cheaper for government to use administrative sanctions.

Objective rules, which are common in licensing schemes, make it easier to gauge the extent of the breach and make prosecution less dependent on proving intent that consumers suffered, or would suffer, a loss. In addition, a regulator is more likely to be able to use its own resources to obtain evidence to prosecute an offender; it is less reliant on the participation of consumers.³¹

Policy objectives

Step 2 highlights the policy objectives that government may wish to achieve with the use of occupational regulation. According to the then Minister for Consumer Affairs, consumer protection activities in Victoria are based around a vision of ‘confident consumers and protected communities’.

³⁰ M. Kleiner 2006, op. cit., p. 159.

³¹ Consumer Affairs Victoria 2006, *Using licensing to protect consumers’ interests*, Research Paper No. 9, p. 14.

The Government works toward achieving this vision by pursuing three major objectives:

- The first objective is to protect and promote the interests of consumers, consistent with the consumer rights endorsed in the *United Nations Guidelines for Consumer Protection*.³²
- The second is to ensure that markets work in the interests of consumers and the broad community. Informed and discerning consumers help stimulate effective competition which in turn contributes to innovation, quality improvements and lower prices — the cornerstones of higher living standards.
- The third objective is to improve access to consumer protection services, particularly for vulnerable and disadvantaged groups.³³

Based on a review of legislation, published material on occupational licensing schemes, second reading speeches, and other sources, the framework has summarised the government's objectives for licensing under six headings: probity, competence, making markets work, consumer redress, and informed consumer choice.

These categories are important as the relevant licensing requirements — which form part of Step 4 — are matched to each policy objective.

Product and service standards

The final element of Step 2 relates to the hierarchy of potential approaches to occupational regulation. Typically, occupational licensing focuses on four P's:

- Product — involving the regulation of the quality of goods or services;
- People — involving the competencies of licensed occupations;
- Procedures — involving the regulation of conduct and processes undertaken by professionals; or
- Place — involving the regulation of location, structure, size, and physical attributes of the businesses being regulated.³⁴

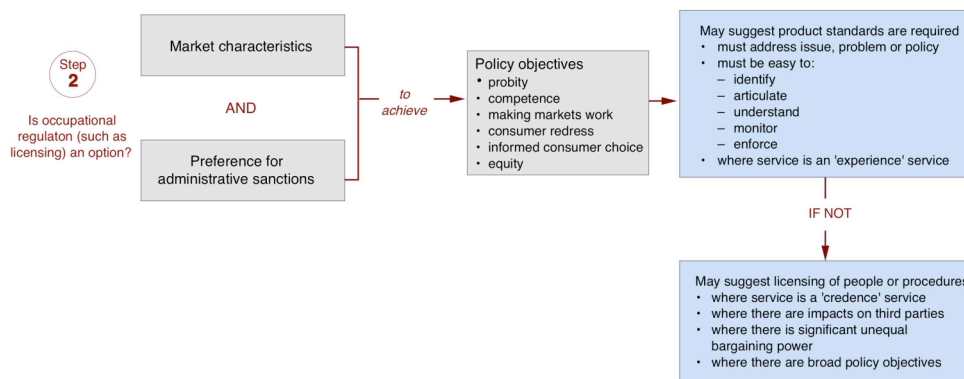
The hierarchy proposed in this step is to focus first on product regulation, where it is relevant to do so, before considering other forms of regulation such as regulation of people, procedures, or place — see Figure 2.3.

³² United Nations 2003, *United Nations Guidelines for Consumer Protection*, www.un.org/esa/sustdev/publications/consumption_en.pdf, accessed 6 March 2007.

³³ J. Lenders MP 2004, *Ministerial Statement on Consumer Affairs (September 2004)*, www.consumer.vic.gov.au, p. 2.

³⁴ This classification is based on the Allen Consulting Group's summation of broad licensing requirements.

Figure 2.3

REGULATING PRODUCTS, PEOPLE AND PROCEDURES

The reason for this hierarchy is that more often than not the development of occupational licensing leaps to regulating place or people in circumstances where some form of product or service standard would suffice — this was the broad conclusion of numerous National Competition Policy (NCP) reviews of occupations such as pharmacists. Such an approach will lead to unnecessary costs for industry, consumers, and the community more broadly.

Requiring an initial focus on product standards — such as the specification of minimum motor car warranty conditions — is not expected to result in change to existing licensing schemes, but rather ensure that policy makers never lose sight of the need to best match policy solutions to problems and not simply implement commonly accepted or historical solutions.

Compulsory product and service standards can take three forms:

- information provision standards, which seek to ensure that a minimum level of information about a product or service is disclosed to potential buyers;
- product/service quality standards, which seek to ensure that only products/services which meet certain minimum technical criteria are provided in the market; and
- product/service compatibility standards, which seek to ensure an operational interface between two or more products or services (e.g. voltage requirements for electrical appliances, common terminology in occupational services).

However, product standards are rarely used as the primary approach to occupational regulation. The main reason for this is the difficulty with identifying appropriate standards and enforcing those standards. With this in mind, the hierarchy suggests that product standards should only be used therefore, if they:

- address the issue, problem or policy area of concern;
- are easy to identify, articulate, understand, monitor, and enforce; and
- where services are *experience services* as discussed above in the section on 'consumers lack information'.

Finally, it is noted that there is considerable parallel between product standards and the general obligations under the Fair Trading Act and the Trade Practices Act relating to false and misleading conduct.³⁵

2.4 Choose the appropriate form of occupational regulation

The discussion in the CAV paper entitled *Choosing between general and industry specific consumer regulation* suggests that general legislation should be preferred to other regulatory styles or approaches.³⁶ The paper states however, that if this is not appropriate then consideration should be given to the use of industry specific regulation — namely where:

- general regulation is not working;
- general regulation cannot be improved to address the problem;
- the problem is big enough to warrant further action;
- specific regulation can effectively target the problem and the industry involved; or
- the problem and the industry are stable enough to make detailed action effective over time.³⁷

While these are all reasonable tests, they require policy makers to consider the use of industry specific regulation on a case-by-case basis. More broadly, this is a limitation of most of the guidance material on the use of occupational licensing — that is, they rarely provide guidance but rather set out pros and cons of various options and matters that should be considered on a case-by-case basis. The proposed approach in this framework supports this position, up to a point. More specifically, this framework draws on the work of Coglianese and Lazer to provide further guidance on when to use general and industry specific regulation.³⁸

The Coglianese and Lazer paper sets an alternative approach to a one-size fits all, or a hierarchy of general, followed by specific, regulation. The following discussion is presented therefore as an additional tool from which policy makers can consider their choice of regulatory instrument.³⁹

³⁵ For example, s. 46 of the *Fair Trading Act 1999* allows for the making of regulations that prescribe an information standard, where this may consist of the requirements for, and the form and nature of, the information which it is reasonably necessary to give to persons to whom the services are to be supplied about the nature, the characteristics and the suitability for the purpose of the services. It is also noted that s. 34 of the *Fair Trading Act* allows for regulations that prescribe safety standards for goods and services as are reasonably necessary to prevent or reduce the risk of injury to any person.

³⁶ This is consistent with the Victorian Guide to Regulation which suggests that where possible, performance based regulation (in this case the *Fair Trading Act*) is favoured over prescriptive regimes. The proposed rule in Step 3 however, recommends that use of performance or prescriptive or process-based regulations is a matter of assessment.

³⁷ Consumer Affairs Victoria 2006, *Choosing between general and industry specific consumer regulation*, Department of Justice, Research Paper No. 8, Melbourne.

³⁸ C. Coglianese and D. Lazer 2002, *Management-Based Regulation: Prescribing Private Management to achieve Public Goals*, AEI-Brooking Joint Centre for Regulatory Studies, Working Paper 02-11, November.

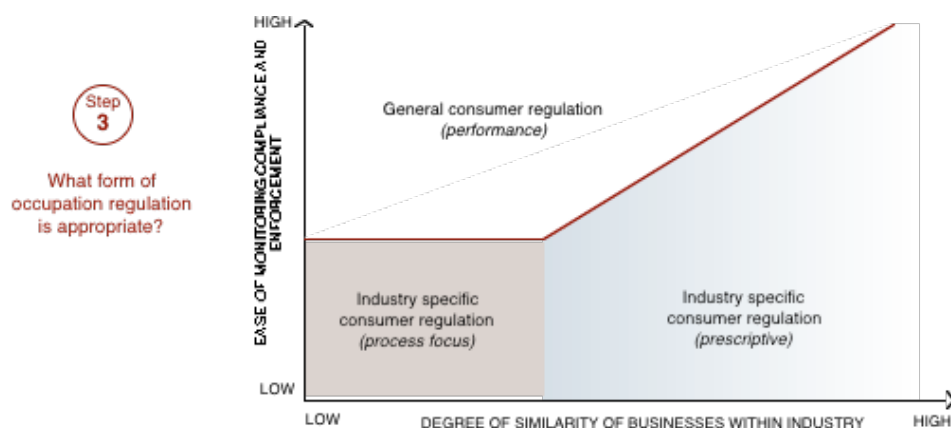
³⁹ As discussed later in *Step 5 — Is licensing the best approach?*, the ultimate determining process for choosing between regulatory options is a cost benefit analysis of alternative approaches. That is, there is no avoiding the need to consider these matters on a case-by-case basis and therefore in this regard, the current guidance materials are correct. The purpose here though, is to provide a tool that policy makers can use as part of their 'initial' or early deliberations on regulatory options.

By adapting the approach developed by Coglianese and Lazer it is possible to consider the choice of when to use general versus specific regulatory options, as depicted in Figure 2.4. This figure — and therefore the approach in Step 3 — is to consider the question of whether or not to use:

- performance-based regulation (general) — easily interpreted as the *Fair Trading Act*;
- prescriptive regulation (industry specific) — interpreted as industry specific regulation; and
- process regulation (industry specific) — also interpreted as industry specific regulation.⁴⁰

Figure 2.4

CHOOSING THE APPROPRIATE FORM OF REGULATION



Adapted from C. Coglianese and D. Lazer 2002, *Management-based regulation: prescribing private management to achieve public goals*, AEI-Brookings Joint Centre for Regulatory Studies, Working Paper 02-11, p. 17⁴¹

⁴⁰ For more detail on performance based and prescriptive based regulation see the *Victorian Guide to Regulation*.

⁴¹ The diagram reflects the decision criteria for choosing between the three regulatory styles. Underlying the model is a desire to adopt 'optimal' regulatory policy and in theory, the optimal policy will be one that is tailored to each business to address each specific policy issue of concern relating to that business. The problem though is that identifying the 'optimal' policy will be limited by the transaction costs. At one level, the lower those costs then the more reasonable it is to be prescriptive, as it would best target the policy problem. In reality though, in all but selected circumstances, transaction costs will result in sub-optimal outcomes if prescription is adopted. In recognition of this the framework provides a mechanism for considering the trade-off between monitoring and enforcement costs and the costs associated with identifying 'optimal' policy. The latter is achieved by adopting "similarity of the business" as a proxy for optimal policy matching. For example, if all businesses were exactly the same (such as in the case of a monopoly) then, all things being equal and no other 'enforcement' transaction costs, it would be cost effective to develop prescriptive regulation for that monopoly that directly targets each policy issue of concern. Transaction costs however, abound, even ignoring the potential for regulatory failure. In this regard the model suggests that when:

- * the industry is relatively dissimilar and monitoring and enforcement are hard then process regulation is best suited as it is too costly to 'optimally' tailor individual regulation to each business (i.e. can't be prescriptive) and it is not possible to easily or cost effectively enforce performance based regulations;
- * the industry is relatively similar but it is hard to monitor and enforce then it is likely to be better for government to use prescriptive regulation, as government can spend the least amount of money designing 'optimal' regulation for those similar businesses and given their similarity then the impact of regulation will be relatively equally (i.e. it won't create a competitive or innovative disadvantage);
- * the industry is relatively dissimilar but it is easy to monitor and enforce then performance based regulation is likely to be optimal as it provides business with the maximum flexibility in how they respond to general rules — such as, not engaging in misleading or deceptive conduct — and therefore is most likely to be the least cost regulatory approach; or

In this figure, the y-axis represents the capacity of regulators to monitor and enforce compliance with occupational licence requirements — the greater the ease of monitoring and enforcing compliance then the more likely performance based or general legislation, such as the Fair Trading Act, should be used. The x-axis represents the degree of similarity of industry structure, both across locations and over time. For a regulated sector to be similar it means that:

- at a given point in time most regulated entities have similar operations, size, structure, and ownership forms; and
- they have similar clients who have similar requirements; and
- the inputs (e.g. technologies) used by the occupations are the same across businesses and they tend to be stable over time.

Step 3 is not put forward as the final word on when to use the Fair Trading Act or industry specific licensing; rather it is a rule of thumb to help policy makers consider what is likely to be the best approach given what is already known about the occupations and the consumers of these services. This was also a strong caveat associated with the Coglianese and Lazer model — see Box 2.2.

Box 2.2

WHY USE THE COGLIANESE AND LAZER MODEL

The Coglianese and Lazer model sets out a framework for considering the choice between different regulatory styles — namely (and what they call) performance based regulation, technology based regulation (which is more appropriately called prescriptive regulation), and management based regulation (which is better known in Australia as process regulation).

Their framework provides a basis for ‘selecting the regulatory instrument that, under given conditions, achieves the greatest net social gain, that is the benefits minus the government’s costs of selecting and implementing a standard minus the regulated entities compliance costs’.

The stated assumption underlying the Coglianese and Lazer model is that it is more costly for Government to develop tailor-made (or optimal) regulation where there is greater dissimilarity within an industry.

We would argue that another underlying assumption is that by adopting their approach it promotes innovation and least cost compliance costs for business (not just government), and as such policy makers should err on the side of granting flexibility to business to choose how best to comply with regulatory objectives.

The Coglianese and Lazer model provides a basis for this as its dual focus on monitoring and enforceability, on the one hand, and similarity on the other, ensures government adopts general (or performance based regulation) when it is relatively cost effective to do so and when it maximises the potential for efficient compliance. That is, when it is easy to monitor and businesses are relatively dissimilar then the use of general regulation is likely to be optimal.

Coglianese and Lazer do acknowledge though that their model is by no means the only possible scenario where different regulatory styles could be used, but rather their model is a helpful tool to think through the implications of adopting one regulatory style over another.

Based on C. Coglianese and D. Lazer 2002, *Management-based regulation: prescribing private management to achieve public goals*, AEI-Brookings Joint Centre for Regulatory Studies, Working Paper 02-11

* the industry is relatively similar and it is easy to monitor and enforce compliance then the model does not provide any clear guidance to choose between performance based rules or prescription, as prescriptive would be cost effective to identify but since monitoring is ease then a simple performance based rule could equally achieve desired policy objectives — given the potential for regulatory failure, our advice in this situation is to err on the side of using performance based regulation, however, in situations where the risk of non-compliance is of paramount importance then it may be better to err on the side of prescription.

2.5 Choosing specific licensing requirements

Having decided that there is a role for government, that occupational regulation is an option, and having considered what is the best regulatory instrument, Step 4 sets out the potential regulatory approaches open to government. These options are taken from an extensive review of licensing requirements in Victoria, and to a lesser extent, New South Wales. While there may be additional approaches used in other jurisdictions, the following should be sufficiently comprehensive to provide guidance on what options are available and when those options would be appropriate. In general, the approaches discussed are probably best suited for industry-specific regulation but some of the approaches could easily be incorporated in the Fair Trading Act.

Consistent with the desire to ensure policy solutions are matched with policy problems, the specific licensing approaches or options are couched in terms of the regulatory objectives summarised in Step 2, namely:

- probity;
- competence;
- making markets work;
- consumer redress;
- informed consumer choice; and
- equity and other policy objectives.

Each is discussed in turn below.

Probity

Much of the focus of occupational licensing is on prevention or prohibition of certain activity. In this regard, often the aim of occupational licensing is to prohibit undesirable conduct and to exclude from an industry people who pose a risk of engaging in undesirable conduct. For example, the second reading speech on the Second-Hand Dealers and Pawnbrokers Bill states that:

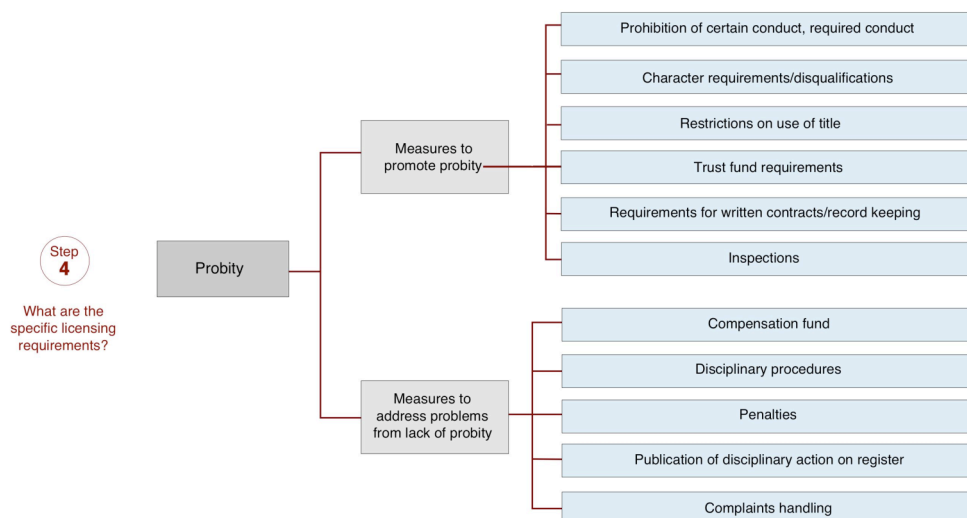
It is there to protect consumers, to cut off avenues for thieves to dispose of stolen goods, and to have in place mechanisms to trace stolen goods if they enter the system. In large part, this is achieved by the registration scheme designed to exclude persons who, as demonstrated by past behaviour, may be susceptible to dishonest activity.⁴²

To address concerns about probity, there are two broad approaches:

- measures that promote probity — such as, prohibition of certain conduct, character requirements, restrictions on the use of title, trust fund requirements and requirements for written contracts; and
- measures that address problems from lack of probity — such as the use of compensation funds or insurance, disciplinary procedures, penalties, publication of actions on a register, and complaints handling, see Figure 2.5.

⁴² F. Smith and S. Ward 2004, *Regulatory Architecture: Practitioners' Perspectives*, paper prepared for the National Consumer Congress, Melbourne, March, p. 4.

Figure 2.5

LICENSING REQUIREMENTS TO FOSTER PROBITY**Competence**

Governments often aim to increase skill levels in certain areas, or across the economy as a whole. Occupational licensing creates greater incentives for individuals to invest in more occupation-specific human capital, because they will be more able to recoup the full returns to their investments if they need not face low-quality substitutes for their services.⁴³ Furthermore, licensing can help to reduce skills deficiencies:

- where there is a clear skill deficiency caused by market failures;
- for which the skills requirements for an occupation are easily accessible;
- for which the skills requirements can be quantified and framed in the licence requirement; and
- for which the appropriate level of skills can be tested before the awarding of a licence.⁴⁴

To address policy concerns about the competency of participants in an occupation, regulations can draw on:

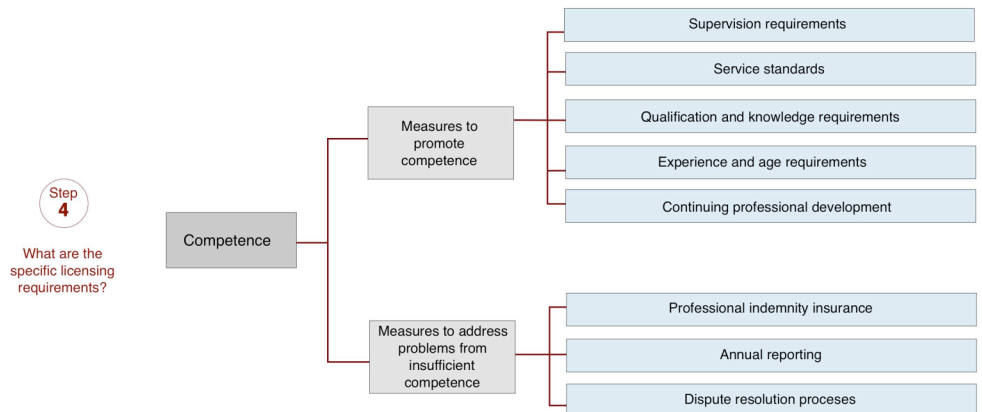
- measures to promote competence, including service standards, qualification requirements, experience requirements and continued professional development; and
- measures to address problems from insufficient competence, including professional indemnity insurance, annual reporting and dispute resolution procedures, see Figure 2.6.

⁴³ See G. Akerlof 1970, 'The Market for Lemons: Qualitative Uncertainty and the Market Mechanism', *Quarterly Journal of Economics*, 84, August, pp. 488–500; C. Shapiro 1986, 'Investment, Moral Hazard and Occupational Licensing', *Review of Economic Studies*, 53, pp. 843–62.

⁴⁴ Frontier Economics 2003, *An Economic Review and Analysis of the Implications of Occupational Licensing*, Department for Education and Skills, p. viii.

Figure 2.6

LICENSING REQUIREMENTS TO FOSTER COMPETENCE



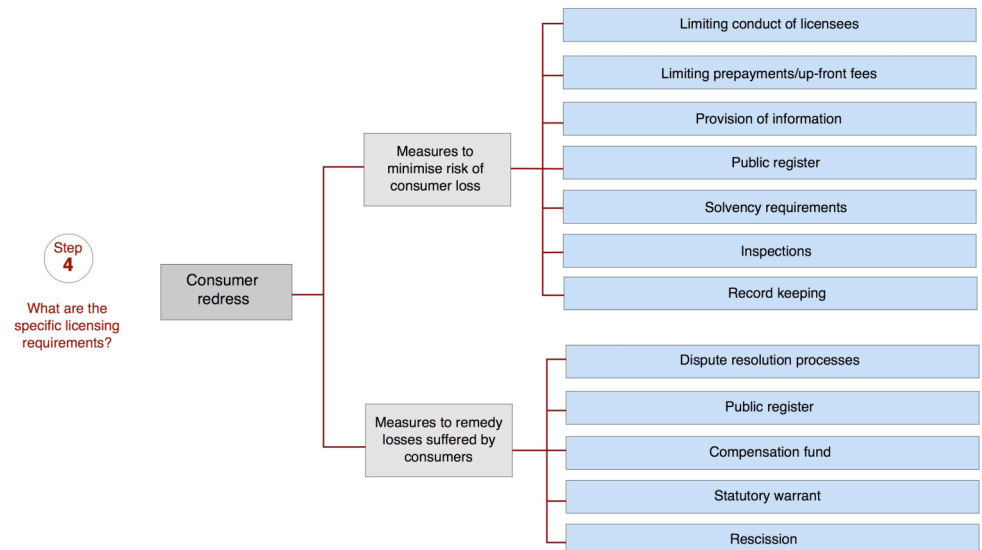
Consumer redress

The two broad areas where regulators tend to focus on consumer redress relate to:

- measures to minimise the risk of consumer loss, including provision of information, limiting prepayments, limiting up front fees, specifying matters in contracts and auditing licence holders; and
- measures to remedy losses suffered by consumers, including dispute resolution procedures, maintaining a public register, and a compensation fund, see Figure 2.7.

Figure 2.7

LICENSING REQUIREMENTS TO FACILITATE CONSUMER REDRESS



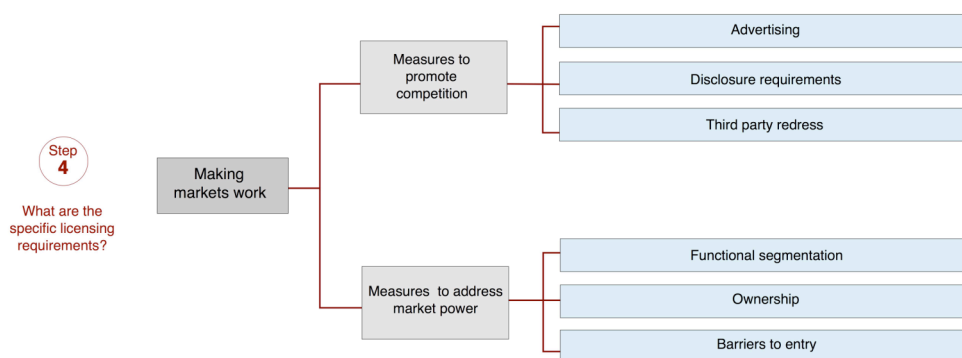
Making markets work

As a result of the recommendations of various NCP reviews, a number of changes were implemented to existing occupational licensing schemes. For the purposes of this report, these types of changes, and the resulting licensing requirements, have been couched in terms of the language used in the relevant policies and second reading speeches, namely:

- measures to promote competition — such as using licensing to contribute to the competitiveness of the market for consumers and traders by increasing confidence in the industry; and
- measures to address market power — such as functional segmentation, changes to ownership requirements and to barriers to entry, see Figure 2.8.⁴⁵

Figure 2.8

LICENSING REQUIREMENTS TO MAKE MARKETS WORK



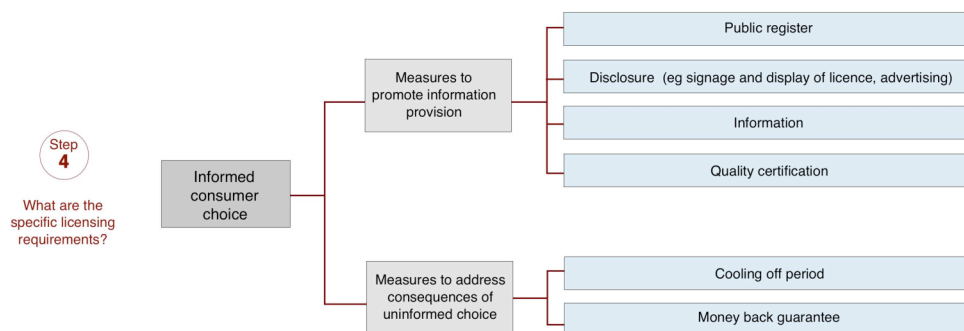
Informed consumers

Promoting informed consumers is a core policy initiative for consumer protection agencies, and the specific licensing requirements used to achieve this can be grouped in terms of:

- measures to promote information provision which include a public register, disclosure requirements, information provision, and quality certification; and
- measures to address consequences of uninformed choice, which include cooling off periods and guarantees, see Figure 2.9.

⁴⁵ F. Smith and S. Ward 2004, *Regulatory Architecture: Practitioners' Perspectives*, paper prepared for the National Consumer Congress, Melbourne, March, p. 7.

Figure 2.9

LICENSING REQUIREMENTS TO INFORM CONSUMERS**2.6 Is licensing the best approach?**

Having considered the options to address the problem(s) it is important to consider whether the proposed options, which have until now been considered on an individual problem-by-problem basis, represent the most efficient combination of regulation.

Sometimes it might be more efficient to use existing frameworks or other policy initiatives to address multiple problems, even though application of this framework might suggest two separate regulatory solutions. In effect, this is an administrative cost argument that if it is cheaper to use existing approaches or if approaches can be combined, then combining policy targets may represent a better outcome than multiple policies targeting the same number of problems.⁴⁶

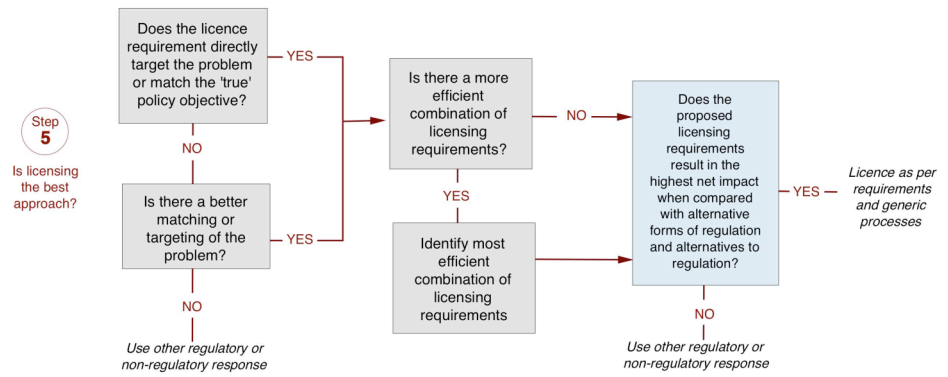
By way of example, the application of the framework may lead to a conclusion that a trust account is needed for moneys that are collected and held in advance of services being provided, and at the same time, but for different reasons, insurance is needed to provide for consumer redress. When considered together though, it may not be the cheapest approach to require a trust account and insurance. There may potentially be cost advantages of requiring the establishment of a trust account that also provides insurance type services.

Following a decision on the best combination of licensing requirements it is then necessary to consider whether or not the proposed licensing approach is the best approach of all the possible regulatory alternatives. In this regard, there is no getting around the need for a cost-benefit analysis on a case-by-case basis — as highlighted in Figure 2.10.

⁴⁶ It is noted that the ‘Tinbergen rule’, named after Nobel laureate Jan Tinbergen, requires that for policy to be effective government must use the same number of independent economic or regulatory instruments as there are policy objectives. While this might suggest that the above approach is at odds with fundamental economic theory, it is noted that Tinbergen’s work focused on macroeconomic stability using fiscal and monetary policy, whereas the proposed framework is a microeconomic analysis of occupational licensing. When considered at the micro level, it is quite likely that the cost of inappropriately targeting multiple policy objectives by using one policy may not, in all circumstances, outweigh the administrative benefits. See J. Tinbergen 1956, *Economic Policy: Principles and Design*, Amsterdam: North-Holland.

Figure 2.10

IS LICENSING THE BEST APPROACH?



While the figure highlights that there is no getting around the need for a cost-benefit analysis, if the earlier steps are undertaken correctly then it should be a relatively straightforward exercise to assess the proposed approach relative to non-licensing alternatives.

2.7 Conclusion

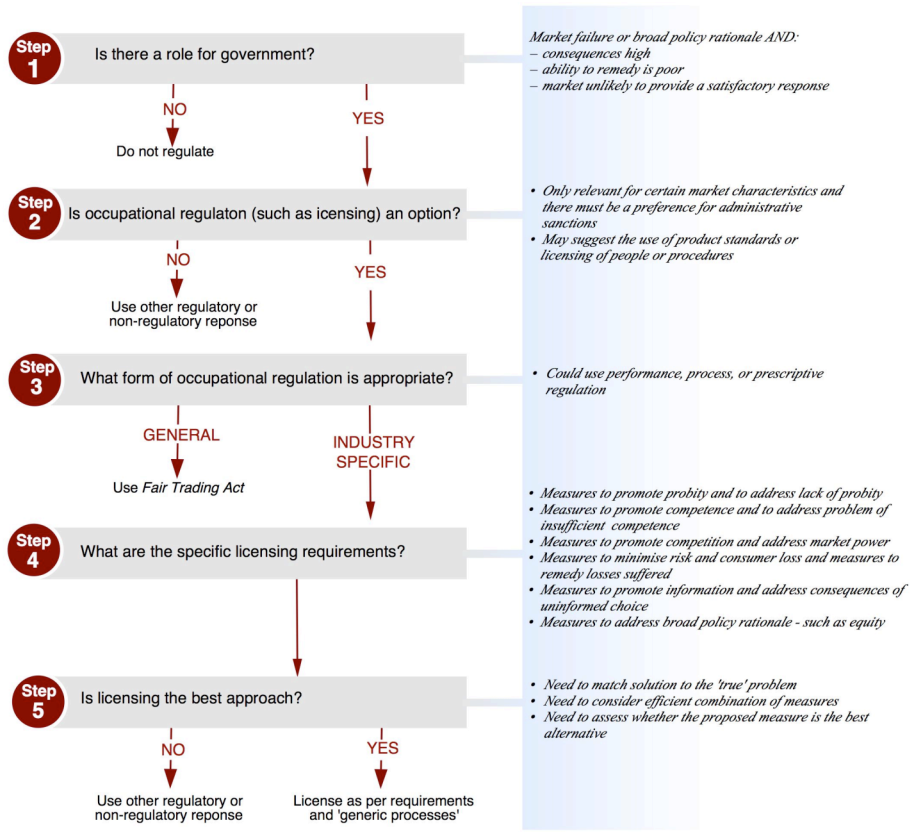
The above framework sets out a five-step process for the consideration of when to use occupational licensing. The intention is to ensure that licensing is used only when necessary and to promote the appropriate matching of policy solutions to policy problems.

Given the potential for occupational licensing to result in anti-competitive outcomes through the introduction of barriers to entry, it is paramount that policy makers independently assess the benefits and costs of restricting participation in, or the behaviour of, an occupation. In fact, consumers pay these costs either way, and so the cure needs to result in a better outcome than the illness.

The proposed framework discussed above, and summarised in Figure 2.11 is designed to assist with that assessment.

Figure 2.11

OVERVIEW OF LICENSING FRAMEWORK



Chapter 3

Good practice licensing processes

Government policy is often informed by the approaches used in other jurisdictions. This report seeks to assist with this process by identifying ‘good practice generic licensing processes’.

Much of the literature on this topic is written in the area of process management, particularly in the fields of quality management systems and certifications.⁴⁷ However, limited work has been done on the topic of ‘good practice’ generic processes within the regulatory literature. This lack of guidance from a regulatory perspective is due to two main reasons:

- Firstly, licensing processes tend to be internal to the licensing agency, and as such, are generally viewed as being a lower order priority for publishing than for the entry and practising requirements for licensees. For example, in the European Commission’s guide to business start-up procedures, only part of the requirements relate to business interactions with the relevant licensing agencies. Instead, most of the guide focuses on matters relating to internal business structures, corporate governance, obtaining finance, market analysis, and the legal documents needed to establish a business.⁴⁸
- Secondly, licensing processes are established to facilitate the operation of the licensing systems — that is, they provide the organisational infrastructure for the broad licensing objectives to be achieved. While there are clearly similarities in licensing schemes across jurisdictions, the processes that facilitate the operation of these schemes are specific to each licensing agency. The ability to draw conclusions about the ‘good practice’ nature of *processes* that are generic to a broad set of regulatory schemes is difficult (in contrast with regulatory *design*, about which much has been written), and is not addressed by the regulatory literature.

With this in mind, and drawing on the available literature, this chapter outlines a suite of good practice generic licensing processes that provide a procedural prism through which to frame and review licensing processes.

⁴⁷ For a discussion of the application of process management to the public sector context, see: T. Gullledge and R. Sommer 2002, ‘Business process management: public sector implications’, *Business Process Management Journal*, Vol. 8, No. 4, pp. 364–376; and E. Ongaro 2004, ‘Process management in the public sector: the experience of one-stop shops in Italy’, *The International Journal of Public Sector Management*, Vol. 17, No. 1, pp. 81–107. As an example of quality management system requirements, see: Standards Australia/Standards New Zealand 2000, *Quality management systems — requirements*, Sydney/Wellington.

⁴⁸ European Commission 2006, *Draft document on model case definition of start-up procedures*, Brussels.

3.1 Developing generic licensing processes

According to the World Bank and the International Finance Corporation, establishing an occupational licensing scheme, or reviewing one for that matter, requires a four-stage focus:

- *diagnosis* — where the objectives of licensing processes are questioned in light of government policy and objectives;
- *process design* — where each of the existing processes are examined to determine whether or not they continue to be necessary;
- *implementation* — where reform is actively promoted, new systems designed, and change implemented; and
- *evaluation* — where the effects of the changes are assessed relative to the objectives of the licensing scheme and the expected outcomes of the changes affected by the processes used.⁴⁹

When considering ‘generic processes’, it is taken as given that the objectives of the scheme have been assessed and set so as to ensure an appropriate, proportionate response to the policy objectives.⁵⁰ In this regard, Box 3.1 presents six good process principles for developing and administering regulation endorsed by the Regulation Taskforce, which could be applied to guide the development or review of occupational regulation.

Box 3.1

THE PRINCIPLES OF GOOD REGULATORY PROCESS

The Regulation Taskforce recommended six good process principles for developing and administering regulation. The Taskforce viewed that if these principles were consistently applied there would be less regulation made and retained, and that the implementation of the regulation that was made would provide less cause for complaint. The Taskforce’s six principles are:

- governments should not act to address ‘problems’ until a case for action has been clearly established;
- a range of feasible policy options — including self-regulatory and co-regulatory approaches — need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework;
- only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted;
- effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements;
- mechanisms are needed to ensure that regulation remains relevant and effective over time; and
- there needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

Source: Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January, pp. 146–147

⁴⁹ International Finance Corporation 2006, *Simplification of business regulations at the sub-national level: A reform implementation toolkit for project teams*, Washington.

⁵⁰ For an overview of the principles of the principles of regulatory design, see the Department of Treasury and Finance 2005, *Victorian Guide to Regulation*, Melbourne, pp. 3.2–3.12.

On the expectation that the objectives of occupational licensing have been determined to be appropriate (i.e. the *diagnosis* stage has been completed), efficiency then becomes the driving imperative for deciding upon which ‘generic processes’ are appropriate, where efficiency, measured as part of any ‘evaluation’, informs ‘process design’ and ‘implementation’. This requires that licensing processes are established and implemented that require the least amount of resources to achieve the desired outcome, and relate solely to ensuring and prompting efficiency within the regulator and the regulatory scheme.

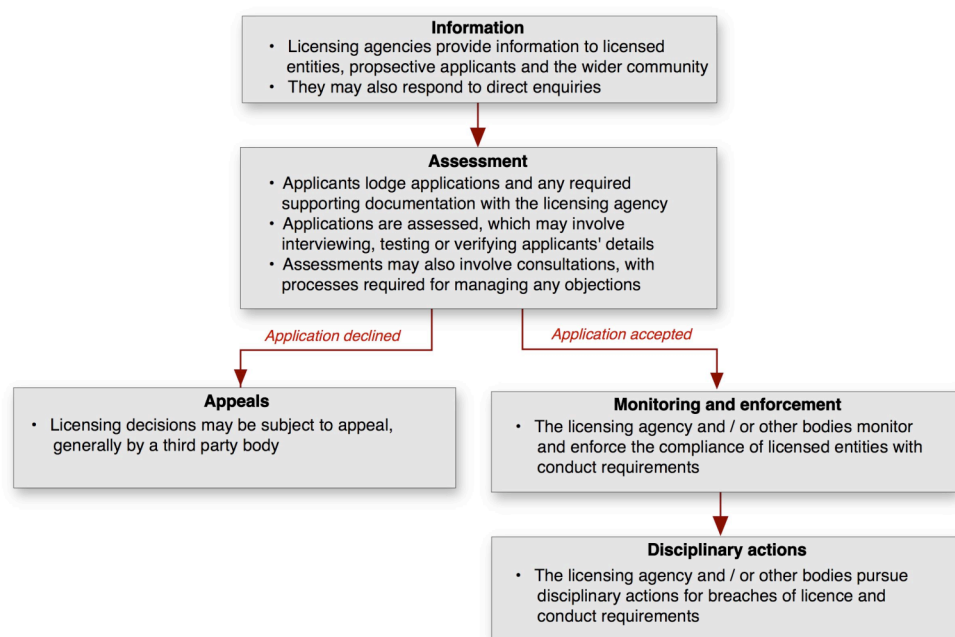
It’s worth stressing that what is meant here is a focus on the total cost and not simply component costs. The incidence of regulation will fall on different sectors of the community depending on the nature of the regulatory requirements. A process could for instance impose very little cost on government but require significant resources from industry or consumers, or visa versa. For example, licences that require competency standards tend to pass the cost of those requirements onto industry and consumers, whereas licensing requirements that require monitoring of standards and enforcement for breaching those standards tend to require government resources, of which the cost is rarely passed through to industry in the form of fees but rather paid for by government (i.e. all consumers). The principle of efficiency therefore becomes a consistent theme throughout good practice generic licensing processes.

3.2 Good practice generic licensing processes

There are five stages that comprise the generic licensing process, which is set out in Figure 3.1, and discussed further below in terms of good practice processes.

Figure 3.1

THE GENERIC LICENSING PROCESS



Information⁵¹

The purpose of providing information to prospective applicants is to minimise the points-of-contact with government and hence keep application costs to business as low as possible.⁵² In this regard, licensing agencies should provide appropriate and accessible information on registration and licensing to potential applicants, including publishing details of the schemes that they administer. This will require the licensing agency to:

- identify the documentation required of applicants, as well as government, for each step;
- differentiate clearly between application processes and renewal processes;
- provide guidance to potential applicants on:
 - the time involved in assessing an application — both from the perspective of the licensing agency and the applicant and in terms of specific time needed versus waiting time;
 - the information required to support the application process;
 - any follow-up requirements that may be needed (such as police or referee checks);
 - the potential for specific conditions being placed upon a licence, under what circumstances this would occur, why they may be needed, and ways for the applicant to avoid any such conditions;
 - the fees attached to the application process;
- decide on the best way to communicate this information, which could involve publishing guidelines, practice notes, draft examples, web-based information, speeches, public meetings, surveys, meeting in person with licensees, potential applicants and other stakeholders, communiqués, media releases, annual reports, and so on;
- use plain language and consistent drafting wherever possible, which is tailored to the occupation being regulated and the requirements being imposed;

⁵¹ In the absence of a 'single list' of generic licensing processes available to draw from, the following processes are drawn from an assessment and consolidation of material published by numerous sources. While there may well be other processes that could be added the following list represents a high-level overview to provide the reader with a broad rather than specific list of processes. Sources that have been used to develop these processes include: The Australian National Audit Office 2007, *Administering Regulation Better Practice Guide*, March; Standards Australia 2006, *Customer satisfaction — Guidelines for complaint handling in organizations (ISO 10002:2004, MOD)*, Sydney; The Council on Licensure, Enforcement and Regulation (CLEAR) 2006, *Framework for developing consistent descriptions of regulatory models: United States*, <http://www.clearhq.org/>, accessed 15 March 2007; Office of the Chief Information Officer (n.d.), *Licence management architecture flow charts*, Melbourne; Department of Trade and Industry 1998, *Enforcement Concordat: Good practice guide for England and Wales*, <http://www.dti.gov.uk>, accessed 21 March 2007; New South Wales Office of Fair Trading 2007, personal communications with the Allen Consulting Group.

⁵² Obtaining information can be time consuming and expensive, given applicants may have to spend considerable time searching for relevant licensing information. Sometimes it may be more efficient for government to consolidate such information and make it available to prospective applicants. This is the argument underlying Business Licence Information Services (or BLIS). Analysis undertaken by the Bureau of Industry Economics suggests that BLIS generates a net benefit ranging between 2:1 and as high as 12:1, depending on the inputs and assumptions used, with the majority of this relating to cost savings of industry in the form of time and telephone cost savings (The Bureau of Industry Economics 1996, *Business licences — International benchmarking*, Australian Government Publishing Service, Canberra, p. 44). For further information see the Business Licence Information Service, <http://www.bli.net.au/>.

- explicitly state the criteria for assessing applications and the means for reviewing decisions; and
- ensure guidance material and supporting documentation is endorsed at the appropriate levels of relevant agencies to promote a shared commitment for the processes set out in the documents.

While the rationale for publishing details on licensing requirements is to minimise the pre-application contact between potential licensees and the licensing agency — that is, the point is to provide sufficient information to answer applicants' questions — there still may be some applicants who have questions that are not answered by the published material, who require a response from the licensing authority before their application can be completed, or who simply prefer face-to-face contact or direct communication.

It is important, therefore, for licensing agencies to establish processes to respond to enquiries about applications, including responding to the application itself. Responding to enquiries could involve the following processes:

- establishing a contact point, including phone number, email address and mailing address, which allows for key licensing agency staff to be contacted;
- establishing protocols for dealing with enquiries from potential applicants, current applicants, previous applicants, licensees, and former licensees, which sets out:
 - responding to enquiries;
 - the type of information that can be discussed;
 - referral processes for issues that cannot be resolved over the phone;
- using pre-application consultation and information sessions, which provide:
 - an opportunity to answer questions directly;
 - the ability to address generic questions and issues before they are asked;
 - the potential to improve the application process in light of stakeholder feedback;
- developing generic answers to standard questions from applicants, such as where to obtain information, how to complete application forms, as well as advising on the standard time, costs, and resources required of the applicants to complete an application assessment; and
- providing the opportunity for applicants and licensees to access and print their profile, records, compliance and monitoring record — this concept could be extended to providing information to potential consumers of licensing services in the form of registration of standards, rankings, complaints, testimonials and so on.

Assessment

After applicants have lodged their applications, the licensing agency needs to assess whether the applicants satisfy the criteria for obtaining an occupational licence. Decision-making processes used to assess applications should be documented, and should be subject to internal (and sometimes external) review to confirm that

established procedures are followed. Applicants should be provided with fully documented decisions that state the reasons for the decision, with applicants having recourse to an internal review process.

In practice, the licensing process may involve a range of bodies in addition to the licensing agency. It is therefore important to coordinate the efforts of those separate bodies involved in the licensing process. While the assessment stage of the generic licensing process typically involves the greatest levels of inter-agency contributions, coordination between all bodies is imperative throughout the licensing process. Box 3.2 sets out some good practice guidelines for coordinating the involvement of multiple bodies in the licensing process.

Box 3.2

GOOD PRACTICE COORDINATION ACROSS THE LICENSING PROCESS

Coordination between the licensing agency and other areas of government that provide support to the licensing process is critical to ensuring streamlined government services and consistency to industry, consumers, and other stakeholders. This requires agreement on the respective roles and responsibilities of government agencies involved in licensing, including:

- agreeing policy and process matters will be coordinated across regulators or government agencies;
- identifying how roles and responsibilities will be split — that is, resolving demarcation issues — to ensure everyone is clear about who will do what, when, and how;
- assessing the resource requirements for joint initiatives;
- agreeing on, where appropriate, resource sharing or re-imbusement arrangements for effort incurred by one agency for the benefit of another agency;
- considering what information, data, and feedback is to be shared, who will get access to the information, on what basis can it be used, and how privacy matters will be managed;
- establishing a clear relationship between audit functions and compliance monitoring and the licensing application and renewal areas:
- the results of monitoring and compliance activities need to be taken into account for renewal and ongoing licensing approval processes, which is probably best done on a monthly basis, if real time information provision is not possible; and
- areas of greatest concern, as highlighted by complaints against existing licensees, monitoring activities, or compliance activities will be those areas that the licensing authority should focus on for prospective applicants.

Additionally, all coordination arrangements should be documented so that roles and responsibilities are clear and issues of concern or dispute can be avoided by referring back to the coordination agreements.

In relation to the assessment of applications:

- the assessment methodology should be risk-based, taking account of the applicant's level of experience as a regulated entity; and
- appropriate risk management strategies should be in place to address the administrative risks posed by the regulator's approach to staffing compliance monitoring activities, keeping in mind the risks of internal conflicts of interest and regulatory capture.

As part of the application process, it is important to seek feedback from third parties of the potential or anticipated affects of granting a licence. If feedback from third parties is not obtained, then the granting of a licence may result in unexpected costs being imposed on those parties.

In this regard, licensing agencies should develop processes to:

- seek feedback from third parties and other stakeholders, which may involve:
 - identifying potential stakeholders or persons likely to be affected by licensing decisions;
 - considering, ahead of any complaint, whether or not to consult with them or simply provide the opportunity for other stakeholders to raise concerns;
 - ensuring staff appreciate the need for, and the objectives associated with, consultation and seeking feedback from third parties — namely to ensure that application decisions are considered using the best available information and not simply that which is provided by the applicant;
 - ensuring the results of third party comments, where relevant, are integrated into licensing procedures in the future;
- encourage the applicant and the third party to resolve directly any issues they may have;
- ensure systems are in place to allow for the licensing agency to make a decision on the application in the event that the applicant and the third party(ies) cannot resolve their concerns. To do this requires objective criteria for granting a licence to be established in advance and could include matters such as:
 - estimating the costs (or benefits) to third parties, and where this can't be quantified, to consider the issues of concern in a qualitative manner;
 - establishing the level or quantum of impact on third parties that would be acceptable and those that are not — this could include a bias in favour of granting a licence unless there are any compelling social, environmental or safety concerns; and
 - promoting transparency in the evaluation and determination of the application where there are third party concerns — that is, publish the assessment or at least inform interested parties directly.

Appeals

Following a licensing agency's decision concerning an application, applicants may lodge an appeal or a complaint if their application was declined, had conditions placed upon a licence, or if they are otherwise aggrieved with the licensing process. The ability to resolve any such appeals efficiently and equitably is a desirable feature of any licensing scheme. Resolving appeals requires processes that:

- allow for appeals to be received and considered;
- ensure stakeholders are aware of the complaint handling services offered (such as phone numbers or complaints hotlines), how to access them, in what circumstances, and the jurisdiction of the service;
- promote the collection and consideration of information relevant to the complaint and where appropriate, the distribution of that information to interested parties, so as to demonstrate consistency and objectivity in decision making;
- allow for parties to a dispute to have access to relevant information;
- inform parties to a dispute or the complainant of the reasons for the initial and final decision;
- ensure people are aware of further avenues for resolution (if relevant);
- allow for the collection, compilation and analysis of complaints and dispute data, so as to improve the licensing system and identify areas of common concern for broader policy consideration;
- promote accountability of the licensing agency and the complaints handling process, including the use of:
 - independent bodies such as VCAT to make decisions;
 - pre-determined evaluation criteria;
 - performance monitoring and evaluation; and
 - independent review of the process and outcomes.

For those complaints that may not necessarily relate directly to licensing decisions, complaint handling should follow processes that:

- are easily accessible and visible to all complainants;
- clearly state details about the process involved in making and handling complaints, including where and how complaints can be made, time periods associated with making complaints, and how the complainant can obtain feedback on the status of the complaint;
- include flexible methods of making complaints (e.g. complaints could be received orally or in writing);
- provide support to complainants with specific needs (such as making interpreters available to complainants);
- acknowledge receipt of complaints immediately;
- address complaints promptly and in accordance with their urgency;

- inform complainants of the progress of their complaint through the complaint-handling process;
- are free of charge to the complainant;
- protect personally identifiable information concerning the complainant, unless the complainant expressly consents to its disclosure;
- are linked with other processes of the organisation's quality management systems; and
- have their performance measured and reviewed.

Monitoring and enforcement

In relation to compliance monitoring, the monitoring agency should:

- have a documented, risk-based compliance monitoring strategy, which identifies the types and frequency of monitoring activities, and who will conduct them;
- consider the costs that the monitoring strategy imposes on regulated entities;
- systematically review regulatory risks, with the monitoring strategy adjusted as necessary to reflect the identification of new or emerging risks;
- make decisions concerning regulated entities' level of compliance in a timely manner;
- document any compliance assessment and regulatory decisions arising from assessments and provide it to the assessed regulated entity; and
- subject compliance assessments to quality assurance processes to ensure that they are lawful and have followed established procedures, contributing to improved consistency of assessments and decision making over time and across the regulator.

Where areas of concern are identified, the monitoring agency should provide the regulated entity with clear advice explaining why any remedial work may be necessary and over what timeframe, ensuring that legal requirements are clearly distinguished from any best practice advice. Additionally, the monitoring agency should be prepared to discuss compliance failures or problems with anyone experiencing difficulties.

In relation to enforcement activities, the agency responsible for enforcement should:

- provide information on regulations and enforcement practice;
- consider providing an opportunity for discussion before taking any formal enforcement action;
- give a clear explanation of the need for any immediate action;
- have a set of graduated responses to address non-compliance;
- document criteria to assist decision makers in designing a regulatory response that is proportionate to the risks posed by non-compliance;

- provide clear guidance in the regulator's operational procedures on the steps to be taken to assess the risks posed by non-compliance and to determine whether immediate regulatory action is needed to control the most serious threats;
- have procedures that are clearly defined, and staff trained in their application, that facilitate timely, targeted and lawful regulatory action when non-compliance is found; and
- document all regulatory decisions taken when addressing non-compliance.

Disciplinary actions

It may prove efficient to include guidance with published material on application and renewal requirements, relating to potential disciplinary action for non-compliance, including:

- prosecution;
- revocation of a licence;
- suspension of a licence for a fixed period or until a particular condition is met;
- denial of licence renewal until certain conditions have been met;
- restriction or limitation of the practice of business;
- requirement to participate in a specific investigation or provide information to the licensing agency;
- requirement to undertake remedial action;
- public censure or reprimand;
- issuing of a probation notice; and
- payment of a fine.

Broader processes involving the pursuit of disciplinary actions should focus on the principle of proportionality. For example, the Enforcement Concordat states:

We will minimise the costs of compliance for business by ensuring that any action we require is proportionate to the risks. As far as the law allows, we will take account of the circumstances of the case and the attitude of the operator when considering action.

We will take particular care to work with small businesses and voluntary and community organisations⁵³ so that they can meet their legal obligations without unnecessary expense, where practicable.

⁵³ Department of Trade and Industry 1998, *Enforcement Concordat: Good practice guide for England and Wales*, <http://www.dti.gov.uk>, accessed 21 March 2007, p. 25.

Application of proportionality within the disciplinary process should include:

- tailoring disciplinary action to risks to minimise costs of compliance;
- publishing prosecution guidelines;
- applying the principles of risk assessment to enforcement activity, with enforcement bodies focusing their efforts on those whose activities give rise to the most serious risks, or where potential hazards are the least controlled; and
- ensuring disciplinary action is proportionate to the seriousness and persistence of the infringement, and is the minimum action necessary to secure future compliance.

There are several principals relating to the consistency of disciplinary approaches taken by the regulator, to ensure consistency within the enforcement body. These include publishing benchmarking of enforcement bodies, and building good disciplinary action practices into the corporate business plans of enforcement bodies.

It is important to recognise that while the good practice generic licensing processes described in this chapter present a starting point for performance improvement, licensing schemes should nevertheless be reviewed holistically with a focus on the objectives for which they have been established to achieve. Berg demonstrates this tenet using the example of the Australian Utility Regulator's Forum, which devised a framework of best practice principles, processes and organisational arrangements for utility regulation activities.⁵⁴ Berg argues that this framework needs to be extended to include *sector performance* as the ultimate indicator of regulatory performance. This inclusion reflects the fact that if firms in the sector are not performing in a manner equal to that achieved by similar firms in other jurisdictions, then the regulation is unlikely to be 'best practice'. Regulatory outcomes, therefore, represent an additional perspective that should be considered beyond the procedural composition of good practice provided here.

Similarly, taking a holistic view of licensing schemes may highlight those internal processes that are similar across licensing schemes, and where there may be potential efficiencies to be captured by promoting a single contact point within government. This is discussed further in Box 3.3.

⁵⁴ S. Berg 2000, 'Developments in Best-Practice Regulation: Principles, Processes, and Performance', *Electricity Journal*, July, pp. 11–18.

Box 3.3

PROMOTING A SINGLE CONTACT POINT FOR 'LIKE' LICENSING ARRANGEMENTS

Coordination of licensing enhances efficiency and reduces transaction costs for businesses that have to consult and interact with multiple agencies and tiers of government in order to obtain the necessary approvals to conduct their business.

Governments have recognised the cost to business of this and attempted to promote a single contact point for selected licence applications. Examples of this include the Business Licence Information Service (BLIS) — which consolidates all licensing requirements in the one spot and the Business Master Key initiative — where government takes responsibility for all individual licensing issues across government once an application is received.

The processes involved in promoting a single contact point include:

- using common registration identifiers for businesses either as part of a single database of licensees or for cross referencing of licensees across multiple databases;
- agreeing on arrangements with other regulators on how a one-stop-shop for licence applications would operate, including resources, staff, promotional material, documentation, timeframes, responding to enquiries, and handling complaints;
- establishing storage and document archiving systems which allow for simple administration and access;
- promoting a single contact point, telephone number, web site, mailing address for licensing schemes;
- establishing and benchmarking against uniform timeframes for the steps of the approval process;
- establishing and benchmarking against uniform standards on information provided to the licensing authority and how the information is used;
- promoting the coordinated use of standardised language across licensing areas;
- developing a basic business licence that combines and redesigns government forms to ensure simplicity and ease of completion;
- where possible, processes should use simple identifiers so that a licensee or applicant can be easily identified; and
- ensuring that single contact point processes are consistent across licensing schemes and with broader government policies.