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Liberal Professions in Moldova – Neglected Economic Potential

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The German Economic Team Moldova ("GET Moldova"), which is active in Moldova since 2010, advises the Moldovan government and other state authorities such as the National Bank of Moldova on a wide range of economic policy issues and on financial sector development. Our analytical work is presented and discussed during regular meetings with high-level decision makers. GET Moldova is financed by the German Federal Ministry of Economy and Technology.

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Executive Summary

The sector of liberal professions in Moldova operates below its potential. Its contribution to the economy's employment and value generation is smaller than in most other European countries. Especially the business related professional services show a striking low performance according to official statistics. This is in contrast to the high potential that the sector has for the development of the economy.

Regulation plays a key role in the liberal professions development framework. Examining the regulation of the sector in Moldova reveals some peculiarities. Firstly, not all liberal professionals are regarded as economic entities and thus have no equal access to SME support programs. Secondly, some liberal professionals are subject to special taxation regulation that differs from business taxation. Thirdly, self-regulation and professional bodies play a minor role compared to international practice. These three findings together with the current low economic role lead to the impression that the sector has been neglected by economic policy so far.

A review of international current reform trends and experiences indicates that on one hand special regulation for some services provided by liberal professions are necessary in order to protect public welfare; this is the case for instance for health services. On the other hand, deregulation of market entry and market conduct rules for liberal professions have resulted in net job growth, higher innovation and value generation growth without drawbacks on service quality, price levels or customer protection. Moldova could use this experience for reforming the regulatory framework of its sector. Additionally, further insights into the impediments for the sectors development are necessary.

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Content

1	Introduction	5
2	Current situation of the liberal professions in Moldova	5
3	Liberal professions regulatory framework	8
4	Public policy towards liberal professions development: International trends	11
5	Conclusions and implications for Moldova	15
6	Selected references	16

Index of tables

Table 1: Employment of liberal professions in Moldova and Germany	5
Table 2: Employment in professional, scientific and technical services in Moldova, Germany, EU ..	7
Table 3: Value added of professional, scientific and technical services in Moldova, Germany, EU ..	7
Table 4: Opportunities and risks of liberal profession regulation instruments	9
Table 5: International experience regarding market opening policy	11
Table 6: International experience regarding market conduct deregulation	12
Table 7: International experience regarding non-discrimination of liberal professions and easing restrictions on business structures	13
Table 8: International experience regarding easing administrative burden, compliance costs	14

1 Introduction

Liberal professions play an important role in the economic transition and development process. They provide high quality professional services that are a necessary input for sophisticated industrial production, for technology-based goods and service industries. At the same time, they provide high quality services for private households; an increase in a countries production and aggregate demand usually leads to an increase for such high quality service, e.g. in the fields of health care, arts, education etc. A definition and an extensive explanation of the term “liberal professions” are provided in Box 1 below.

Since Moldova has a limited industrial basis, the development of the entire service sector is one major strategic option for economic policy in order to catch-up with the economic growth in Europe. Within the service sector, liberal professions play a key role. Therefore, this policy paper sheds some light on the current economic development stadium of liberal professions in Moldova.

The regulatory framework is of particular importance for the development of the liberal professions sector. The regulatory framework usually contains special regulations for market access and market conduct such as prices, advertising rules, forms of inter-professional co-operation etc.

The EU has recently focused on the regulation of the liberal profession sector with respect to increasing the sectors growth potential. We highlight some trends in international best practices and derive policy recommendations with the aim to enhance the contribution of the liberal professions sector to Moldova’s economic development.

2 Current situation of the liberal professions in Moldova

The liberal professions sector in Moldova is underdeveloped in comparison to most European countries, as can be demonstrated by a number of structural indicators.

Firstly, the liberal professions sector is smaller than in Germany and the EU. In Germany, for instance, the liberal professions account for 10.8% of the economy’s total employment. Leaving out the liberal professions in the arts and education sector, the contribution to the overall employment is still 7.6%. In contrast, the liberal professions in Moldova – again without taking into account the arts and the education sector – contribute 4.8% to the employment. Table 1 summarizes these figures.

Table 1: Employment of liberal professions in Moldova and Germany

	Moldova	Germany
Contribution of liberal professions to employment*	4.8%	7.6%

**without arts and education sector*

Source: National Bureau of Statistics of Moldova, 2011; Institute for Liberal Professions in Germany, 2011.

Box 1:

Definition liberal professions

Liberal professions are professions that a) are practiced self-employed, b) provide special services.

Liberal professionals are self-employed people who provide those special services.

Special services is actually a list of services, there is no abstract definition. There are three major areas of such special services:

- Professional services (legal advice, auditing, tax consulting, consulting, engineering etc.)
- Ambulant medical services
- Arts

These services are typically dominated by liberal professionals; the reasons for that lies in the regulatory framework, because only certain economic agents are allowed to provide such service and that is why these agents are called liberal professionals.

- Example 1:
- A lawyer is a liberal professional
 - Legal advice is the service
 - Lawyer is the liberal profession

Note: A jurist who is employed in a company is not a liberal professional. He has got the same education and might do similar work, but she/he is subject to different regulation.

- Example 2:
- A self-employed children's doctor is a liberal professional
 - Ambulant medical services is the service
 - Medical practitioner is the liberal profession

Note: A children's doctor who is employed in a hospital is not a liberal professional. He has got the same education and does similar work, but she/he is subject to different regulation.

For both the economic analysis and for the regulation analysis, the type of service is the important object of study. A liberal professional is in economic terms a service provider; in legal terms a person who possesses the license to provide such a service.

A major difference of the German and Moldovan economy is in the role of the sector “professional, scientific and technical activities”. This sector is typically dominated by liberal professions. It includes all legal activities and professions that provide business-related services such as accounting, consulting, engineering, architectural services, design etc. Only 2.0% of Moldovan persons in employment work in this sector, as opposed to 5.9% of the German employment. Very similar results emerge when comparing to the average of all EU member countries, as shown in Table 2.

Table 2: Employment in professional, scientific and technical services in Moldova, Germany, EU

	Moldova	Germany	EU 27
Contribution of professional, scientific and technical services to employment	2.0 %	5.9 %	5.6 %

Source: National Bureau of Statistics of Moldova, 2011; Eurostat 2011.

Secondly, the value generation of liberal professions is smaller than in Germany and the EU.

Again, the sector of professional, scientific and technical services shows the most dramatic difference with respect to Gross Value Added: It is only 0.8% in Moldova, in contrast to 5.8% of German value creation. The same is to say for the comparison with the EU average, as illustrated in Table 3.

Table 3: Value added of professional, scientific and technical services in Moldova, Germany, EU

	Moldova	Germany	EU 27
Gross value added of professional, scientific and technical services	0.8 %	5.8 %	5.9 %

Source: National Bureau of Statistics of Moldova, 2011; Eurostat 2011.

Thirdly, the liberal professions sector in Moldova has stagnated for many years. The value generation of professional, scientific and technical services has even declined by 1.2 percentage points since 2005¹. This is contrast to the developments in Germany and in the EU, where the liberal professions sector is growing at above average speed. Employment of liberal professions in Germany, for instance, has increased by 13%² in the same time since 2005; a similar picture emerges when analyzing the gross value generation.

¹ Source: National Bureau of Statistics of Moldova, 2011.

² Source: Institute for Liberal Professions in Germany, 2011.

3 Liberal professions regulatory framework

As described above, the development stadium of the liberal professions in Moldova is sub-optimal.

The regulatory framework is most likely one of the reasons for the underdevelopment, but not the only reason. Other important influence factors are: the growth of demand for business related professional services, the growth of demand for consumer related professional services; continuity of fiscal and social policy, esp. public expenditure for health, arts and education; availability of skilled and experienced workforce; labor costs; tax burden; administrative burden and compliance costs.

However, international reform experience shows that a modernized regulatory framework can boost the sectors development. Since this sector has a high relevance for the economic development, it is worth discussing the regulatory framework conditions, having still in mind, that other conditions are important too.

There is nothing like a general liberal profession framework. Each type of profession requires a very specific regulation. Some provisions that are suitable in one service area can be counter-productive in another service area. That is why detailed recommendations are only possible for specific professions. We are, nevertheless, able, to give some general recommendations.

Before highlighting some areas for improvement, we like to give some general explanations regarding liberal profession regulation.

Liberal professionals are first and foremost normal economic entities before being special in some aspect. That is why liberal professions' regulation should be based on the business regulatory framework. In other words: all legislative provisions that apply to businesses are applicable to liberal professionals, too. Special regulation for liberal professions should amend but not replace general business regulation.

Special regulation requirements emerge from the nature of some of the services provided by liberal profession. Among the special type of services that require additional regulation are legal advice, health services, tax consulting and auditing.

The nature of such services requires additional regulation in order to assure the following policy goals: consumer protection, supply security, quality of services, affordable prices. Short explanations are presented in the following.

The aims of special regulation on liberal professions

a) Consumer protection

Some of the services provided by liberal professionals are difficult to explain and thus difficult to understand for both business and private customers. This is for instance the case for legal advice. Therefore, the "normal" consumer protection law is regarded as insufficient and needs additional regulation aiming at strengthening the customers position and protect his/her rights. Example: A consumer can hardly assess the competency of a legal adviser, leaving him/her in an inferior position in negotiations with the respective service provider.

b) Supply security

Some of the services provided by liberal professionals are regarded as essential for a countries economy and welfare. This is for instance the case for health services. Special legal requirements aim at securing the availability of such services.

Example: When medical practitioners prefer locating in the big cities, the supply of health services in rural areas could suffer.³

c) Quality of services

For many services provided by liberal professionals, it is difficult for customers to observe the quality of the services. A lack of trust in the quality of services would lead to a decreasing demand. Quality assurance, therefore, stabilizes demand resp. facilitates demand growth.⁴

Example: When the quality and reliability of tax consulting is questionable, the demand for such consulting decreases, because costumers see no value added.

d) Affordable prices

Some of the services provided by liberal professionals are regarded as essential for peoples' well-being and living standard. It is a matter of political priority to facilitate the access to such services for all citizens including citizens with very low income. General public policy goals in this respect outrank economic policy goals.⁵ Example: Health services should be affordable for all citizens.

To sum up: Public welfare is the overall objective of special regulation for liberal professions.

The instruments of special regulation on liberal professions

Several regulatory instruments are used⁶ for achieving the sketched goals. However, there it is always a balancing act between adequate regulation and over-regulation. Whilst the first has positive impact on the sectors development, the latter has negative effects on markets and endanger the risk of hindering the development. Outweighing opportunities and risks is very difficult. Table 4 highlights the most common regulatory instruments and sketches advantages and possible drawbacks.

Table 4: Opportunities and risks of liberal profession regulation instruments

Regulation instrument	Example	Opportunities of adequate regulation	Risks of over-regulation
<i>Market access regulation (entry regulations, exclusive rights for liberal professions)</i>	Licenses	Assures high quality of services Customer protection Facilitates the build of mutual trust between professionals and customers	Limits number of professionals Hinders efficient competition: <ul style="list-style-type: none"> • Price increase • Quality decrease

³ In economic terms: Some liberal professionals produce a public good; market dynamics can lead to an allocation which is efficient from the individual's point of view, but inefficient from the national perspective.

⁴ In economic terms: The problem of asymmetric information can lead to market failure.

⁵ In economic terms: Liberal professionals produce a public good.

⁶ This is the case in the USA, in EU member states and many other countries.

<i>Price regulation</i>	Fixed prices	Assures affordable prices and thus access to services for all citizens and/or ⁷ Secures supply by guaranteeing high income level for professionals	Cartel power of self-regulated bodies keep prices high
<i>Advertising rules</i>	Prohibition of advertising	Protects customers from manipulation	Limits competition Hinders innovation
<i>Restrictions on the forms of inter-professional co-operation</i>	Lawyers and consultant may not work as joint teams	Assures high quality of services (no "dilution" with other service industries)	Hinders innovation Keeps prices high (no use of synergy effects)
<i>Restrictions on organizational structures of businesses providing professional services</i>	Lawyers may not incorporate	Assures high quality of services	Hinders innovation Keeps prices high (no use of synergy effects)
<i>Regulation of cartel-authority practices</i>	Professionals are exempted from competition law	Assures high quality of services Supply security by guaranteeing high income level for professionals	Hinders efficient competition: <ul style="list-style-type: none"> • Price increase • Quality decrease

Source: Own representation.

The responsible institutions for special regulation on liberal professions

There is another trade-off entailed with regulating the liberal professions, namely between the need for regulatory state interventions and the protection of freedom of profession. In order to minimize the degree of state intervention, the administration can delegate the regulation to professional bodies. The latter are formed and governed by the members of the respective profession. This is often referred as self-regulation. Self-regulation of the professionals is an acknowledged method for improving public welfare and limiting interventions in the freedom of profession. It is worth mentioning that the balance between state regulation and self-regulation differs a lot among EU member states.

⁷ Usually it is a trade-off, but it can be solved with additional instruments such as a legal-aid system that at the same time guarantees high income for lawyers and affordable fees for clients. Another approach is the health insurance system in Germany: It guarantees high incomes for medical practitioners by using guaranteeing fixed prices for medical services and at the same time guarantees access to medical services for all citizens. Having said this, the latter is not able to control the regional allocation of medical supply, which means that in rural areas there are often shortages of medical services.

Having said this, researchers have observed that professional bodies with self-regulating authority power show the tendency to over-regulate the market. In other words, the self-regulation produces more restrictions and requirements than necessary with respect to the objective of protecting the public welfare. Such over-regulation can affect the economy negatively (see above Table 1).

4 Public policy towards liberal professions development: International trends

There has been a scientific and political debate about the relevance of negative effects of over-regulation in liberal professions for about 20 years (as mentioned in chapter 2). As a result of this discussion, several countries have reformed their regulatory frameworks for professional services, often referred as deregulation in public discussion. The term deregulation is actually not a perfect appropriate term because it addresses only parts of the reform process. In the UK, for example, the reform contained a deregulation in the sense of cutting back regulatory market restrictions, but at the same time the reform transferred regulatory power from the professional bodies to the state administration, which is usually contrary to the idea of deregulation.

Results from research on the outcomes of reforms are available for several countries. The following tables sketch briefly the most recent international reform trends and experiences, regarding market opening policy, market conduct deregulation, non-discrimination of liberal professions and easing restrictions on business structures as well as regarding the easing of the administrative burden and compliance costs.

Table 5: International experience regarding market opening policy

<i>Typical policy instruments</i>	Easing entry regulations for professionals Reducing exclusive rights for professionals
<i>Experiences with respect to economic effects</i>	Quality of services increases Prices decrease No negative effect on availability of services/supply security No negative effect on customer protection Numbers of professionals increase Net job creation Value added increases Innovation increases
<i>Political efficiency</i>	Very high, because costs of policy implementation are very low and there are no deadweight losses
<i>Relevance for Moldova</i>	High relevance All market access regulations for all liberal professions' sectors should be regularly assessed in order to identify unnecessary or even counter-productive over-regulation.

Source: Own representation.

Table 6: International experience regarding market conduct deregulation

<i>Typical policy instruments</i>	<p>Elimination of fixed prices</p> <p>Elimination/reducing of price recommendations</p> <p>Easing advertising restrictions</p>
<i>Experiences with respect to economic effects</i>	<p>Quality of services increases</p> <p>Prices decrease</p> <p>No negative effect on availability of services/supply security</p> <p>No negative effect on customer protection</p> <p>Numbers of professionals increase</p> <p>Net job creation</p> <p>Value added increases</p> <p>Innovation increases</p>
<i>Political efficiency</i>	<p>Very high, because costs of policy implementation are very low and there are no deadweight losses</p>
<i>Relevance for Moldova</i>	<p>Medium relevance</p> <p>Recommend prices in some sectors (e.g. for lawyers) seem to be not very effective. Fixed prices exists as well (e.g. for notaries), but effectiveness is unclear.</p> <p>Nevertheless, all price regulations for all liberal professions' sectors should be regularly assessed in order to identify unnecessary or even counter-productive over-regulation.</p> <p>Advertising rules (e.g. Law on advertising nr. 1227 from 27.06.1997) should be regularly assessed in order to identify unnecessary or even counter-productive over-regulation. This becomes more important the better the sector develops.</p>

Source: Own representation.

Table 7: International experience regarding non-discrimination of liberal professions and easing restrictions on business structures

<p><i>Typical policy instruments</i></p>	<p>Ensure access to state procurement, esp. break tenders into lots in order to facilitate the participation of small service providers</p> <p>Ensure access to state SME promotion programs</p> <p>Ensure equal treatment with respect to taxation Allowing all forms of inter-professional co-operation</p> <p>Allowing all organizational structures of businesses providing professional services</p>
<p><i>Experiences with respect to economic effects</i></p>	<p>No negative effect on availability of services/supply security</p> <p>No negative effect on customer protection</p> <p>Numbers of professionals increase</p> <p>Net job creation</p> <p>Value added increases</p> <p>Innovation increases</p>
<p><i>Political efficiency</i></p>	<p>Very high, because costs of policy implementation are very low and there are no deadweight losses</p>
<p><i>Relevance for Moldova</i></p>	<p>High relevance:</p> <p>The Moldovan legislation treats several types of liberal professions not as economic entities, for instance lawyers are not regarded as entrepreneurs and are not allowed to incorporate.</p> <p>Several types of liberal professions are discriminated in Moldova in several aspects, for instance with respect to:</p> <ul style="list-style-type: none"> • Taxation (deductibility of costs) • Access to state SME promotion programs

Source: Own representation.

Table 8: International experience regarding easing administrative burden, compliance costs

<p><i>Typical policy instruments</i></p>	<p>Easing administrative burden of tax regulation Partial or complete exemption of liberal professions from substantive requirements such as reporting and record keeping Less frequent inspections Lighter fines for non-compliance</p>
<p><i>Experiences with respect to economic effects</i></p>	<p>No negative effect on availability of services/supply security No negative effect on customer protection Numbers of professionals increase Net job creation Value added increases Innovation increases</p>
<p><i>Political efficiency</i></p>	<p>Very high, because costs of policy implementation are very low and there are no deadweight losses</p>
<p><i>Relevance for Moldova</i></p>	<p>High relevance: Administrative burden and high compliance costs are major impediments for all Moldovan economic entities.</p>

Source: Own representation.

5 Conclusions and implications for Moldova

As mentioned already, a general liberal profession framework does not exist and is not suitable. Each type of profession requires a very specific regulation. We are, nevertheless, able, to give some general recommendations.

As a result of our brief analysis of the liberal professions sector and taking into account international best practices, we recommend the following first step on the way to a modernized regulatory framework:

1. Improve data basis about the liberal professions sector

The current available statistical data are not sufficient for a thorough quantitative economic analysis and for an effective policy design and evaluation.

2. Eliminate discrimination of liberal professions

All liberal professionals should be acknowledged as “normal” entrepreneurs by Moldovan legislation. They all should be subjected to the same business law provisions as other businesses. This includes the same treatment regarding taxation (e.g. tax rates, deductible costs, book-keeping and reporting standards etc.). They should have access to state SME programs.

3. Identify and eliminate over-regulation, strengthens the role of professional bodies

It is very striking that professional bodies play only a minor role in the system of regulation in Moldova. This is on contrast to most European countries. As mentioned above there is a current debate about the balance between self-regulation and state regulation and there are trends in some countries to roll back regulatory power from professional bodies to state authorities. However, as for Moldova, it should be thoroughly examined whether the current system is a result of a comprehensive debate on regulation efficiency or whether it is a legacy system. If the latter turns out to be the case, a reform discussion is needed.

4. Research on further factors hindering the development of the liberal professions

The dramatic underdevelopment of the sub-sector professional, scientific and technical services as stated by official statistics (see chapter 2) cannot be explained by inefficient regulation to the full extent. More insights are necessary.

Final remark: The liberal professions sector has apparently been neglected by economic policy so far. The sector bears much potential for the Moldovan economy. Especially professional services have - by nature - lower capital endowment requirements than manufacturing businesses. They, furthermore, have higher productivity and innovation rates than other services. They provide better jobs in terms of both salary and working conditions than other service sectors. Above all, the availability of business-related professional services is a key factor of international investors' decision making when considering direct investment in Moldova. Therefore, developing professional services is an opportunity that should be taken immediately.

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