Chapter 6
Policy Implications of the Evolution of Occupational Licensing in the United States and Elsewhere

The impossibility of any individual or small group conceiving of all the possibilities, let alone evaluating their merits, is the great argument against central governmental planning and against arrangements such as professional monopolies that limit the possibilities of experimentation. On the other side, the great argument for the market is its tolerance of diversity; its ability to utilize a wide range of special knowledge and capacity. It renders special groups impotent to prevent experimentation and permits the customers and not the producers to decide what will serve the customers best.
—Milton Friedman (1962, p. 160)

All professions are conspiracies against the laity.
—George Bernard Shaw (1906)

The modern state owes and attempts to perform a duty to protect the public from those who seek for one purpose or another to obtain money. When one does so through the practice of a calling, the state may have an interest in shielding the public against the untrustworthy, the incompetent, or the irresponsible.
—Robert H. Jackson in Thomas v. Collins (1945)

This book explains how licensing is varied and expanding in the U.S. labor market and is pervasive around the world. Yet, the comments above by Milton Friedman, George Bernard Shaw, and Robert Jackson state different views of the conceptual benefits and costs of occupational regulation. Within this context, what are potential policy implications of this growing labor market institution? This chapter identifies several potential changes that may be helpful in improving the functioning of the labor market. More specifically, what policies should be developed to decide who can perform which functions
under the law? Certain policies can provide barriers to service provisions and drive up costs. As an example, there are restrictions on what tasks can legally be undertaken by dental hygienists relative to dentists and nurse practitioners relative to physicians. Second, occupational licensing is implemented by state boards, which can restrict geographic mobility and imposes labor market frictions. Third, by imposing time and monetary costs on the entry into certain occupations, licensing restricts job creation and impedes entrepreneurial activity. This can reduce innovation and creativity among a class of individuals as the Friedman comment above alludes to regarding innovation. For example, for electricians, an innovation such as plastic wiring may require a different safety protocol than copper wiring, but the licensing authority may require the older procedures. The delays in official protocol and implementation may lead, for example, to workplace injuries for electricians (Kleiner 2013).

This chapter will propose several policy reforms that attempt to deal with the problems that occupational licensing creates in the labor market. The first is the creation of federal guidelines, based on state economic and labor market conditions for occupational licensing boards. These guidelines will be established based on the demonstrated costs and benefits associated with licensing in various occupations or tasks. Second, the policy recommendations will suggest greater reciprocity across state boundaries in the recognition of occupational licenses, and third, they will examine the use of certification of occupations as an alternative for many current and emerging occupations.

Because occupational licensing varies by state, another channel through which licensing can affect employment is by reducing mobility. The patchwork of regulations raises the cost of cross-state mobility for workers in these occupations. This will result in slower adjustment costs to regional economic shocks, which can result in higher unemployment. Licensing also can lead to higher prices for services because it restricts employment (Bond et al. 1980; Cox and Foster
While it is not possible to precisely estimate the effects of substantially reducing licensing, both the logic of the issue and the available evidence suggest that such a reduction could translate into significantly higher employment, better job matches, and improved customer satisfaction. Low-income consumers, in particular, would benefit because reduced barriers to entry would lower the prices of services provided, for example, from plumbers and electricians (Cox and Foster 1990; Shapiro 1986). Without doing a detailed analysis at the occupation-by-occupation and state level, it would be impossible to say which occupations can be justified based on quality consideration, though when studies have been conducted they have found at least in some cases that licensing reduces employment and increases prices but does not result in better services. For example, Kleiner and Kudrle (2000) find that occupational licensing of dentists does not lead to improved measured dental outcomes but is associated with higher prices of certain services, likely because there are fewer dentists. Similarly, Kleiner and Todd (2009) find that tougher licensing of mortgage brokers is not associated with fewer housing foreclosures but is related to higher-priced mortgages.

The existing body of work completed on occupational licensing offers just a sample of the possible reforms that could be done. For example, a sensible reform that has been identified is to allow dental hygienists to operate a practice without the supervision of a dentist. However, taking a piecemeal approach, I propose five general reforms that states and localities could take that would rationalize future and existing regulations:

1) Prospective evaluations. State and local governments should require benefit-cost analysis prior to the new occupational licensing requirements. The burden should be on the government together with the interest groups representing the occupation to demonstrate that the social benefits of
these requirements exceed the economic costs. If the benefits to the public exceed the costs, governments and the interest groups should also demonstrate that the proposed regulations are the least restrictive means of furthering the goals of the regulations.2

2) Retrospective evaluations. State and local governments should develop and execute a plan to evaluate existing occupational licensing requirements. The evaluations could be based on existing studies or new analyses. When the costs of the evaluations are shown to exceed the benefits, the requirements should be modified or dropped.

3) Reciprocity. When licensing is deemed to be in the interest of the public, weighed against the economic costs, states and localities should accept, as much as possible, licenses granted in other states.

Proposal 3 would facilitate cross-state mobility and make it more difficult for special interests to tighten regulations in order to increase their monopoly power over the supply of labor in a given state. Under this proposal, targeting the 10 states with the most mobility between them would go a long way toward solving the problem.3

If state and local governments were to seriously undertake proposals 1–3, the available evidence suggests that employment in these occupations would grow and monopoly rents would fall. The main fiscal cost on states would be from the loss of fees for occupational licenses.

There is a way for governments to raise revenues while at the same time curtailing the use of occupational licensing and increasing employment:

4) Impose a surcharge or tax on workers in licensed occupations where there is evidence that the licensing leads to barriers to entry perhaps as much as the rents within the occupation.
Policy Implications in the United States and Elsewhere 83

Proposal 4 is more unorthodox, but it is based on sound economic principles. When occupational licensing leads to entry barriers, workers in those occupations enjoy monopoly rents. This surcharge would draw from those rents without adverse employment consequences. Moreover, as has been well documented, when there are employment restrictions, even if they can be justified based on their benefit to the public, special interest groups have incentives to tighten the restrictions beyond what is optimal. Taxing rents would reduce the incentive for these groups to engage in this kind of lobbying.

5) Certification policies as a substitute for licensing.

Proposal 5 is based on the analysis of the benefits and costs of licensing; there may be some occupations where lesser forms of regulation, such as certification or registration, or even no regulation, may be beneficial. For example, locksmiths, ballroom dance instructors, shampooers, interior designers, upholsters, pet groomers, and hair braiders may not pose sufficient risk to health and safety to warrant the full regulation or “right to practice” of licensure. An additional policy would be to suggest that occupations such as these be moved by the state from licensing to certification or other lesser forms of regulation or no regulation.

THE FEDERAL ROLE

Although there are occupational licensing requirements at the federal level, it is state and local rules that by far have the broadest reach. Research also has found that licensing has the most pronounced effects when it is subject to multiple layers of jurisdiction. Local requirements tend to have less bite. For these reasons, the federal government is well suited to promote a set of best practices, such as those listed above. This could be achieved through a combination of moral suasion and monetary incentives.
Under this plan, states would be encouraged to submit a proposal that outlines specific steps they aim to take to reduce unnecessary licenses or allows licensed practitioners to more easily move between states, counties, or cities. The proposals should describe steps they plan to take to reduce barriers to entry in specific occupations (e.g., dental hygienists and nurse practitioners), as well as broader “process” reforms they would undertake, such as 1–3 above. The plans would be reviewed by a panel of experts in the area that could include academics, business and labor leaders, and government officials, and a partial award would be distributed to the most meritorious plans, with the remaining amount withheld until certain benchmarks have been met.

Because these practices do not impose a substantial fiscal burden on states, the incentives do not have to be large for this to have an effect on state take-up. The incentives from the successful “Race to the Top” fund were $4.3 billion, which is far smaller than even conservative estimates of the costs of licensing. The monetary incentives are scalable, but importantly on a dollar for dollar basis, their economic benefits are likely to exceed costs. As a start, the Obama administration submitted a budget that included a $15 million dollar appropriation to implement such a program (Porter 2015).

Calls to reduce occupational licensing barriers to interstate mobility have come from the executive branch of the U.S. federal government, including the U.S. Department of the Treasury and the U.S. Department of Defense (2012). These policy recommendations have been made in part because the families of military personnel have had a difficult time moving across states and pursuing their careers because of the variations in state licensing laws. The Department of Defense views this effect as a hardship on military families. At a minimum, the ability to recognize other state licenses, similar to recognizing driver’s licenses across states, would serve to help military families as well as assist the economy in general in greatly reducing structural or frictional unemployment due to state regulation barriers. It would also allow licensed workers to maximize their
incomes and productivity by enabling them to move across state lines without institutional constraints. In fact, in many cases it is harder to move across states for occupations such as dentists and optometrists because potential professionals have to take or retake examinations.

Licensing has also been cited as being a barrier for upward income mobility for individuals with low incomes or wealth. For example, occupational licensing was recently cited in Representative Paul Ryan’s (R-WI) national approach to reduce poverty in his 2014 monograph, *Expanding Opportunity in America* (Ryan 2014, p. 66). He noted the following:

Another category of rules and regulations that can hurt low-income families are state and local occupational-licensing regimes. These requirements often prevent workers from entering or advancing in the workforce. Government at all levels requires licenses to perform certain occupations. In some cases, such as medical doctors, this requirement is appropriate. However, in other cases, these licensing requirements merely protect entrenched incumbents.

Eliminating irrational or unnecessary licensing requirements would not be a panacea, but it would open up new opportunities for low-income families and reduce costs for consumers. The vast majority of these licensing requirements are the result of state and local laws. State and local governments should begin to dismantle these barriers to upward mobility.

In concert with other federal programs that he identifies in his monograph, Rep. Ryan sees reducing occupational regulation for low-income individuals as an important antipoverty program. Specifically, he sees reducing government barriers to entry into a job through occupational licensing as an element in reducing poverty in the United States (Ryan 2014).

The federal government reimbursement or grant funding requirements also enhance the growth of occupational licensing. For example, the federal government will deal with or fund only licensed surveyors for contracts or grants involving surveying roads or parks. As a result, the states think they have the need to license surveyors. In health care, occupational therapists, in order to be reimbursed under
Medicare or other federal programs such as the Affordable Care Act, must have a state license. In these cases, the federal government puts pressure on the states to license additional occupations or ramp up the requirements to attain a license.

AT THE STATE LEVEL

Although occupational licensing has been growing, several proposals have been made to slow its growth in favor of certification. For example, in Minnesota the legislature passed a bill out of the Minnesota Senate Commerce and Consumer Protection Committee that explicitly favors certification over licensing in both 2011 and 2012. The bill states that

no government shall require an occupational license, certification, registration, or other occupational regulation that imposes a substantial burden on the person unless the government demonstrates that it has a compelling interest in protecting against present and recognizable harm to the public health and safety, and the regulation is the least restrictive means to furthering that compelling government interest. . . . [A]n individual who brings an action or asserts a defense under this section has the initial burden of proof that the statute or administrative rule or a government practice related to the statute or rule substantially burdens the individual’s right to engage in an occupation not prohibited by law. If the individual meets the burden of proof . . . the government must then demonstrate by clear and convincing evidence that the government has a compelling interest in protecting against present and recognizable harm to the public health and safety, and the regulation is the least restrictive means for furthering that compelling governmental interest.4

This is an illustration of “model legislation” on occupational licensing that is currently being proposed by the Institute for Justice, a libertarian public interest law firm that has handled numerous cases for individuals who have challenged occupational licensing laws on the grounds that they limit free speech or the freedom to work.
The proposed Minnesota statute goes a long way toward favoring a policy of the least possible regulation of occupations by the government, and it allows the courts to determine whether an individual has been economically harmed or if there are compelling health and safety issues that warrant the occupation to be licensed. Consequently, the burden of proof shifts from the individual to the state, which must show that there is a potential health and safety hazard from an individual not being licensed in order to perform their job tasks. One possible drawback of the proposed licensing regulation in Minnesota is the increased litigation costs if individuals who thought that they could do the work were engaged in a significant number of lawsuits. The legal costs could be balanced by the reduction in economic rents to the members of the licensed occupations and increased aggregate output for the services of the members of the licensed occupations.

Other states have also moved toward deregulating occupations but use somewhat different approaches. For example, as was mentioned in Chapter 1, in April 2014, the governor of Indiana signed legislation called the Senate Enrolled Act 421, which required the Indiana Professional Licensing Agency to study and establish a commission on the concept of self-certification registration as an alternative to licensing and issue a report to the legislative council before October 1, 2014. According to the governor, the report must include the following:

- occupations that may be included on the list
- whether to provide title protection for the individuals included on the list (a form of certification)
- enforcement provisions that would be used
- a description of auditing and maintenance of the list
- the cost of establishing and maintaining a list
- the cost of an individual applying for and renewing inclusion on the list
A potential result of the commission is the conversion of most of Indiana’s licenses to voluntary private certifications for a wide variety of occupations, most of which are non-health-related ones. In addition, it would allow citizens to add their names and private certification numbers to a state-run registry. The changes aim to move the regulatory process toward private sector accreditation rather than public boards, which are often dominated by the members of the occupation. However, the private sector monitors also may be subject to pressures to limit entry by the occupations they serve. For example, credit agencies failed to monitor financial institutions during the financial crisis of 2008 because they were intimidated by the larger banks and afraid that they might lose their business. An additional issue is that states sometimes abrogate their oversight duties by allowing the professional associations to set standards that are often beyond what is needed for health and safety. For example, in many states, the educational licensing standards for physical therapists come from the professional association’s boilerplate policy and may not consider what is best for the patient or for competent care, prices, and access to the services. Consequently, the professional associations establish the de facto terms of entry and reciprocity rather than the state licensing boards.

INTERNATIONAL POLICY ISSUES

Occupational regulation is an important labor market institution in the EU, and it is growing in China. It is becoming a dominant labor market institution in the EU, covering up to one-quarter of the labor force, although the vast majority of occupations in China are certified rather than licensed (Chi, Kleiner, and Qian, forthcoming). It deserves more attention than it currently has been receiving by researchers and policymakers. The EU Commission has focused its policy on reducing barriers to mobility and fostering labor movement within the EU (Koumenta et al. 2014). Although some of the research has not found
any major influence of the legal restrictions on migration, EU policymakers should not ignore the fact that becoming licensed involves a cost to the individual, not the least in relation to the skill and location-specific investments it entails. While steps toward reciprocity can partly address the former, the latter still remains a key consideration in an individual’s cost-benefit analysis to migrate. In addition, the length of time that occupational licensing has been in effect and the stringency of the entry requirements are both better predictors of a wage premium than whether the occupation is licensed in the EU. The wage effects of occupational licensing in the UK are similar to those found in the United States when human capital factors are taken into account, suggesting that there are economic returns to licensing in the UK.

Similarly, occupational regulation in China is rapidly increasing. The national occupational regulation system in China is different from the U.S. system of primarily state-by-state regulation. Similarly, China has occupational certification and licensing regulations. Using imputation based on occupation code and licensing rules, 9 percent of respondents would be licensed in 2003 (Chi, Kleiner, and Qian, forthcoming). This is much lower than the U.S. rate of about 29 percent in 2006. However, the wage effects are remarkably similar, showing the influence of occupational licensing to be about 14 percent. Again, the influence of licensing seems to be a fairly robust phenomenon across different nations and institutional settings.

SUMMARY AND IMPLICATIONS FOR U.S. OCCUPATIONAL LICENSING POLICY

This book provides a detailed, nontechnical overview of occupational licensing in the United States, China, the United Kingdom, and the European Union for students of the labor market, consumers, the public, and policymakers. Occupational licensing is an institution that rarely is discussed or receives the media attention that its size and
It makes up about 29 percent of the U.S. workforce, up to 24 percent of the workforce in the EU, about 14 percent in the UK, and about 9 percent in China. The book examines the institution of occupational licensing from a historical perspective and offers a rationale for its existence and costs, an international perspective, and policy implications.

A major argument for licensing occupations is that it eliminates or reduces the consumer’s risk of seeking the services from practitioners of an occupation. If testing and background checks “eliminate charlatans, incompetents or frauds” (Council of State Governments 1952), then consumers may be willing to pay a higher price for the services offered by the regulated occupation. A review of the body of theory from experimental economics and psychology shows that consumers value the reduction in downside risk more than they value the benefits of a positive outcome. This consumer preference for reducing the risk of a highly negative outcome has been called “loss aversion,” which is an element of the prospect theory developed by Kahneman and Tversky (1979). For example, social welfare may be increased substantially by minimizing the likelihood of a poor outcome as a consequence of going to an incompetent physician, because the incompetent physicians have been weeded out as a result of licensing. Consequently, occupational licensing may also reduce patients’ perceived benefits of receiving nonstandard but potentially highly effective treatment from an unlicensed practitioner of nontraditional medicine. Using the power of the state to both limit the downside risk of poor quality care and reduce the possibility of an upside benefit may be a trade-off that maximizes consumer utility or welfare. Evidence of the acceptance of this trade-off can be found in the growth of occupational licensing during the past century in many countries (Kleiner 2006).

The gains from an unregulated service can be potential benefits from greater free market competition of lower prices and greater innovation without the constraints of a regulatory body, such as a licensing board. The upside potential gain can be achieved through
both the use of nonstandard methods or new research that has not
been approved by the licensing agency as appropriate for the medi-
cal service (Rottenberg 1980). Deviations from prescribed methods
of providing a service are discouraged by licensing boards and may
even be found to be illegal. For example, not having a dentist on-site
is illegal in the United States when providing a service such as teeth
cleaning in some states. Dental hygienists generally are not allowed
to “practice” without a dentist on-site, with the “site” being defined
by statute or the dental board. In addition, dental hygienists gener-
ally are not allowed to open offices to compete with dentists in most
states. Although this policy reduces the chance that a dental hygienist
will fail to find a major disease that may require immediate attention,
it also reduces the ability of the hygienist to provide the limited ser-
dices that particular patients say they want. Moreover, there is little
leeway for the dental service industry to provide new or innovative
services without the risk of being found in violation of the licensing
laws. The licensing laws give rise to the labor relations concept of
“featherbedding,” whereby in this case, dentists are required to be on
the premises but do little observable productive work.

Consequently, for medical services, regulation through licensing
can be the equivalent of a closed shop in unionized markets. Theo-
retically, higher wages are likely to result from restricted labor sup-
ply. Because closed shops in unionized markets are illegal in both
the United States as a result of the Taft-Hartley amendments to the
National Labor Relations Act and in the UK, it is interesting that,
with respect to organized labor markets, a similar restriction to closed
shops is nevertheless permitted in licensed medical occupations.

Certification grants title (occupational right-to-title) protection to
persons meeting predetermined standards. It is often thought of as a
better policy alternative than occupational licensing for three reasons:

1) Certification has benefits over licensing for workers. It does
not fence out workers or cause the type of problems in labor
markets that licensing does. Licensing may cause workers to
lose the opportunity for upward mobility because of the bar-
riers to entry. A reduction in licensing requirements could enhance employment growth prospects in the state. Licensing further reduces the ability of workers to move across state lines and engage in work that is the most beneficial to them and to society. Certification of practitioners, when properly managed, does not have these negative features.

2) It is better for consumers. Similar to licensing, certification sends a signal to consumers about who has met the government’s requirements. However, it does not reduce competition and gives consumers more choices for the kinds of services they want.

3) Certification can reduce the unnecessary and often excessive lobbying by occupational associations to try to convince legislators to enact licensing regimes under the assumption of protecting the public.

Moving to a system of certification rather than occupational licensing gives consumers more choices and provides useful information about the purveyor of the service. Many consumers and politicians say licensing protects against “loss aversion” and may be worth the costs of granting monopoly power to an occupation. In other words, consumers respond more to knowledge about bad services than good conditions, which suggests that they respond more to information that reduces their utility than to information that increases it; this is consistent with prospect theory (Kahneman and Tversky 1979). To illustrate, for an uninformed consumer who is considering brain surgery, licensing provides the guarantee that the provider of a service has at least finished medical school and taken a licensing exam. Nevertheless, a doctor who specializes in pediatrics and has never performed major surgery could legally perform brain surgery under most state licensing laws. Under certification, anyone who is not a certified brain surgeon could not argue that she has completed the course and passed the appropriate exams and claim to be a brain surgeon. If she claimed to be certified and was not, she would face legal penalties determined by the state. She could, however, legally
perform the operation with the patient’s consent. Under a regime of certification, the patient could have the surgery completed by a certified brain surgeon, a pediatrician, or a medical technician who has access to the latest technology on brain surgery. Information on all alternatives would be available to the consumer of the service, but insurance companies could put constraints on consumer decisions based on their knowledge of the procedure and legal liability issues.

Lists and reviews of practitioners similar to those maintained by the Better Business Bureau or Angie’s List, a consumer-based service review website, provide some protection, but they have little enforcement powers beyond moral suasion. A central monitoring authority like the state, which screens potential applicants and provides greater assurance about the abilities of the individual, would be more useful, especially for low-income individuals or those with mental or physical disabilities. Without this enforceable “title protection,” little quality assurance could be provided to the public on this listing of practitioners. The cost of being removed from the list of registered practitioners without the legal penalties of having “inappropriate skills” or competence may lead to insufficient consumer knowledge of the quality of the skill.

Without the legal costs of title infringement, service providers would have little economic incentive to be honest. Furthermore, it may not provide sufficient protection for providers of the occupation to undertake the investments that are required to advance in the field. If low-quality practitioners can claim to have the skills and expertise to perform a task, then optimal investments in human capital acquisition may not take place. Unlike lesser forms of regulation, certification allows consumers to select only those who have met the certification requirements established by the profession or any other services, and it allows for the purchase of lower-quality service but without the brand. This market alternative under certification can serve as discipline for the professions to not greatly limit barriers to entry. In conclusion, the central policy question for occupational licensing is, to what extent should the government protect the consumer and their families against their own bad decisions?
Notes

1. For additional examples see Carroll and Gaston (1981).
2. This proposal was recently introduced in the Minnesota State Legislature (2012).
3. Between 1995 and 2000, the 10 state pairs with the largest gross mobility between them were (New York, Florida), (New York, New Jersey), (California, Nevada), (California, Texas), (California, Arizona), (Florida, Georgia), (California, Washington), (California, Oregon), (California, Colorado), and (New Jersey, Pennsylvania).
4. For a detailed explanation of the statute, see Minnesota H.F. No. 2002, as introduced in the 87th Legislative Session (2011–2012), posted on the state website February 1, 2012 (Minnesota State Legislature 2012).