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Market Intervention by the Courts: The Economics of Occupational Boundary-Setting

Abstract

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MARKET INTERVENTION BY THE COURTS: THE ECONOMICS OF OCCUPATIONAL BOUNDARY-SETTING

STEVEN B. JOHNSON* and JOHN B. CORGEL**

I. INTRODUCTION:

Market intervention by the courts may take many forms and may occur in a variety of contexts.¹ Sometimes even the most obscure types of judicial decisions can exert a significant impact on the efficiency of exchange (i.e., the price-quality equilibrium) in the market.² Consequently, one criterion for evaluating legal precedent is its impact, if any, on the efficiency of exchange in the market.

An area where the courts have, either consciously or unconsciously, confronted the question of whether to intervene in the market is in the resolution of jurisdictional boundary disputes between licensed occupations.³ Jurisdictional boundaries between occupations define the types of services that may be offered by an occupational group and determine whether that occupational group has an exclusive right to provide those services. Some courts, for example, have held that only attorneys may prepare sales contracts, deeds, mortgages, and other legal documents involved in a real estate transaction, while real estate brokers, agents and title insurers may fill in the blanks of prepared documents only if they do not extend the authority of those documents.⁴ Since there are many services that could conceivably be offered by more than one occupational group, the establishment of jurisdictional boundaries by the courts may have a significant impact on the efficiency of exchange in a wide variety of service markets.

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1 For example, an injunction against copyright or patent infringement is a type of market intervention by the courts.

2 For example, a decision as to whether a book, movie, or magazine is "pornographic" and can thus be banned by a state government exercising its police power, or whether it has "redeeming social value" and is thus protected under the First Amendment, can exert a significant impact on the market. While such a decision is apparently concerned with artistic, not economic, issues, its economic impact is an important concern as well.

3 Boundary-setting between licensed and nonlicensed practitioners of a particular occupation is a closely related issue which this paper implicitly addresses.

4 *E.g.*, *State Bar v. Guardian Abstract & Title Co.*, 91 N.M. 434, 575 P.2d 443 (1978); *Hulse v. Criger*, 363 Mo. 26, 247 S.W.2d 855 (1952). See Brossman & Rosenberg, *Title Companies and the Unauthorized Practice Rules: The Exclusive Domain Reexamined*, 83 DICKINSON L. REV. 437, 459-61 (1979); Shedd, *Real Estate Agents and the Unauthorized Practice of Law*, 10 REAL ESTATE L.J. 135 (1981).

The purpose of this paper is to examine the manner in which courts have resolved jurisdictional disputes between licensed occupations and determine whether the precedents established have tended to promote or impede the efficiency of exchange in the service markets. The first section reviews the manner in which state and federal courts have resolved occupational boundary disputes. The next section addresses the economics of occupational boundary-setting. This economic theory is utilized in the third section to assess the relative efficiency of occupational boundary-setting by the various state courts. A summary of the results and conclusions is presented in the final section. For purposes of the study, the existence of occupational licensing, while presenting some interesting issues of its own, is taken as given.⁵

II. JUDICIAL RESOLUTION OF JURISDICTIONAL DISPUTES BETWEEN LICENSED OCCUPATIONS

A survey of state court decisions reveals that, in general, state courts have tended to resolve jurisdictional disputes between licensed occupations by categorizing the disputed services as either:

- (1) services which may be marketed only by members of a particular licensed occupational group;⁶ or
- (2) services which may be provided by members of more than one occupational group if: (a) provision of such services is "incidental" to the provision of related services that the occupational group is already licensed to market; and (b) no separate fee is charged for the provision of these "incidental" services.

⁵ The occupational licensing literature is extensive. In addition to the studies cited elsewhere in this paper, works in this area include: M. FRIEDMAN, *CAPITALISM AND FREEDOM* 137-60 (1962); Holen, *Effects of Professional Licensing Arrangements on Interstate Labor Mobility and Resource Allocation*, 73 J. POL. ECON. 492 (1965); Maurizi, *Occupational Licensing and the Public Interest*, 82 J. POL. ECON. 399 (1974); Gellhorn, *The Abuse of Occupational Licensing*, 44 U. CHI. L. REV. 6 (1976); Stolar, *Occupational Licensing: An Antitrust Analysis*, 41 MO. L. REV. 66 (1976); Leffler, *Physician Licensure: Competition and Monopoly in American Medicine*, 21 J. L. & ECON. 165 (1978); Shepard, *Licensing Restrictions and the Cost of Dental Care*, 21 J. L. & ECON. 187 (1978); White, *Dynamic Elements of Regulation: The Case of Occupational Licensure*, 1 RESEARCH IN LAW AND ECON. 15 (1979); Carroll & Gaston, *State Occupational Licensing Provisions and Quality of Service: The Real Estate Business*, 1 RESEARCH IN LAW AND ECON. 1 (1979); Smith, *Production of Licensing Legislation: An Economic Analysis of Interstate Differences*, 11 J. LEGAL STUD. 117 (1982); Johnson & Corgel, *Antitrust Immunity and the Economics of Occupational Licensing*, 20 AM. BUS. L.J. 471 (1983).

⁶ In most cases, no jurisdictional boundary dispute arises when the seller of the disputed service does not hold himself out to the public as offering the service for sale and provides the service without charge. Hence, the term "marketed" refers to the act of holding oneself out as providing the service for compensation.

A survey of federal court decisions reveals that, in general, federal courts have tended to deal with such disputes by either dismissing them on jurisdictional grounds⁷ or concluding that the disputed services are immune from state licensing requirements:

- (1) under the "federal supremacy doctrine" because they are authorized by federal administrative or other authority;
- (2) under federal antitrust law; or
- (3) because they are protected by either the first, fifth, or fourteenth amendment.

A. Resolution of Occupational Boundary Disputes by State Courts

State courts tend to agree that each occupational group licensed by the state has a core of services which it is uniquely qualified to provide and should, therefore, be marketed only by its members. For example, lawyers are generally acknowledged to be uniquely qualified to provide courtroom advocacy, physicians to diagnose and treat disease, and certified public accountants to audit and express opinions on a firm's financial statements.

Most occupational boundary disputes that come before state courts involve the allegation that some party has engaged in the unauthorized practice of a particular licensed occupation and should, therefore, be: (1) denied compensation for the disputed services; (2) enjoined from further provision of such services; and/or (3) fined or otherwise penalized for providing these services. In general, state statutes concerning unauthorized practice tend to provide little practical guidance in resolving such questions, and the law in this area has, therefore, tended to be largely judicially-derived.⁸

While state courts tend to agree in principle that each licensed occupational group is uniquely qualified in some respect, they generally do not agree as to just which services should be restricted to which occupations. More specifically, state courts often differ

⁷ Since these cases generally do not involve diversity between the parties (as required for federal jurisdiction under 28 U.S.C. § 1332 (1976)), they must establish the presence of a federal question (as required for federal jurisdiction under 28 U.S.C. § 1331 (1976 & Supp. V. 1981)). In the vast majority of these cases, however, federal courts have concluded that the dispute centers around an interpretation of state law, rather than a federal question.

⁸ For example, most statutes simply prohibit the unauthorized practice of law, medicine, etc., without defining their respective scope of activities. Some states adopt a circular approach by defining the practice of law as what lawyers do, medicine as what physicians do, etc. See Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 STAN. L. REV. 1, 4-5 (1981).

over the question of whether other occupational groups ought to be allowed to perform services that are closely related to those falling in or near the core of a particular licensed occupation. For example, they have reached different results on the question of whether an accountant preparing a client's federal income tax return ought to be allowed to resolve questions of tax law without seeking the advice of an attorney.⁹

At one end of the spectrum are courts in states such as Pennsylvania and Minnesota, that generally allow other occupational groups to provide services falling in or near the core of a particular licensed occupation if the services are "incidental" to the performance of services that they are already licensed to market and if no separate fee is charged for these services. Such courts generally require that the party alleging unauthorized practice bear the burden of proving that the disputed service: (1) is within the core of a licensed occupation of which the seller is not a member; and (2) is not ancillary to the performance of some service that the seller is licensed to market. Further, to establish unauthorized practice it must be demonstrated that the seller: (1) held himself or herself out as being specially qualified to perform the disputed service; and (2) sought separate compensation for providing the disputed service.¹⁰

At the other end of the spectrum are courts in states such as Kentucky and Florida, that rarely allow other occupational groups to provide services that fall in or near the core of a particular licensed occupation, even if the services are "incidental" and no separate fee is charged. Such courts generally require that the party alleging unauthorized practice prove only that: (1) the disputed service is within the realm of a particular licensed occupation of which the seller is not a member; and (2) the seller sought compensation, directly or indirectly, for providing the disputed service. These courts attach little importance to the fact that the disputed service is merely "incidental" to the provision of some service the seller is licensed to market.¹¹

State courts that construe the "incidental services" doctrine narrowly, thereby drawing relatively rigid boundaries between oc-

9 See e.g., Bittker, *Does Tax Practice by Accountants Constitute the Unauthorized Practice of Law?*, 24 J. Tax. 184 (1966) and Misiewicz and Parsons, *When Does Tax Work by an Accountant Constitute Unlawful Practice of Law?*, 16 TAX. ACCTS. 172 (1977).

10 See, e.g., Brossman & Rosenberg, *supra* note 4; Weckstein, *Limitations on the Right to Counsel: The Unauthorized Practice of Law*, 1978 UTAH L. REV. 649 (1978).

11 *Id.*

cupations, tend to affect service markets differently than do courts that construe the doctrine broadly, drawing less rigid boundaries. Consumers in states like Pennsylvania and Minnesota, whose courts fall in the latter category, enjoy a wide choice of sellers from whom to purchase various services, while similar consumers in states like Kentucky and Florida, whose states fall in the former category, are restricted to a much narrower choice of sellers.

B. *Resolution of Occupational Boundary Disputes by Federal Courts*

Federal courts generally dismiss, on jurisdictional grounds, cases involving boundary disputes between state-licensed occupations, unless the right of the occupational group or practitioner to provide the disputed service is protected under the "federal supremacy doctrine," federal antitrust law, or the first, fifth, or fourteenth amendment. Unlike state courts, whose function is to determine the appropriate application of the state's statutory scheme for prohibiting unauthorized practice of state-licensed occupations, federal courts are concerned with the constitutional and antitrust validity of the scheme or a particular application of it. Although the actual number of federal cases in this area is relatively small,¹² it is possible to draw certain inferences about the types of statutory schemes that have been invalidated.

Applications of unauthorized practice schemes that have been invalidated because of incompatibility with the federal supremacy doctrine generally involve an unlicensed practitioner who is authorized by a federal agency to provide some service which also falls within the realm of a state-licensed occupation. For example, the Supreme Court has held that a nonlawyer who is authorized by the U.S. Patent Office to file patent applications and represent applicants in administrative proceedings before that agency is not guilty of the unauthorized practice of law because of immunity under the federal supremacy doctrine.¹³ This immunity prevents unauthorized practice schemes from interfering with federal agencies operating within a state.

Application of a state's unauthorized practice scheme is barred by federal antitrust law when it is shown that the application: (1) is

¹² Rhode, *supra* note 8, at 44, notes that of the 84 reported decisions involving allegations of unauthorized practice of law between 1970 and 1980, only ten considered first amendment claims and three considered due process claims.

¹³ Sperry v. Florida, 373 U.S. 379 (1963).

not a valid exercise of state police power; and (2) constitutes a "conspiracy in restraint of trade."¹⁴ In one such case, a federal court held that a state bar's unauthorized practice committee advisory opinions that prohibited lay employees from engaging in title search activities on behalf of a title insurance company, coupled with the threat of disciplinary proceedings, constituted an illegal restraint of trade under the Sherman Act.¹⁵

Finally, applications of unauthorized practice schemes have been invalidated when incompatible with the first, fifth, or fourteenth amendment. Invalidation under the first amendment may occur if application of the scheme unjustifiably restricts both a practitioner's ability to convey information and the public's opportunity to receive it. For example, the Supreme Court has upheld the right of the NAACP to counsel and refer individuals to its affiliated attorneys as a form of political expression protected by the first amendment.¹⁶ Invalidation under the fifth or fourteenth amendment may occur if application of the scheme effectively denies "due process" to individuals wishing to offer a particular service for sale in the market. A scheme does not satisfy due process if it fails to ensure dispassionate administration free from the taint of self-interest. For example, federal courts have held that a board composed solely of optometrists in private practice lacked the requisite impartiality to rule on matters concerning the unauthorized practice of optometry because of their economic stake in the outcome of each ruling.¹⁷

C. The Relative Roles of State and Federal Courts

While federal courts monitor important constitutional and antitrust aspects of unauthorized practice schemes, state courts decide how jurisdictional boundaries are actually drawn between licensed occupations. Consequently, the most important determinant of how a judicially-derived occupational boundary-setting scheme affects the service markets is whether state courts apply the "incidental services doctrine" broadly or narrowly.

14 Sherman Act, 15 U.S.C. § 1 (1980).

15 *Surety Title Insurance Agency, Inc. v. Virginia State Bar*, 431 F. Supp. 298 (E.D. Va. 1977), *order vacated pending resolution of state law question*, 571 F.2d 205 (4th Cir. 1978), *cert. denied*, 436 U.S. 941 (1978).

16 *NAACP v. Button*, 371 U.S. 415 (1963).

17 *Gibson v. Berryhill*, 331 F. Supp. 122 (M.D. Ala. 1971), *aff'd*, 411 U.S. 564 (1973).

III. THE ECONOMICS OF OCCUPATIONAL BOUNDARY-SETTING

Boundary-setting for licensed occupations can exert a significant impact on the efficiency of exchange (i.e., the price-quality equilibrium) in the service markets. The magnitude of this impact is determined by three factors:

- (1) the extent to which occupational groups that are technologically capable of supplying the restricted services are excluded from the market by boundary-setting;
- (2) the elasticity of demand for the restricted services; and
- (3) the extent of "informational asymmetry" in the market for the restricted services.¹⁸

A. *Extent to Which Boundary-Setting Excludes Potential Suppliers from the Market*

To determine the extent to which boundary-setting excludes potential suppliers from the market, it is useful to view each potential supplier of a service as a "firm" that desires to enter the market. In the absence of legal barriers, generally the most important determinant of a firm's ability to supply a service is the seller's expertise.¹⁹

Expertise is acquired by the training an individual receives and can be either "general" or "specific."²⁰ "General training" provides an individual with expertise that is applicable in a wide variety of situations and localities. Examples of general training include a medical school education or the completion of an apprenticeship to become a journeyman electrician. "Specific training" provides individuals with expertise that is applicable only in a particular situation or locality. Examples of specific training include certain types of military training that are only of limited use to civilians, such as artillery training, or training to familiarize new employees with the physical layout of their workplace. While most

18 As defined in Section III(C), *infra*, "informational asymmetry" is the possession of superior market information by sellers who refuse to disclose the information to buyers. See Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. Econ. 488 (1970).

19 For expository reasons, services for which the ability to raise large amounts of capital to acquire equipment, etc., is also an important determinant (e.g., the provision of satellite communication services) are not specifically considered. With only minor modification, however, the analysis presented is equally applicable to such services.

20 See G. BECKER, HUMAN CAPITAL, 19-37 (1975); Becker, *Investment in Human Capital: A Theoretical Analysis*, 70 J. POL. ECON. 9, 12-13 (1962 Supp.).

actual training is neither completely general nor completely specific, this dichotomy is useful in explaining why alternative occupational groups may or may not be capable of supplying a particular service to the market.

For purposes of this paper, the expertise that results from general training is referred to as "general expertise" while the expertise that results from specific training is referred to as "local information." Even though members of a licensed occupational group may possess greater general expertise in providing a particular service, it may still be possible for other occupational groups to provide the service if local information can be substituted, to at least some degree, for general expertise. Dentists, for example, possess greater general expertise in the care and treatment of teeth, but dental technicians, possessing local information about x-raying teeth, may also be able to perform that service.²¹ Consequently, it is the extent to which local information can be substituted for general expertise that determines which occupational groups have the technological ability to supply a particular service to the market.

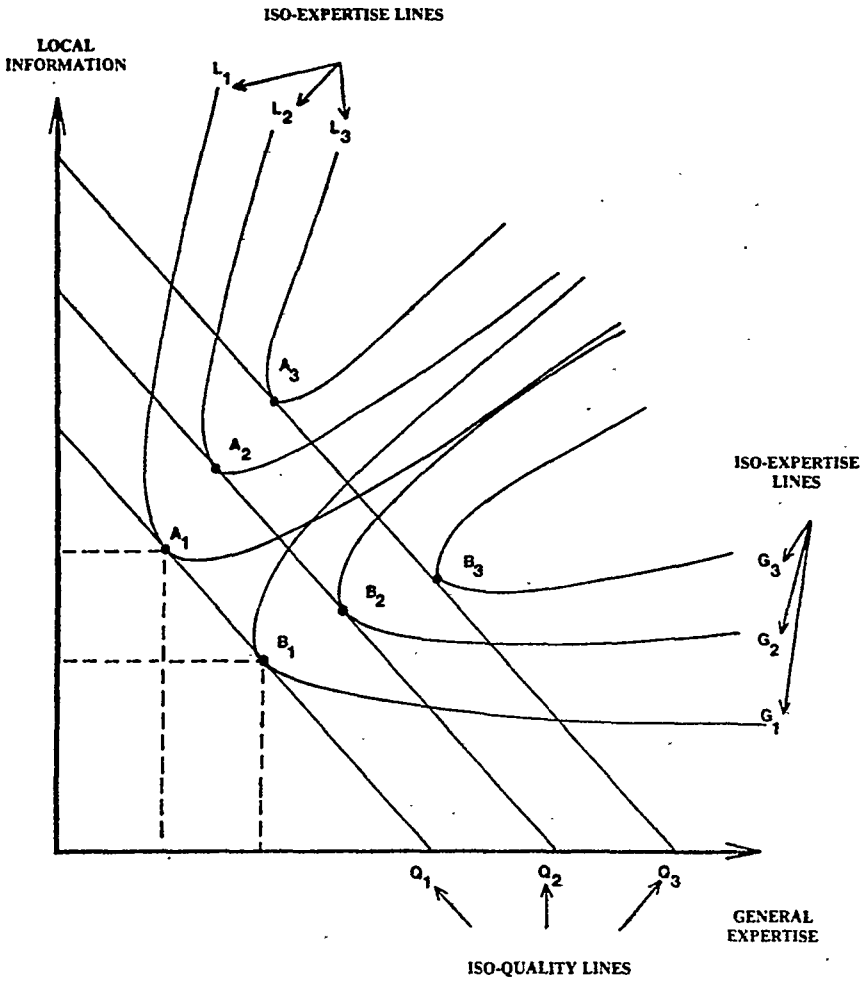
One possible relationship between the substitutability of local information for general expertise and quality of service is depicted in Figure 1.²² The vertical axis represents the degree of local information necessary to provide a particular quality of service, and the horizontal axis represents the degree of general expertise necessary to provide a particular quality of service. Q_1 , Q_2 , and Q_3 are iso-quality lines with Q_1 being the lowest quality service and Q_3 being the highest quality service (i.e., $Q_1 < Q_2 < Q_3$). L_1 , L_2 , and L_3 are iso-expertise lines that represent combinations of local information and general expertise where the dominant type of expertise is local information. Points A_1 , A_2 , and A_3 represent the quantity and combination of local information and general expertise possessed by each of three respective occupational groups that possess more local information than general expertise. G_1 , G_2 , and G_3 are iso-expertise lines representing combinations of local information and general expertise where the dominant type of expertise is general expertise. Points B_1 , B_2 , and B_3 represent the quantity

21 See Note, *Restrictive Licensing of Dental Paraprofessionals*, 83 YALE L.J. 806 (1974).

22 The actual extent to which local information and general expertise may be substituted for one another in determining an individual's competence to provide a particular service is, of course, an unresolved empirical question. Therefore, Figure 1 is presented for expository purposes only. For a more detailed discussion of how such a figure is derived, see BECKER, *supra* note 20.

FIGURE 1

Substitutability of Local Information for General Expertise in the Provision of a Service



and combination of local information and general expertise possessed by each of three respective occupational groups that possess more general expertise than local information.

While the actual substitutability of local information for general expertise may vary from service to service, the figure illustrates some important general relationships. First, members of an occupational group possessing more local information, but less general expertise, may be able to provide a service of quality equal to that which could be provided by members of an occupational group possessing more general expertise (e.g., A_1 can provide a service equal in quality to B_1). In addition, members of an occupational group possessing a particular quantity and combination of local information and general expertise (e.g., A_1 or B_1) may be able to increase the quality of the service they provide by increasing either their general expertise or local information. The strength of these relationships determines the extent to which boundary-setting actually restricts supply by precluding other qualified, but not necessarily identically trained, suppliers from the market.

B. *Elasticity of Demand for Restricted Services*

If occupational boundary-setting restricts the supply and increases the price of a service, then consumers will either seek available substitutes or elect to do without the service when demand for the service is sufficiently elastic.²³ The availability of substitutes for restricted services is determined by the ability of the market to provide acceptable surrogates via alternative forms of information or performance. For example, if consumers are willing to use information found in the *Wall Street Journal* instead of the services of an investment counselor or consult a book on do-it-yourself divorce instead of an attorney, then such publications can be viewed as substitutes for the corresponding services.

In general, consumers will shift to a substitute only if the changeover costs²⁴ are lower than the increase in the price of the restricted service. Thus, restrictions on supply imposed by restrictive occupational boundary-setting will induce consumers to adopt

²³ The elasticity of demand for a particular service is a measure of the extent to which the quantity of the service purchased will decline as its price increases. Technically, elasticity of demand is defined as $\frac{\partial Q}{\partial P} \cdot \frac{P}{Q}$. If this is less than -1, the demand for the service is elastic.

²⁴ One implicit changeover cost is a deficiency in the quality of the substitute when compared to that of the original service.

substitutes only if the increase in the price of the restricted service is sufficient to offset the changeover costs. Since changeover costs vary from service to service, as well as from consumer to consumer, substitutes may not be uniformly available to all consumers.²⁵ In general, the greater the availability of substitutes for a restricted service, the smaller the impact exerted on the market price-quality equilibrium by restrictive boundary-setting.

Overall, the elasticity of demand for a restricted service is determined by both the availability of substitutes and the willingness of consumers to do without the service altogether. Therefore, occupational boundary-setting which causes a decrease in the supply of a service for which demand is relatively inelastic (i.e., a necessity) will generally exert a greater impact on the market than boundary-setting which decreases the supply of a service commonly regarded as a luxury.

C. *Extent of Informational Asymmetry in Markets for Restricted Services*

Over the past decade economists have also begun to evaluate occupational licensing in terms of its ability to provide information to potential consumers about the quality of services. The emergence of this informational perspective on the role of occupational licensing (and, in turn, occupational boundary-setting) can be traced to a seminal paper by George Akerlof.²⁶ Akerlof suggests that occupational licensing may improve the efficiency of exchange in markets where buyers are unable to effectively differentiate the various services offered for sale on the basis of quality. In such markets, sellers possess information about quality, but may refuse to disclose it to potential buyers. According to Akerlof, if this informational disparity or "asymmetry" between buyers and sellers is not corrected, a type of market failure referred to as "adverse selection" may result.²⁷

25 For someone who has had a long and trusted relationship with his or her stockbroker, for example, the costs of shifting to the *Wall Street Journal* for investment information may be significantly higher than for someone who has had a more formal relationship.

26 Akerlof, *supra* note 18, at 493.

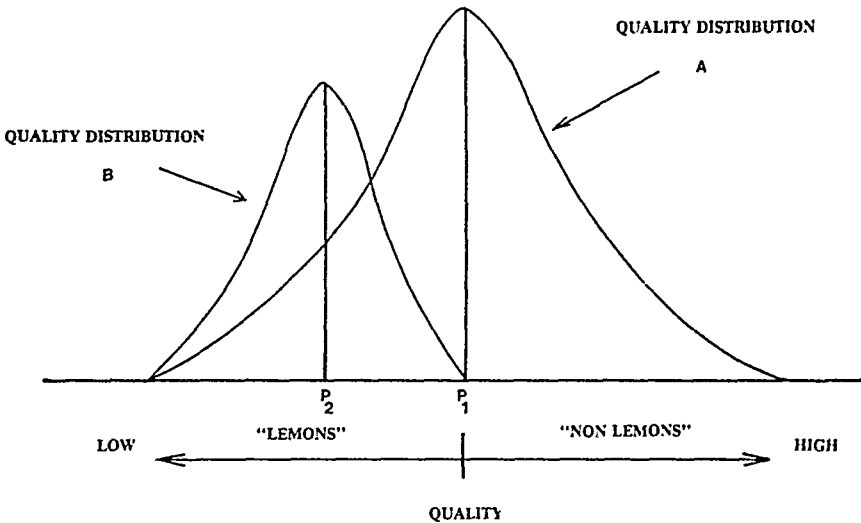
27 Akerlof, *id.* at 488, explains this "adverse selection" problem as follows:

There are many markets in which buyers use some market statistic to judge the quality of prospective purchases [e.g., average quality]. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller. As a result there tends to be a reduction in the average quality of goods and also in the size of the market. It should also be perceived that in

In order to demonstrate this adverse selection phenomenon, Akerlof posits that the used car market is characterized by an asymmetry of information between buyers and sellers so that potential buyers cannot differentiate "lemons" from "good cars" (i.e., "nonlemons"). In such markets, sellers of lemons will not reveal the quality of their merchandise and will, therefore, demand a price consistent with the productive capabilities of a nonlemon. Since buyers cannot differentiate lemons from nonlemons, the market equilibrium price will be based on what buyers perceive to be the average quality of all cars in the market, not on the actual quality of any particular car.

FIGURE 2

Price-Quality Relationship in a Market with Informational Asymmetry



The consequences of this unwillingness of buyers to pay a higher price than they perceive the average quality car to be worth is demonstrated by means of Figure 2. Quality distribution A represents the density function that corresponds to the actual quality of all possible used cars offered for sale in the market. Since buyers are unable to differentiate lemons from nonlemons, the resulting market price is P_1 , the price of an average quality car. As a result, sellers of lemons are more than willing to sell their cars for P_1 , but sellers of nonlemons will withhold their cars from the market. At this point, only lemons are offered for sale in the market and the quality distribution shrinks from distribution A to distribution B. Since buyers are unable to differentiate the above-average quality lemons in distribution B, the market price shifts from P_1 to P_2 , the price for the average quality lemon. At this point, only below-average lemons are offered for sale in the market and the quality distribution again shrinks and the market price shifts further to the left. It is this iterative process which leads to the type of market failure which Akerlof refers to as adverse selection.

The same sort of informational asymmetry that characterizes the used car market may be present in markets for professional services. While the quality of professional services varies, differences in quality often are not observable by potential buyers. If buyers of medical services, for example, are unable to differentiate the services offered by physicians on the basis of quality, then high quality physicians may be unable to obtain an adequate price for their services, and overall quality may deteriorate as higher quality service is priced out of the market. By requiring a minimum level of quality, occupational licensing may be one means of averting adverse selection in markets for professional services.

Two corollaries to Akerlof's theory have been offered in support of the notion that informational asymmetries between buyers and sellers are often corrected by the market itself without the need for regulatory intervention. One corollary, attributable to Spence,²⁸ suggests that, in markets characterized by extreme informational asymmetries, sellers of high quality services have an incentive to voluntarily disseminate or "signal" their qualifications

these markets social and private returns differ, and therefore, in some cases, governmental intervention may increase the welfare of all parties.

28 Spence, *Job Market Signaling*, 87 Q. J. ECON. 355 (1973).

to potential buyers. By disseminating this information to buyers, a seller can differentiate his or her services from lower quality services and obtain a higher than average price.²⁹

In order for this voluntary dissemination or signaling to occur in a particular market, two conditions must be present: (1) there must be an endemic signaling mechanism available (i.e., a method by which sellers can have their assertions of quality verified to give them credibility); and (2) there must be an expectation by sellers that the benefits to be obtained by such signaling will exceed its costs. In the used car market analyzed by Akerlof, there is no endemic signaling mechanism, and hence no signaling occurs.³⁰ In markets where such a mechanism does exist, however, signaling may automatically alleviate informational asymmetries between buyers and sellers.

In line with this signaling corollary, Moore³¹ asserts that voluntary certification can provide the same benefits as does occupational licensing, but without its potentially anticompetitive side-effects. This assertion suggests that voluntary certification can facilitate signaling in markets for professional services by providing a mechanism by which sellers can elect to signal (i.e., verify) their competency to potential buyers.

A second corollary to Akerlof's theory, attributable to Stigler,³² suggests that buyers often have an incentive to search out and acquire information that will enable them to make more informed purchasing decisions. Therefore, the problem of informational asymmetries may be self-correcting in markets where information is not extremely asymmetric and costly. By acquiring information about the quality of the various services available in such markets, buyers can avoid the purchase of overpriced services and obtain a better value for their money.³³

29 This incentive is similar conceptually to that which motivates producers to advertise their goods in order to establish a "brand-name" advantage in the market.

30 M. SPENCE, *MARKET SIGNALING* 93-94 (1974), notes that "Verbal declarations (by sellers of used cars) are costless and therefore useless. . . . Reliability reports from the owner's mechanic are untrustworthy Guarantees do not work. The seller may move to Cleveland, leaving no forwarding address."

31 Moore, *The Purpose of Licensing*, 4 J. L. & ECON. 93, 104 (1961).

32 Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

33 Stigler's original concern was with price information search, not quality information search. See also Wilde & Schwartz, *Equilibrium Comparison Shopping*, 46 REV. ECON. STUD. 543 (1979); Vailan, *A Model of Sales*, 70 AM. ECON. REV. 651 (1980). Only recently have models been proposed which encompass the fact that sellers choose both price and quality, and that information on these variables may be costly for consumers to obtain. See, e.g., Leland, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality Stand-*

For buyer search to occur in such markets, however, two conditions must be present: (1) there must be an intermediary channel (e.g., a consumer information agency or information broker) through which buyers can acquire the information they desire; and (2) there must be an expectation by buyers that the benefits to be obtained from such an information search will exceed its costs. According to Stigler, there are many markets where both these conditions exist and buyer search may automatically alleviate informational asymmetries between buyers and sellers.³⁴

In extending this corollary, Schwartz and Wilde³⁵ imply that the imposition of occupational licensing may hamper the emergence (or continued existence) of the intermediary channels needed for buyer search. This suggests that occupational licensing may actually interfere with the natural self-correcting tendencies of the market.

In addition to occupational licensing, voluntary certification, and buyer information search, other possible remedies for the problem of adverse selection in markets for professional services include the imposition of two-part tariffs and the adoption of random licensing rather than licensing based on quality.³⁶ Although economists often differ as to which remedy is most appropriate, current economic theory has concluded that occupational licensing is preferable only when the market itself is unable to avert adverse selection by means of seller signaling, buyer information search, or some similar nonregulatory remedy.³⁷

Since restrictive boundary-setting tends to increase the impact of occupational licensing, it may improve the efficiency of exchange in markets where consumers are unable to distinguish alternative services on the basis of quality. Conversely, in service markets not

ards, 87 J. POL. ECON. 1328 (1979); J. Farrell, A Model of Price and Quality Choice with Informed and Uninformed Buyers (1980) (unpublished manuscript, Department of Economics, M.I.T.); Y. Chan & H. Leland, Prices and Qualities in Markets with Costly Information, (1980) (unpublished manuscript, University of California, Berkeley).

34 Stigler, *supra* note 32, at 220 explains that: "As the market grows . . . there will [often] appear a set of firms that specialize in collecting and selling information. They may take the form of trade journals or specialized brokers."

35 Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 637-38 (1979).

36 For a discussion of these alternatives, see Leland, *supra* note 33, at 1342.

37 As suggested in Schwartz & Wilde, *supra* note 35, at 631: "A decision to intervene [in the market] . . . cannot be sustained by a showing that an appreciable number of customers are uninformed; rather, the normative question should be whether the existence of imperfect information has produced noncompetitive prices and terms."

characterized by informational asymmetry, it may lower the efficiency of exchange.

D. Assessing the Efficiency of Occupational Boundary-Setting

Efficiency of exchange in the service markets is defined as the extent to which the marginal product (MP) of the services sold, an indicator of quality, corresponds to their sale price (P). Consequently, the short-run market price-quality equilibrium for a service can assume one of three states:

- (1) $MP = P$ (efficient exchange);
- (2) $P > MP$ (seller-dominated exchange); or
- (3) $MP > P$ (exchange characterized by adverse selection).

Thus, the efficiency of occupational boundary-setting can be assessed in terms of whether P and MP converge or diverge.

The extent to which occupational boundary-setting increases or decreases the efficiency of exchange in a service market is determined by both the nature of the restrictions imposed and the preexisting state of the market. For example, boundary-setting that excludes only the sale of inferior services (i.e., lemons) may improve the efficiency of exchange in a market characterized by informational asymmetry. Conversely, boundary-setting that excludes the sale of both inferior services and services of acceptable quality (i.e., nonlemons) may decrease the efficiency of exchange in a market in which consumers are able to differentiate services on the basis of quality.

This relationship between the efficiency of occupational boundary-setting and the preexisting state of the market, which is examined in greater detail in the next section, implies that the efficiency of a particular set of restrictions cannot be assessed without reference to the market which they affect. Accordingly, a boundary-setting scheme that is efficient in one market may not be efficient in another.

IV. THE ECONOMIC EFFICIENCY OF OCCUPATIONAL BOUNDARY-SETTING BY STATE COURTS

As discussed in Section II, there is considerable variance in the manner in which courts in different states apply the "incidental services" doctrine. State courts that apply the doctrine narrowly tend to establish rigid territorial boundaries for state-licensed occupations, while courts that apply the doctrine more broadly tend to allow a greater variety of potential sellers to enter the market.

As discussed in Section III, the extent to which occupational boundary-setting can alter the market price-quality equilibrium (i.e., the relationship between MP and P) for a restricted service is determined by the extent to which potential suppliers are precluded from the market for the service, the elasticity of demand for the service, and the extent of informational asymmetry in the market. Therefore, the efficiency of occupational boundary-setting that emerges from a narrow application of the "incidental services doctrine" must be evaluated on the basis of these factors.

A. The Efficiency of Boundary-Setting Resulting from Narrow Applications of the Incidental Services Doctrine

Since the efficiency of occupational boundary-setting emerging from narrow applications of the incidental services doctrine is determined by the three factors cited above, it is necessary to understand how each affects the price-quality equilibrium in the market for a restricted service. Viewed in a partial equilibrium sense, the greater the tendency of boundary-setting to exclude competent suppliers from the market, the greater the tendency for $P > MP$. Also, the greater the inelasticity of demand for the restricted service, the greater the tendency for $P > MP$. Finally, the greater the informational asymmetry in the market for a restricted service (1) the greater the tendency for $MP = P$ if boundary-setting excludes only inferior quality services from the market, or (2) the greater the tendency for $P > MP$ if boundary-setting excludes suppliers from the market on some basis other than the quality of their services.

Given these relationships, state courts that apply the incidental services doctrine narrowly tend to decrease the efficiency of exchange in a market for a restricted service when occupational boundary-setting excludes technologically competent suppliers from the market, demand is relatively inelastic, and potential consumers are unable to distinguish inferior services from services of acceptable quality. In such a case, the imposition of barriers in the market disrupts the efficiency of the preexisting price-quality equilibrium.³⁸

³⁸ This impact can be readily understood by referring to Figure 1. In such a case, the practical effect of occupational boundary-setting by courts in states such as Kentucky and Florida is to restrict access to the market to groups like A_1 . By precluding groups like B_1 ,

On the other hand, state courts that apply the doctrine narrowly tend to increase the efficiency of exchange for a restricted service when boundary-setting excludes only inferior services from the market and potential consumers are unable to differentiate inferior services from those of acceptable quality.³⁹ The imposition of barriers in the market in such a case may alleviate adverse selection and allow the market to equate P with MP.

While in some cases it is possible to determine whether a narrow application of the incidental services doctrine will increase or decrease the efficiency of exchange for a restricted service, in other cases it is not possible to make such an assessment. The net effect on the efficiency of exchange cannot be readily ascertained when, for example, occupational boundary-setting excludes both technologically competent and incompetent suppliers from the market, demand is relatively inelastic, and potential consumers are unable to differentiate inferior services from those of acceptable quality. In such a case, the net effect depends on whether the increase in efficiency due to the exclusion of incompetent suppliers is sufficient to compensate for the decrease in efficiency due to the inelasticity of demand and the exclusion of technologically competent suppliers.

B. The Efficiency of Boundary-Setting Resulting from Broad Applications of the "Incidental Services Doctrine"

The efficiency of occupational boundary-setting that emerges from broad applications of the incidental services doctrine is determined by the same factors used in analyzing narrow applications of the doctrine. Viewed in a partial equilibrium sense, the greater the failure of boundary-setting to exclude inferior services from the market, the greater the tendency for $MP = P$ if potential consumers are able to differentiate services on the basis of quality, and the greater the tendency for $MP > P$ if potential consumers are unable to differentiate services on the basis of quality. Also, since technologically competent suppliers are not excluded from the market, the elasticity of demand for an unrestricted service will not affect the efficiency of exchange.

which are also technologically capable of providing the same quality of service, supply is unnecessarily reduced and the result is $P < MP$.

³⁹ Since only inferior quality services are precluded from the market in such a case, the elasticity of demand for the service is irrelevant.

Given these relationships, state courts that apply the incidental services doctrine broadly tend to decrease the efficiency of exchange in a market for a relatively unrestricted service when services both of inferior and acceptable quality are offered for sale in the market and potential consumers are unable to distinguish them. Thus, the failure to impose sufficient barriers to exclude inferior services from the market may contribute to the problem of adverse selection.

By contrast, state courts that apply the doctrine broadly tend to increase the efficiency of exchange when both inferior and acceptable services are offered for sale in the market and potential consumers are able to distinguish them. Restraint in imposing barriers to exclude potential suppliers from the market will, in such cases, lead to an efficient market, with $MP = P$.

As in the case of state courts that apply the incidental services doctrine narrowly, there are situations in which it is not possible to determine readily whether a broad application of the doctrine will increase or decrease the efficiency of exchange in the market for a service. The net effect on the efficiency of exchange cannot be ascertained when, for example, both inferior and acceptable services are offered for sale in the market, potential consumers are unable to differentiate them, and there is no feasible means of establishing barriers that will exclude only inferior services from the market. In such a case, the net effect depends on whether the decrease in efficiency due to adverse selection is lower than the decrease in efficiency that would result from occupational boundary-setting, which will exclude technologically competent suppliers from the market.

C. Implications for State Courts

Several important implications for state courts can be drawn from the foregoing analysis:

- (1) occupational boundary-setting that permits only a particular licensed occupational group to supply a service can increase the efficiency of exchange in the market for the service only if the boundary-setting can exclude inferior services without also excluding acceptable services and if potential consumers are largely unable to distinguish inferior from acceptable quality services;
- (2) the extent to which the services supplied by one occupa-

tional group are qualitatively equivalent or inferior to those supplied by another group is determined by both the "general expertise" and "local information" possessed by each group and the extent to which one form of expertise can be substituted for the other; and

(3) the elasticity of demand for a restricted service influences the extent to which the exclusion of technologically competent suppliers from the market will reduce the efficiency of exchange.

V. CONCLUSION

Occupational boundary-setting resulting from narrow applications of the incidental services doctrine exerts an adverse effect on the efficiency of exchange, unless only inferior services are excluded from the market and consumers are largely unable to differentiate inferior from acceptable services. Since there is currently no foolproof method of setting occupational boundaries to ensure that only inferior services are excluded from the market, present schemes of restrictive boundary-setting generally lower the short-run efficiency of exchange in the service markets. Further, the anticompetitive effects of restrictive boundary-setting may be exacerbated over the long run. For example, members of an occupational group that is given an exclusive right to provide a particular service may be able to increase the monopoly rents they earn by unjustifiably raising the requirements for becoming a licensed member of the group. In this fashion, licensing requirements may be used to further reduce the supply of restricted services and drive up prices. In addition, over the long run, restrictive boundary-setting may stifle innovation in the provision of restricted services by discouraging the adoption of technologically superior or more cost-effective methodologies and procedures.⁴⁰

In the process of adjudicating the cases that come before them, courts, either consciously or unconsciously, formulate policies with potentially far-reaching economic consequences. As this study illustrates, economic models and methods of analysis are currently available to assist the judiciary in establishing effective policy in the area of occupational boundary-setting.

40 For a discussion of how regulation of this sort can stifle innovation by the protected group, see Posner, *Natural Monopoly and Its Regulation*, 21 *STAN. L. REV.* 548, 577-84 (1959).