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Morris M. Kleiner
University of Minnesota

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Occupational Licensing: Protecting the Public Interest or Protectionism?

Morris M. Kleiner
University of Minnesota
and
W.E. Upjohn Institute for Employment Research

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Abstract

The issue of the government regulation of occupations involves the role of government in reconciling the special interests of the practitioners with those of society. The strictest form of occupational regulation is occupational licensing which is extensive and growing. In 2008, nearly 30 percent of the workforce was required to hold a license up from around 10 percent in 1970. There are potential job loss implications in the growth of occupational licensing for the labor market and the economy. An alternative form of regulation, the certification of occupations, which does not impose a "closed shop" on entry and mobility, may be a policy to avoid the job loss implications of occupational licensing.

Key Words: Occupational licensing, wages, employment, regulation

Occupational licensing provides an example of one of the essential tasks of democratic societies, which is to establish a proper balance between freedom and order. The issue of the government regulation of occupations involves the role of government in reconciling the special interests of the practitioners with those of society. From this general principle of democratic governments, this policy brief examines the regulation of occupations by government and suggests that an implementation of policies that have begun by state governments might lead to more economic growth and jobs.

Occupational licensing is extensive and growing. In 2008, nearly 30 percent of the workforce was required to hold a license (Kleiner and Krueger 2010), up from around 10 percent in 1970. Occupational regulation in the United States generally takes three forms. The least restrictive form is registration, in which individuals file their names, addresses, and qualifications with a government agency before practicing their occupation. The registration process may include posting a bond or filing a fee. In contrast, certification permits any person to perform the relevant tasks, but the government—or sometimes a private, nonprofit agency—administers an examination or other method determining qualifications and certifies those who have achieved the level of skill and knowledge for certification. For example, travel agents and car mechanics are generally certified but not licensed. The toughest form of regulation is licensure, which is often referred to as "the right to practice." Under licensure laws, working in an occupation for compensation without first meeting government standards is illegal. In 1992 the Council of State Governments estimated that more than 800 occupations were licensed in at least one state, and more than 1,100 occupations were licensed, certified, or registered (Brinegar and Schmitt 1992).

It is well understood that occupational licensing can serve as a barrier to occupational entry resulting in reduced employment, monopoly rents for workers in the occupation, and higher prices for consumers (Friedman 1962).

Kleiner and Krueger (2009) show that after controlling for education, labor market experience, occupation, and other controls, licensing is associated with a 15 percent wage premium in the labor market. This estimate may partially reflect a premium for higher unmeasured human capital, but it is also consistent and likely in large part due to rents associated with a "closed shop" that is a feature of occupational licensing.

There is little empirical work on the effects of licensing on employment levels or growth rates, but the existing estimates suggest that they could be large. Kleiner (2006) examines employment growth rates in states and occupations with stronger versus weaker occupational licensing requirements. Specifically, Kleiner compares employment growth of occupations that are licensed in some states to the same occupations that are not licensed in other states between the years 1990 and 2000. In order to account for differential growth rates between states, a comparison was made between the growth rate of occupations that are either fully licensed or fully unlicensed in both sets of states.[1] Using a difference-in-difference regression analysis, the estimates show that partially licensed occupations had a 20 percent lower growth rate in states with licensing relative to states without licensing and relative to the difference in growth rates between these sets of states of fully licensed and fully unlicensed occupations. This estimate implies

[1] The partially licensed occupations he considers are librarians, respiratory therapists, dieticians, and nutritionists. The fully licensed occupations are lawyers, dentists, and cosmetologists. The fully unlicensed occupations are economists, computer programmers, and glaziers.

that a licensed occupation that grew at a 10 percent rate between 1990 and 2000 would have grown at a 12 percent rate if it were unregulated.[2]

Because occupational licensing varies by state, another channel through which licensing can affect employment is through reduced geographic 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 state labor market changes, which can result in higher unemployment (Kleiner, Gay, and Greene 1982).

Because it restricts employment, licensing can also lead to higher prices for services faced by consumers. This has been documented in a number of studies, including Shepard (1978), Bond et al. (1980), Cox and Foster (1990), and Kleiner and Todd (2009).

While it is not possible to precisely estimate the effects of substantially reducing occupational licensing, the current evidence suggests 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 reduce the prices of services provided (Shapiro 1986; Cox and Foster 1990). Suppose that the entire 15 percent wage premium for licensing is from rents (as opposed to human capital), labor supply is perfectly elastic, and the labor demand elasticity is 0.5. There are approximately 38 million licensed workers in the United States with average annual earnings of $41,000. Under these assumptions, licensing results in 2.85 million fewer jobs with an annual cost to consumers of $203 billion.[3]

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[2] Note that this estimate only reflects the differential growth rate between licensed and unlicensed occupations, not levels.

[3] Note that this is a transfer from consumers to workers. There will also be estimated deadweight losses (Kleiner, Krueger, and Mas 2011).

Of course, these estimates do not take into account possible benefits from licensing. Licensing may result in higher-quality outcomes for those who obtain services, for example, because it requires a certain amount of education and training. It may also encourage greater investment in human capital because individuals will be able to recoup a higher return for their investment if they are not competing against lower-quality substitutes.

Without doing a detailed analysis at the occupation-by-occupation and state level, it would be difficult to say when licensing of certain occupations can be justified based on quality-consideration, though several studies have found a number of cases where licensing reduces employment, increases prices, but does not result in better services. For example, Kleiner and Kudrle (2000) find that more stringent occupational licensing of dentists does not lead to improved measured dental outcomes of patients, but is associated with higher prices of certain services, likely because there are fewer dentists.[4] A similar result was found for mortgage brokers during the lead up to the decline of the housing market in 2008 (Kleiner and Todd 2009).

A potential improvement in policy is one that some states are already considering. The Minnesota legislature, for example, unanimously passed a bill out of the Minnesota Senate Commerce and Consumer Protection Committee (SF0380) that explicitly favors certification over licensing in 2011. 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

[4] For additional examples, see Carroll and Gaston (1981).

compelling government interest." In addition, the proposed bill states that "an 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." The proposed Minnesota statute goes a long way toward favoring a policy of the least possible regulation of occupations by government, and allows the courts to determine if an individual has been harmed, with the burden of showing health and safety issues falling on the state government. If the bill becomes law in Minnesota, it could serve as a template for other states, and as a consequence, many of the economic and job loss costs of occupational licensing could be substantially reduced.

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