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Occupational Licensing Matters: Wages, Quality and Social Costs

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Introduction

The authors of this article teach economics and public policy at the University of Chicago, the University of Minnesota, and Dartmouth College – three of the finest academic institutions in the United States. Yet, the authors are precluded by law from teaching economics in any public high school in the states of Illinois, Minnesota or New Hampshire. This would be a mere curiosity if the same kind of law, occupational licensure, did not also preclude many low-skilled workers from entering the labor market to do the dwindling number of jobs for which they may be qualified, such as barbering, manicurists or cosmetology. Occupational licensure is the legal process by which governments (mostly the states in the US but also local governments and the Federal government) identify the legal qualifications required to become licensed to practice a trade or profession, after which only licensed practitioners are allowed by law to receive pay for doing the work in the occupation. This form of labor market regulation has rapidly become one of the most significant factors affecting labor markets in the United States and other industrialized countries. The number of persons in licensed professions in the US has grown from around 4.5 percent in the early 1950s to about 29 percent in 2009. More than 800 occupations are licensed in at least one state (Kleiner and Krueger 2009). The trend, in the UK is broadly similar with a doubling of the number of persons required to hold a license to 13 percent in the last dozen years (Humphris, Kleiner and Koumenta 2010).

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The trend towards broader licensure should be a source of interest to policymakers, if not outright concern. Licensure makes it more difficult to enter a profession, which restrains the supply of service providers, and can raise demand curve by suggesting the service is of higher quality. Consequently, this raises the cost of services for consumers. Similarly, state or local licensure in the US can diminish mobility by requiring service providers to fulfill new licensing requirements when they move from one political jurisdiction to another. (For example, a public school teacher with a decade of experience in New Hampshire is not legally allowed to teach in an Illinois public school without taking significant new coursework and meeting state residency requirements). Finally, licensure restricts mobility and the scope of practice within certain professions. Dental hygienists cannot do tasks or open independent offices because the law restricts the overarching tasks to only dentists; a registered nurse in a hospital cannot do a task that state legislators have determined must be carried out by a licensed respiratory therapist (Wheelan 1998).

Of course, these labor market distortions must be weighed against any potential gains to consumers from the quality improvements in the licensed profession. Yet even the putative benefits of licensure have come under academic assault. The quality improvements of licensure are often overstated and may even lower the quality of service provided, if, for example, licensure requirements deter highly productive individuals (with the highest opportunity cost of time) from entering the profession or if the training mandated by lawmakers has no meaningful relationship to performance on the job. It should also be noted that the legislative case for licensure most often comes from practitioners of the profession, rather than aggrieved members of the public. Since the existing practitioners are usually exempted from the new licensure laws, or "grandfathered", they have a powerful incentive to deter competition by continually ratcheting up the requirements to enter the profession or to capture work from unregulated workers by saying the work falls under the regulations. This was the case in Minnesota where cosmetologists argued that hair braiding was a form of cosmetology and therefore could not be practiced without a license. The cosmetologists sued in state court to shut down the hair braiding businesses. In this case, the board was permanently enjoined from enforcing its cosmetology licensing regime against hair braiders and it was also required to publish administrative rules that exempt hair braiders from regulation. Licensure laws must be made or repealed on a case by case basis, with legislators and governors weighing evidence on potential quality improvements against the costs imposed on workers and consumers. Nonetheless, we will argue that lawmakers in the US and Europe should take a much closer look at occupational licensure, a form of "stealth regulation" that we show is growing at a striking pace, seldom justified with rigorous economic analysis and often prescribed by self-interested members of the profession who are, ironically, subsequently exempted from the expensive training that they have argued is essential to protect the public.

Economic and public policy rationale for licensure

To the extent that a licensure law improves average quality in a profession, or merely eliminates the most egregiously poor or dangerous service providers, there are several strong theoretical cases in which licensure laws can improve overall social welfare:

- *Danger to third parties*: Licensure can provide some minimum quality service when a poor service provider poses harm to innocent third parties. A shoddy electrician can burn down a whole neighborhood, not merely the house of the consumer who hired him. Similarly, a doctor can fail to treat a contagious disease properly, creating a public health risk; an architect or engineer can design structures that imperil many more people than the client. However, in some industries such as aircraft manufacturing the product (aircraft) or output is heavily regulated, but the engineers who make the product are not.
- *Society's stake in good service provision*: Licensure can potentially improve the quality of service in cases where consumers are unable to make an informed decision and society has some stake in their wellbeing. For example, schoolchildren (and even their parents in some cases) cannot necessarily recognize incompetent teachers, nor do they necessarily have redress when they can. The quality of this education, particularly for the most disadvantaged children, ultimately has implications for all of society.
- *Paternalism*: Licensure can provide a minimum level of quality when consumers are deemed unable to make an informed decision and society seeks to protect these individuals from themselves. This situation is distinct from the cases above in two respects. First, there is no obvious public cost that results from a poor decision on the part of an individual; this is a matter of society's collective judgment overriding a personal decision. Second, this rationale for licensure is obviously dependent on one's political ideology, as it turns on the individual's right to make a "bad" decision (in contrast to hiring an incompetent electrician who burns down the neighborhood, which even the most devout libertarian would have a hard time defending as a basic right).

It is crucial to note here that providing information for prospective consumers on service quality is not an economically sound rationale for professional licensure. Licensure proponents often argue, rightfully, that consumers have a hard time discerning the quality of a service provider ex ante, either because consumers lack the requisite expertise or because the information is costly to acquire. This information asymmetry can be solved with a less intrusive form of professional regulation known as certification. The government (or any other objective, informed third party) can define the necessary standards or training in a given profession and then "certify" those who are deemed qualified. The key difference from licensure, however, is that consumers are free to hire non-certified service providers. There is an important potential market feedback; if consumers perceive that certification provides meaningful information on quality, then they will be willing to pay a premium for certified service providers. This will in turn induce more professionals to seek certification. However, if certification is not associated with higher quality by consumers, then they will not pay a premium for it, and service providers will not spend time or money to seek it. Over time, certification will thrive where it provides valuable information and disappear where it does not. This is in sharp contrast to licensure, where producers must become licensed (and therefore consumers must hire a licensed service provider) because it is the only legal option and carries with it the weight of the police powers of the state, regardless of the relationship, or lack thereof, between the licensure process and service quality.

Potential costs and concerns

As with any form of regulation, policymakers must weigh the potential benefits of professional licensure against the costs of the subsequent labor market distortions. There are numerous potential drawbacks to licensure, even in cases where such regulation improves quality in the relevant profession:

- *Too much quality*: Not all consumers demand the same level of quality. When members of the legal profession told Milton Friedman that every lawyer should be a Cadillac, he famously replied that many people would be better off with a Chevy (a cheaper but purely functional alternative). If licensure improves quality by restricting entry into the profession, then some consumers will be forced to pay for more "quality" than they want or need, or they may not be able to afford any service at all (Friedman 1962). Even in professions such as law or medicine that require graduate education, many services are quite basic (e.g., drawing up a will or giving a flu shot). Estimates show that occupational licensing raises the wages of licensed practitioners in the US by about 15 percent and around 13 percent in the UK (Kleiner and Krueger 2009; Humphris, Kleiner and Koumenta 2010). For that reason, there are income inequality considerations related to who gains and who loses as the result of licensure. In a model developed by Carl Shapiro (1986) high income consumers gain at the expense of lower income consumers with a preference for lower quality service. When licensure is introduced, more producers choose to be high quality, raising output in the high-quality market and lowering prices for consumers who seek high quality. These consumers are better off in the new steady state because they consume the same high-quality service at a lower price. Consumers who prefer lower quality services are worse off since these services are only available at a higher price than in an unlicensed market, or not at all. Thus, licensing can have a reverse "Robin Hood Effect" by making higher income consumers better off at the expense of lower income consumers.
- *Higher costs can cause dangerous substitutions*: Bad things happen when people decide to pull their own teeth. Consumers who cannot afford licensed professionals have an incentive to do the work themselves – sometimes at great cost to themselves or the public (Kleiner 2006).
- *Minimal or no impact on quality*: Licensure requires that new entrants to a profession undertake specified training, pass a particular exam or fulfill some combination thereof. Any potential benefit of licensure depends entirely on the connection between these requirements and subsequent quality of service. Often there is none. One striking example comes from teachers in Los Angeles. California passed a law placing a cap on class sizes throughout the state. Los Angeles was not able to hire enough certified teachers to fill the open positions. To meet the demand, the district hired thousands of teachers who were not certified or who were in the process of becoming certified but had not yet fulfilled all the state requirements. Subsequent analysis of classroom-level data for 150,000 students over multiple years found that teacher quality did in fact have a profound impact on student performance but that there was no statistical association between whether a teacher was certified and his or her performance in the classroom (Gordon, Kane and Staiger 2006). The authors conclude, "To put it simply, teachers vary considerably in the extent to which they promote student learning, but whether a teacher is certified or not is largely irrelevant to predicting his or her effectiveness". This is consistent with many other findings. For example tougher laws for dentistry had no impact on the quality received by patients who were Air Force recruits or on other more general measures of quality (Kleiner and Kudrle 2000). Also, having tougher licensing laws for mortgage brokers did not reduce the number of foreclosures, but did raise the prices of mortgages in more heavily regulated states (Kleiner and Todd 2009).
- *Creates labor market barriers for disadvantaged populations*: Many licensed professions are relatively low-skilled jobs, such as barbers, manicurists, nurse's aides and cosmetologists. While the social costs of a bad haircut would appear to be negligible, the social costs of creating additional employment barriers for disadvantaged populations are most certainly not. For example, licensure laws often exclude ex-felons, which is defensible in many professions, but can also make it extremely difficult for ex-offenders to find post-prison employment, thereby contributing to America's high recidivism rate.
- *Reduces mobility within fields*: The proliferation of licensure can raise costs and reduce flexibility in the affected occupations. For example, licensure can make it illegal for an 8th grade math teacher to switch to the 9th grade (because middle school licensure is different than high school)

or for dental hygienists to offer basic dental care without the supervision of a dentist. This professional fragmentation is particularly acute in health care, where more than 76 percent of nonphysicians are licensed (Kleiner and Park 2010) and where there are rigidly defined roles that prevent individuals from moving across jobs or from performing multiple tasks.

- *Promotes and rewards "rent-seeking"*: History (going back to medieval guilds), theory and data all suggest that producers have a strong incentive to create barriers to entry for their professions in order to raise wages. For example, a study of licensed and unlicensed professions in Illinois found that a profession's political organization is positively associated with the likelihood of becoming licensed, holding constant the risk that the profession poses to the public (as reflected in liability premiums) (Wheelan 1998). Meanwhile, the consumers who will be affected by the higher costs associated with licensure are unorganized and arguably underrepresented in the political process. The willingness of a legislature to pass licensure laws without rigorous analysis creates the opportunity and incentive for well-organized producer groups to use the process for personal gain.

Of course, any of these drawbacks is particularly pernicious when the relevant licensure law has no impact on service quality in the profession. An absurd example perhaps makes the case best. Suppose that prospective teachers in a given state were required to run a mile in under six minutes in order to become licensed. The supply of teachers would be limited; wages for existing teachers would go up; some of the best potential educators would be deterred from entering the profession; there would be no quality improvement from having speedy well-conditioned teachers and a likely adverse impact on quality from wrongly screening out those who would have done well in the classroom.

Questions and recommendations for policymakers

Occupational licensure, like most forms of regulation, is neither inherently good nor bad. It is a tool with the potential to protect society from dangerous service providers (and the consumers who hire them); the same tool can distort labor markets in ways such that the social costs far outweigh the benefits. Legislators in the US or Europe ought to consider the following questions when considering licensure policies (when expanding licensure to additional professions, having licensed occupations capture the tasks of unregulated occupations or in those rare cases when rolling back such regulations):

What is the goal of the policy? Legislators ought to distinguish between policies that seek to upgrade average quality in the profession, which often requires extensive training for new entrants, and those that seek to screen out the worst or most dangerous service providers. The latter can often be accomplished at relatively low cost with a simple task-based exam, a criminal background check, a basic safety course or some other mechanism that sorts the worst from the rest. As noted earlier in the paper, if the goal is to provide information for consumers who might not otherwise be able to discern quality, then licensure is not necessary at all. The government (or other credible entity) can offer certification instead. A certification program defines quality and identifies those who achieve it; consumers are free to hire certified professionals or not.

Will the proposed licensure measures achieve the stated goal? The policy arguments for licensure are too often presented as follows: a) Dangerous or incompetent service providers in this profession can cause harm; b) Society would be better off if this harm were eliminated; c) Therefore we ought to license this profession. Frequently the process does not close the logical loop by asking the final question (let alone presenting data to answer it): Will the licensure requirements that we are proposing have the intended effect on quality? Or will the experts, who are members of the regulated occupation, merely restrict entry without appreciably enhancing the health and safety of the community? Analysis across a wide range of professions suggests that the overall effect is to restrict entry and drive up wages with little to no influence on quality.

What will be the impact of licensure on the cost and availability of service provision? Higher quality will usually come at a cost; that cost is not likely to be spread uniformly across the population. Low income consumers may be disproportionately impacted by reduced access to services and rising costs. To paraphrase Milton Friedman, when every service provider becomes a Cadillac, some consumers are going to end up with no car at all. There is likely to be a redistribution effect in the "wrong" direction, as higher income consumers have more choice among higher quality purveyors of a service and lower income individuals are left with fewer affordable service options.

Is this the least costly approach? If there is an unequivocal demand for some increase in the quality of service provision, then policymakers ought to ensure that level of quality with a policy that generates the fewest concomitant costs. Consider a policy to ensure some minimum level of competency for persons operating some kind of machinery that has the potential to injure innocent passersby if used improperly. The government can require a certain set of courses in order to become licensed; it could require passing a practical exam; or it could do both. The least costly approach is the exam only, which measures quality directly (assuming the test is well constructed) rather than specifying inputs and has the lowest opportunity cost for high quality applicants (such as practitioners already licensed in other states, individuals who have operated similar machinery, fast learners, and so on). After all, even if one were to require that all practitioners in a specific profession be able to run a six-minute mile, it is still more efficient to simply test them in a mile run than it is to make them take a one-semester running class and then do the mile test!

Are consumers asking for this protection? If the answer is no, then there may not be a problem that needs solving. One ought to be naturally wary of producer groups that present evidence on how potentially harmful they are to the public while simultaneously arguing that all existing practitioners of this dangerous profession be exempted from the proposed licensure requirements.

Conclusions

Each profession requires a case-by-case judgment based on the particular economic costs and benefits of licensure. However, the extant licensure literature suggests two simple but powerful guides for policymakers. First, academic evidence suggests that the burden of proof should be on those seeking licensure. Evidence of poor quality in a given profession is not sufficient to justify licensure. Those seeking licensure should have to provide compelling evidence that: 1) The proposed legislation would ameliorate the quality problem; and 2) The social costs imposed in the process are not unduly burdensome.

Second, there is no intellectual justification for grandfathering existing service providers. If there is a legislatively-imposed quality improvement for which the benefits exceed the costs, then it ought to be imposed on all current and future practitioners of the profession, presumably with some phase-in period for existing practitioners. In cases where past work experience might reasonably demonstrate some competence, then the same exemption should be offered to practitioners who have plied their trade in other states or countries (e.g. teachers with private school experience) or can somehow demonstrate the same experience-based competence. In cases where existing licensure requirements are being strengthened to reflect a rising expectation of quality, then existing practitioners should be expected to upgrade their skills as well. (After all, the whole point of this "ratcheting up" is that the training requirements used to train current practitioners are no longer sufficient.) If licensure requirements are imposed on all practitioners, rather than on new entrants exclusively, then licensure laws are less likely to be politically engineered by rent-seeking producer groups.

Occupational licensure has a large and growing impact on labor markets without attracting significant public attention or scrutiny. Policymakers ought to revisit the process for creating licensure law and consider amending or rolling back existing laws.

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