



Occupational Licensing: How A New Guild Mentality Thwarts Innovation

BY DANE STANGLER

The late economist Mancur Olson would have been a fan of Jonathan Ames. Ames is the creator of the HBO series *Bored to Death* as well as the eponymous protagonist, an aspiring novelist who moonlights as a private investigator. Olson may have enjoyed the ensuing hijinks, but he would have seen a larger economic lesson in the show.

In his classic book, *The Logic of Collective Action*, Olson demonstrated that small groups are usually more efficient and effective at achieving collective ends than large groups.¹ Despite the narrower interests they represent, small groups find it easier to engage in coordinated behavior and achieve group ends, even when those ends may work against the interests of the larger society. Today, this “logic of collective action” can be seen in the spread of professional and occupational licensing. Whereas in the 1950s only five percent of the American workforce was subject to such licensing, it currently stands at nearly one-third.² What this means is that, to enter certain professions and occupations, individuals must attain minimum levels of education and training and, often, pass exams to demonstrate their competency to practice.

Many worry that this growth, while salutary to a point, has now become a structural rigidity and a drag on economic vitality. Ames’ character, who readily admits to customers that he is an *unlicensed* private investigator, might be seen by Olson as indicative of precisely the type of enterprising spirit that America needs right now.

As it happens, private investigators must be licensed in most states. Licensure may appear reasonable for many professions, such as social workers and marriage and family therapists. For others, strict requirements may appear marginal: barbers, nail technicians, interior designers, real estate agents, landscape architects, and so on.

Meanwhile, it is easy to ridicule some licensing requirements. In Kansas, dry cleaners must obtain professional licenses. Don’t even think about promoting a boxing event in Virginia without a state-mandated license. California and Florida protect an unwary public from unlicensed yacht brokers,³ while in many states those who operate cemeteries must be licensed. Athlete agents must be licensed in Georgia and, in Maryland, locksmiths, pawnbrokers, and secondhand precious metal dealers must be licensed. Some cities add another layer of requirements: New York City and the District of Columbia put prospective sightseeing guides through examination and licensing processes. Naturally, the schools and teachers that train the next generation in these occupations must also be licensed.

To some, the spread of licensing embodies regulation run amok. Yet Olson would be quick to point out that, in most cases, state licensing is sought by the occupations themselves. Licensing restrictions and the barriers to entry they erect have the effect of lessening competition for those who are licensed to practice. Who wouldn’t seek protection from new entry, competition, and innovation that might threaten your livelihood?

Protection from competition, of course, is not the only reason that licensing restrictions exist. It might be easy to poke fun at some of the above occupations for which licensing is required; it is less easy when it comes to things like dentistry, medical services, and legal practice. But who would willingly submit to an unlicensed surgeon or dentist? The growth of occupational licensing as a labor market institution, moreover, has two sources. One is the

absolute growth in the number of occupations subject to state-sanctioned licensing, which has been far from uniform. In some states, nearly 200 occupations require licenses, while in others the number is around 50.

The second source of growth is rather benign: there has simply been greater employment growth in many of the occupations that were already subject to licensing. Natural employment trends have thus driven rising shares of licensed professionals, particularly in fields such as medicine, education, legal services, and accounting.

Such growth has not come without benefits. Licensing enhances quality by excluding poorly skilled providers, induces greater levels of human capital investment, and reduces risk for consumers by providing a guarantee of minimum levels of training and skills. The United States stacks up well internationally: according to the Organisation for Economic Cooperation and Development (OECD), the U.S. is one of the least restrictive countries in terms of entry and conduct regulation for accounting, engineering, architecture, and the legal profession.⁴

Nonetheless, evidence supporting the benefits of licensing is shaky. While consumers may benefit from greater information, they pay for it in the form of higher prices, which means faster wage growth in licensed occupations. Higher prices would be justifiable, of course, if they paid for higher quality. But, researchers have found little evidence that licensing barriers enhance quality, including no reduction in complaints to state licensing boards when comparing different occupations in different states.⁵

Importantly, occupational licensing is an issue around which liberals and conservatives can find common ground. As Kleiner points out, for the left, it is a matter of social justice: rising occupational licensing, especially in certain professions, worsens wage inequality while the higher prices fall most harshly on low-income consumers. For those on the right, it presents an issue of economic liberty because barriers to entry are artificially raised and competition is muted.

Indeed, there is mounting evidence that professional and occupational licensing is blocking innovation and entrepreneurship across large swathes of the American economy. Some state officials, such as the secretary of state in Georgia, have proposed consolidating oversight of professional licensing to reduce frictions and costs.⁶ In February, the Treasury and Defense Departments issued a joint report highlighting the negative impact of licensing on the economic prospects of military families. Specifically, the report notes that the dual impact of licensing requirements and the high migration rate of military families means that “the lack of license portability—the ability to transfer an existing license to a new state with minimal application requirements”—imposes significant burdens on the well-being of military families.⁷ The report recommends conditional endorsement of licenses from other states, temporary or provisional licenses, and faster application processes. A handful of states, working with the Pentagon, have made regulatory and legislative changes to ease the restrictions for military spouses.

What else can be done? In a recent report, *License to Grow*, the Kauffman Foundation, working with law professors and economists, recommends a “driver’s license” approach, which means mutual recognition across states.⁸ This would not require federal preemption, but simply a law mandating that states recognize occupational licenses granted by other states. Right now, a professional moving from one state to another often needs to run a new gauntlet of forms and exams—states will be understandably reluctant to relinquish this revenue stream. In instances in which someone moves from a state where their occupation is not licensed to one where it is licensed, proposals such as those put forth in the Treasury and Defense report—temporary licenses, expedited applications—would be needed.

Another option, promoted by Kleiner, is certification, wherein “any person can perform the relevant tasks, but the government or generally another nonprofit agency administers an examination and certifies those who have passed, as well as identifies the level of skill and knowledge for certification.”⁹ For Kleiner, certification (which is already a large form of regulation) would preserve the incentive for human capital investment, but allow consumers greater choice in selecting services and responding to price increases. This shifts some risk to consumers, but does not require that they sort things out for themselves—they remain free to choose certified providers.

The hardest profession to crack is the law. The standard complaint is that the United States has far too many lawyers, yet the high cost of legal services belies this. The practice of law is restricted in two ways: first, anyone offering legal services must have completed a three-year education at an accredited law school. (Accreditation, in this case by the American Bar Association, is an issue that deserves its own treatment because it is an issue in all of higher education.) Second, legal services can only be provided by a business that is owned by attorneys. Business model innovation is generally not encouraged in the legal profession.

The effect is twofold. First, as in other licensed occupations, these barriers constrict the supply of who can provide what legal services. An alternative model might be found in medicine, where room has steadily opened for nurse practitioners and physician assistants to practice alongside physicians. Paralegals perform a wide array of work within firms, but the law is far behind medicine in this respect (and medicine itself still has ample room for progress—most states restrict the scope of nurse practitioners). There are obviously many areas in which costly legal counsel will still be required, but in routine tasks such as contracts and wills, lower barriers to practice are justified.

Second, restricted competition in the practice of law has wide ripple effects across the economy. In particular, entrepreneurs across a wide array of sectors face high costs for services that could be rapidly commoditized or opened to greater competition. Opening up the legal profession to different business models may offer one solution.

Britain, in fact, has already taken this step, recently changing the law to allow “alternative business structures” in the ownership models of law firms and what types of firms can offer legal services. This will permit new entrants—a software outsourcing company has said it will pursue the acquisition of a law firm—and the raising of outside capital by law firms.¹⁰ Such reform has so far gone nowhere in the United States—one law firm is suing three states for the ability to raise external money, and the American Bar Association has unsuccessfully attempted on more than one occasion to raise the idea of alternative business models. But, if the experiment in Britain succeeds in lowering costs and introducing innovations into the legal profession—with beneficial results throughout the economy—it will be difficult to thwart such reform in the United States.

Nobody argues that, to spur innovation and economic growth, the United States should abandon measures that protect consumers and maintain at least a minimum level of quality service. But there is a point past which the protective costs of occupational licensing outweigh the benefits by hindering new entry, which is the fundamental source of economic growth. The lesson of Mancur Olson and Jonathan Ames is not that we are at the mercy of occupational interest groups or that consumers, at some risk, must find their way through trial and error. It is that there remains considerable room for experimentation, retaining adequate safeguards for quality while promoting innovation and lower costs. At a time of persistent unemployment and concerns over economic vitality, the United States can ill afford to keep these guild-like structures.

Endnotes

¹ Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard, 1965).

² Morris M. Kleiner and Alan B. Krueger, “The Prevalence and Effects of Occupational Licensing,” National Bureau of Economic Research Working Paper 14308, September 2008, at <http://www.nber.org/papers/w14308.pdf>.

³ See, e.g., Matthew Yglesias, “Is Unlicensed Yacht Dealing a ‘Serious Threat’ to the Welfare of the People of Florida?” Think Progress, November 9, 2010, at <http://thinkprogress.org/yglesias/2010/11/09/199033/is-unlicensed-yacht-dealing-a-serious-threat-to-the-welfare-of-the-people-of-florida/>.

⁴ The data are for 2008. OECD, “Indicators of Regulatory Conditions in the Professional Services,” at http://www.oecd.org/document/24/0,3746,en_2649_37443_35858776_1_1_1_37443,00.html.

⁵ Morris M. Kleiner, *Licensing Occupations: Ensuring Quality or Restricting Competition?* W.E. Upjohn Institute (2006), at www.upjohn.org/Publications/Titles/LicensingOccupationsEnsuringQualityorRestrictingCompetition.

⁶ Christopher Quinn, “Changes to Licensing Proposed for Half-Million Georgians,” *Atlanta Journal-Constitution*, February 21, 2012, at <http://www.ajc.com/news/georgia-government/changes-to-licensing-proposed-1356959.html>.

⁷ U.S. Department of the Treasury and U.S. Department of Defense, “Supporting our Military Families: Best Practices for Streamlining Occupational Licensing Across State Lines,” February 2012, at http://www.defense.gov/home/pdf/Occupational_Licensing_and_Military_Spouses_Report_vFINAL.PDF.

⁸ Kauffman Task Force on Entrepreneurial Growth, *A License to Grow: Ending State, Local, and Some Federal Barriers to Innovation and Growth in Key Sectors of the U.S. Economy*, Kauffman Foundation, January 2012, at http://www.kauffman.org/uploadedfiles/a_license_to_grow.pdf.

⁹ Morris M. Kleiner, *Licensing Occupations: Ensuring Quality or Restricting Competition?* W.E. Upjohn Institute (2006), at www.upjohn.org/Publications/Titles/LicensingOccupationsEnsuringQualityorRestrictingCompetition.

¹⁰ “Psst, Wanna Buy a Law Firm?” *The Economist*, January 28, 2012, at <http://www.economist.com/node/21543554>.

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