

*Why are states regulating more and more occupations?*

# A License for Protection

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ONE WOULD BE HARD-PRESSED TO think of a major labor market institution that is growing faster than occupational regulation. Unlike unions, which have declined from about one-third of the workforce 60 years ago to about 12.5 percent in 2005, the regulation of occupations has expanded dramatically. In the 1950s, about 4.5 percent of the workforce was in an occupation that required a state “license to practice.” According to the 2000 Census, this form of occupational regulation has now grown to about 20 percent. In contrast, other labor market topics that typically receive much more attention from economists and the media, e.g., the federal minimum wage, have seen a decline in their effect on the workforce.

Why has occupational regulation grown? And what implications does this growth have for consumers, the regulated occupations, and the workforce?

## THE “PERFECT STORM”

Occupational regulation has grown because it serves the interests of those in the occupation as well as government. Members of an occupation benefit if they can increase the perception of quality and thus the demand for their services, while restricting supply simultaneously. Government officials benefit from the electoral and monetary support of the regulated as well as the support of the general public, whose members think that regulation results in quality improvement, especially when it comes to reducing substandard services.

In general, state regulation of occupations takes three forms. The least restrictive is registration, in which individ-

uals file their names, addresses, and qualifications with a government agency before practicing the 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 (more often) another nonprofit agency administers an examination and certifies those who have passed the level of skill and knowledge for certification. For example, travel agents and car mechanics are among the more than 65 occupations that are generally certified but not licensed. The toughest form of regulation is licensure; this form of regulation is often referred to as the right to practice. Under licensure laws, working in an occupation for compensation without first meeting state standards is illegal.

For the members of the occupation, obtaining licensing is generally the objective, because it imposes state sanctions on new entrants from within a state or for those moving in from another jurisdiction. For the administrators of the professional association, the resulting increase in responsibility and revenue from dues and continuing education usually results in an increase in pay. Moreover, most licensing provisions require continuing education classes for fees, which raise the revenue of the occupation association.

For the occupational association, obtaining licensing legislation means raising funds from members to lobby the state legislature, particularly the chairs of appropriate committees. In addition, the occupation association often solicits volunteers from its membership to work on legislative campaigns. With both financial contributions and volunteers, the occupational association has a significant ability to influence legislation, especially when opposition to regulatory legislation is absent or minimal. Politically active groups that have opposed licensing legislation from time to time include Common Cause, the AARP, and the Institute for Justice. In general, however, the opposition has not been effective in stopping licensing legislation.

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This article draws on Kleiner's recent book, *Licensing Occupations: Enhancing Quality or Restricting Competition?*

The executive branch of government also has little reason to oppose occupational regulation. Within most state agencies, the fees generated from licensing an occupation are generally substantially higher than the costs of monitoring the occupation. The excess funds can be used to help balance the state budget or for small projects that the governor approves, or to curry favor with legislators or politically active constituents.

With the occupation wanting licensing legislation, and with support from the legislative and executive branches of government, it is not surprising that occupational regulation has been among the fastest-growing labor market institutions. According to the Council on Licensure, Enforcement, and Regulation (an agency affiliated with the Council of State Governments), the number of occupations that require licensing in at least one state has grown to more than 800.

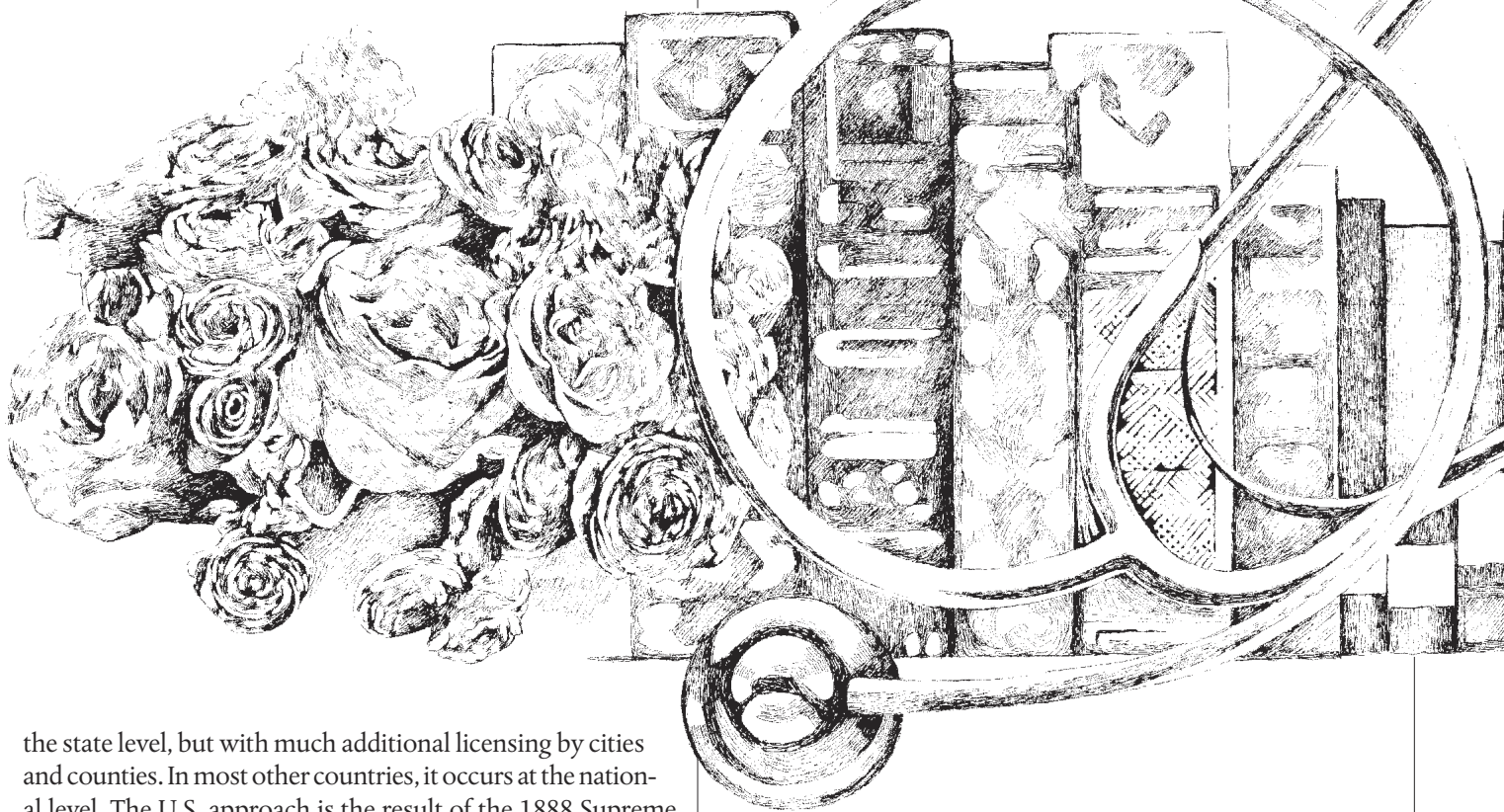
### LEGAL BASIS

In the United States, occupational regulation usually occurs at

licensing in the late 1800s and early 1900s has found that licensing provided to consumers a form of information on minimum quality and standardization. As professional knowledge expanded in fields like health and as the number of available services increased in rapidly growing urban areas, consumers had little information on the quality of essential services. Licensing filled some of that informational gap on quality.

Over time, licensing activities simply expanded to other occupations. Because early licensing was largely in health and the legal professions, related occupations (such as physician's assistant and dental assistant) then became regulated during the post-World War II period. Occupations in other industries, such as construction and financial services, also approached state legislatures to seek regulation.

The presumption that occupational regulation provided



the state level, but with much additional licensing by cities and counties. In most other countries, it occurs at the national level. The U.S. approach is the result of the 1888 Supreme Court decision in *Dent v. West Virginia*, which established the right of states to grant licenses to protect the health, welfare, or safety of citizens. This was interpreted as giving the states the primary right to regulate occupations.

For a long period thereafter, licensing was perceived as a way for state legislatures to protect the public through the monopoly rights granted to regulated occupations. In turn, the members of the occupation were perceived as performing a public service.

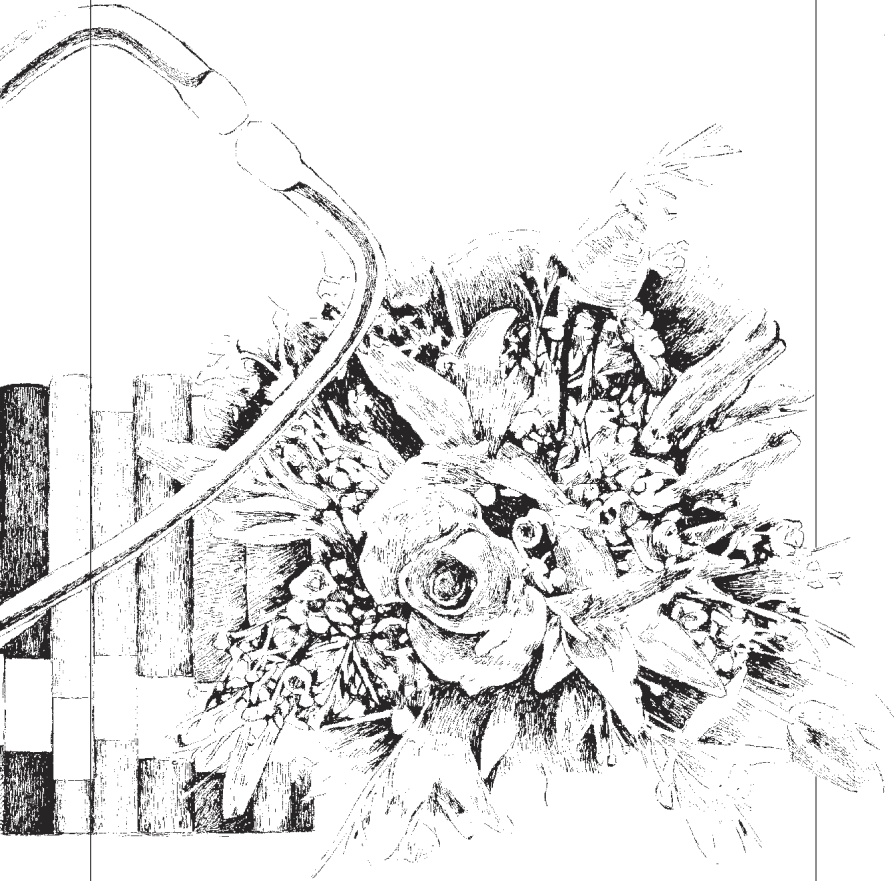
The publicly stated rationale behind licensing was to provide public protection at a time when occupational standards did not exist or were not particularly strict, and information on individuals and their businesses was difficult to obtain. Research on

information and raised quality without any negative economic effects changed in 1975 with *Goldfarb v. Virginia*. In that case, the Supreme Court ruled that the state bar's policy of a minimum association fee violated the Sherman Act's prohibition on monopolies in restraint of trade. Prior to the case, many state and federal courts thought that the "learned professions" should be treated differently because their goal supposedly is to provide services necessary to the community rather than to generate profits. With the 1975 decision, occupational associations could now fall within the terms "trade and commerce" of the Sherman Act.

The central finding in *Goldfarb* was that professional licens-

ing activities affect interstate commerce enough to trigger Sherman Act antitrust provisions. Thus, federal agencies like the Federal Trade Commission and the Department of Justice can sue occupations that constrain trade through unreasonable occupational licensing requirements, as well as bring greater scrutiny to states' occupational policies and procedures. For example, federal lawsuits have been brought against dentists who have sought to restrain the work of hygienists when the restraint could influence federal government programs.

**MORTGAGE BROKERS** Although most occupational regulation takes place in the health-related and construction occupations and industries, regulation of financial services is increasing. The



evolution of mortgage broker regulation illustrates two important ingredients for regulation: a public interest rationale and economic advantages for the regulated.

In 2005, mortgage brokers originated about 60 percent of home mortgages, up from virtually zero 20 years earlier. With the expansion of mortgage brokering, mortgage broker regulation has become an important public policy issue. For completing a mortgage loan origination, the broker is paid a fee that averages over \$2,000. The compensation of mortgage brokers is usually all commission.

This compensation can come in two forms: cash payments directly from the borrower and cash payments from the lender. The lender makes a cash payment to the broker in exchange for an upward adjustment of the interest rate on the loan. This payment can be thought of as negative "points" on a loan. Broker

compensation may be all cash from the borrower, all points from the lender, or a combination of the two. The interest rate adjustment and associated points may be sufficient in some cases to cover all of the borrower's cash closing costs.

Controversies have arisen over whether brokers' fees and related interest rate adjustments (called yield spreads) are optimal arrangements or symptoms of the exploitation of consumer confusion over the complex mortgage terms by mortgage brokers. In response, regulation of mortgage brokers is on the rise, taking the form of licensing brokerage firms and individual employees, as well as restrictions on both loan terms and payments to brokers. Additional regulation, such as application of a "suitability doctrine" (an established feature of securities law) or additional state or federal licensing standards, is under active consideration, and several states' attorneys general are closely monitoring the industry.

The mortgage brokers association has adopted model licensing legislation for the states. The ideal for the association is the licensing of firms and brokers as well as others who are involved in the loan origination process. Recently, Ohio adopted licensing regulation requiring state regulation of all who are associated with the loan origination process. Preliminary analysis of the impact of this form of state regulation shows little effect on the reduction of fraud or loan foreclosures, the primary rationale offered for more regulation. Nevertheless, there has been a major expansion of state regulation of mortgage brokers, and Alaska is now the only state that does not regulate the occupation or firm.

### **THE ECONOMICS OF LICENSING**

Basic economic theory states that wages are dictated by labor supply and demand. Thus, jobs with restricted entry are likely to see higher wages — a phenomenon that is clearly evident with licensed occupations.

Licensing facilitates supply reduction because members of the occupation often dominate licensing boards. They tighten entry requirements, which restricts the available labor supply. In turn, prices for the licensed services rise and earnings for licensed practitioners increase. For consumers who can afford licensed services, quality also rises. But for lower-income consumers, the price increase means that they have no services, must turn to home remedies, or illegally hire unregulated practitioners of the services.

Many studies have confirmed that licensing reduces employment growth. For occupations regulated in some U.S. states and not in others — such as librarians, respiratory therapists, and dietitians and nutritionists — employment growth was about 20 percent greater in unregulated states from 1990 to 2000, using estimates derived from census data.

Studies also confirm that supply restrictions increase earnings. Estimates developed nationally using U.S. Census Bureau and National Longitudinal Survey data for 1990 and 2000 for

more than 50 occupations show that between 4 percent and 17 percent of the difference in hourly earnings is attributed to licensing, based on the occupation, method, and time period examined.

The costs of restricted entry and the induced wage inflation are ultimately borne by consumers. My estimates suggest that regulation redistributes between \$116 and \$139 billion (2000 dollars) from consumers and reduces economic output by \$35 to \$42 billion per year.

That might seem like a lot, but it is less than one-tenth of 1 percent of U.S. total consumption expenditures. The diffusion of costs across consumers helps explain why licensing continues to grow. Average consumers do not often see or feel that price inflation directly; even when they do, as individual consumers, they have little power to do much about it in a policy sense. However, for professional associations and their workers affected by occupational licensing — a much more concentrated group of “winners” — wage premiums provide a clear incentive to be active lobbyists in state capitals and city governments across the country.

Despite the concentration of benefits and diffusion of costs, market forces do break out, but the regulated fight back. A typical response to licensure and higher wages is competition from substitutes. The licensed react, in turn, by defending their turf. For example, dental hygienists have sought to practice without the supervision of a licensed dentist, but dentists have lobbied extensively for restraints on the ability of hygienists to practice alone or even to whiten teeth without the presence of a licensed dentist. Not to be outdone, dental hygienists are seeking legal restraints on the work done by unlicensed and lower-priced dental assistants because they often compete with regulated hygienists.

Even though I have described the politics of regulation as favorable to the regulated, not all regulated professions are equally successful. States began regulating doctors and dentists more than a hundred years ago. But research by Milton Friedman and Simon Kuznets, two prominent Nobel Prize-winning economists, found that dentists allowed more people into the occupation, whereas doctors restricted the supply of new practitioners by limiting positions in medical schools. The consequence was a much more rapid growth in the earnings of doctors relative to dentists during the early part of the 20th century.

And regulation in Europe has produced fewer economic advantages. Rather than focusing on post-graduation tests, countries such as France, Germany, and the United Kingdom tend to regulate the prices charged and the organizational structure that is allowed by practitioners. With the smaller differences in the overall wage structure in Europe and the way occupations are licensed, the overall impact of licensing on hourly wages is much smaller than in the United States.

### HIGHER QUALITY?

Are there measurable benefits to occupational regulation? Evidence of consumer benefits is scarce.

How do consumer complaints for a particular occupation vary across states that regulate the same occupation different-

ly? For example, Wisconsin requires licenses for physical therapists, respiratory care providers, and physician’s assistants. Even though Minnesota certified the same occupations only during the late 1990s and early 2000s, Wisconsin did not have fewer consumer complaints for the occupations relative to a baseline number of complaints that were citations against physicians in each state.

Medical malpractice insurance premiums can also serve as a measure of professional competence. If licensing works as intended, for example, licensed health care practitioners should make fewer mistakes that would result in fewer lawsuits relative to unlicensed practitioners. The insurance industry presumably would provide lower premiums for practitioners in regulated states because incompetent or unscrupulous practitioners would have been weeded out through higher general and occupation-specific education requirements, testing, and background checks provided by licensing.

But the evidence is not supportive. For example, malpractice insurance premiums for pastoral counselors, marriage and family therapists, and professional counselors — who are licensed only in some states — show no difference for individuals of the same age and experience. Online quotes from insurers for typical coverage for an occupational therapist age 35 with 10 years of experience also showed no difference in malpractice insurance premiums among states that license this occupation and those that do not. At least for the insurance industry, licensing does not appear to generate sufficient benefits (reduced accidents) to have them differentiate premiums.

Even in such visible occupations as education, the benefits of licensing are not particularly clear. Two detailed studies in New York and Los Angeles conducted by Thomas Kane at the Harvard Graduate School of Education and other economists showed that the impact of teacher licensing on student achievement is not significant. The analysis found no meaningful differences in student scores in the two cities in classes taught by fully licensed teachers versus those taught by teachers who had completed a short training program such as Teach for America or other abbreviated teacher preparation classes. With no obvious benefits, the net effects of licensure for the occupations examined appear to be negative.

### POLICY OPTIONS

Occupational licensure has many costs and few benefits, but much public support. When policy alternatives to licensing are discussed, a common refrain heard from the public is, “I would never go to someone who is unlicensed.” Licensing has evolved as the culturally and politically acceptable method of quality assurance even though scholarly evidence finds little actual quality improvement and real economic costs. What can be done?

Reform will be difficult. Unlike other regulated sectors of the economy, occupational licensure has become more restrictive over time. Officials at the Council on Licensure, Enforcement, and Regulation have no examples of occupations becoming less regulated and moving toward certification or registration once they become licensed.

This suggests that it is important to prevent new licensure efforts and promote certification and registration that provide “consumer confidence” benefits, but with fewer entry restrictions. For example, certification is a less restrictive form of regulation in which states grant so-called right-to-title protection to people meeting predetermined standards. Those without certification—say, loan officers—may perform the duties of the occupation but may not use the title.

Other efforts from inside regulatory bodies might also return licensing to its consumer protection proclamations. The late Benjamin Shimberg, one of the first researchers to focus on the policy impacts of licensing, suggested some low-cost sunshine policies, one of which was to publicize complaints and disciplinary actions taken by licensing boards.

Shimberg also suggested that licensing boards have a majority of public members. An extension of the Shimberg approach might include an organizational structure that mirrors boards of directors at public universities that have only public members and generally no faculty to oversee the activities of the enterprises. In the same way, licensing boards would have only public citizens, with members of the profession advising the board on technical and other occupational issues. Providing additional public involvement to monitor and control licensing may be a political alternative to less stringent forms of regulation. **R**

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## IS REGULATION AN UNINTELLIGIBLE LANGUAGE?

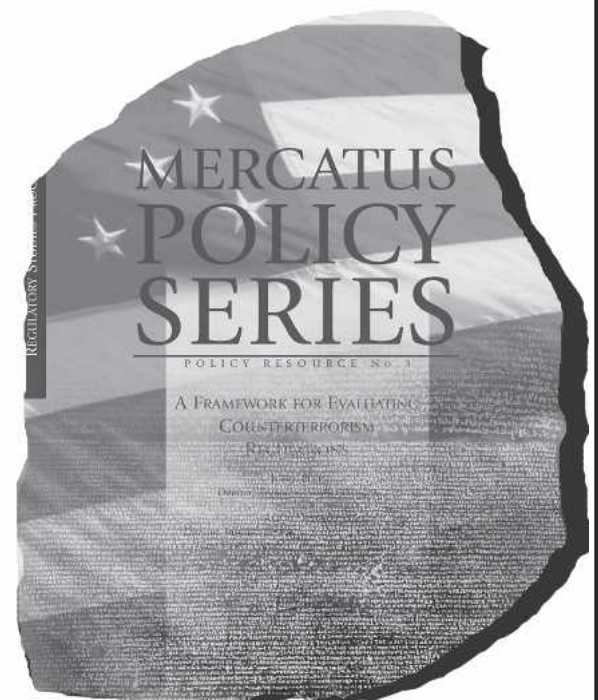
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