

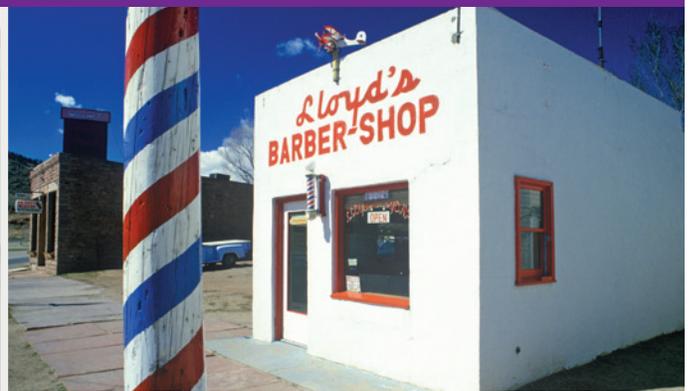
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POLICY BRIEF 2015-01

Reforming Occupational Licensing Policies

JANUARY 2015



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Reforming Occupational Licensing Policies

Occupational licensing is the process by which governments establish qualifications to practice a trade or profession, so that only licensed practitioners are allowed by law to receive pay for doing work in that occupation. This form of regulation has rapidly become one of the most significant factors affecting labor markets in the United States and other industrialized countries. In the early 1950s less than 5 percent of U.S. workers were required to have a license from state government in order to work. By 2008 the share of workers requiring a license to work was estimated to be almost 29 percent. Common occupations requiring a license often include professional occupations like physicians, attorneys, nurses, and teachers, but they also include occupations requiring less formal education such as truck drivers, locksmiths, ballroom dance instructors, and hair stylists. Given its pervasiveness and growth, occupational licensing now has important implications for workers' access to jobs and their potential labor market and economic outcomes.

The main rationales for occupational licensing are to protect the health and safety of consumers and to ensure a sufficiently high level of product or service quality. By making would-be practitioners undergo specific training, pass exams, and complete other requirements, according to this line of thinking, the public is better protected from fraudulent, disreputable, and unqualified service providers. However, not all occupations pose equivalent threats to health and safety. For example, while work by an unskilled electrician could lead to faulty wiring and a fire hazard, it is hard to imagine a similar level of risk from a less skilled interior designer, travel guide, or auctioneer. Moreover, the degree of occupational licensing varies widely across states, even for the same occupation, and it is not clear why some have more restrictive requirements for entering the occupation than others. It is important to realize that the issue of licensing is not necessarily a yes or no concept (i.e., whether a certain occupation is licensed), but often is a matter of degree: How much is required before someone can be licensed? How many functions can only someone with that license perform?

Researchers have examined differences in licensing practices across states to investigate the extent to which stricter licensing regimes lead to observable improvements in service quality. In general, this literature provides little evidence that stricter licensing regimes lead to improved quality of services. Most studies do find effects on wages, employment, and prices, however. It seems that higher prices resulting from occupational licensing are reflected in higher wages for licensed practitioners, but there is also potentially some cost to would-be practitioners who are discouraged from entering the industry by strict or expensive licensing requirements. Furthermore, differences in

licensing requirements across states often mean that licensed workers in one state cannot readily move to another state and continue working in their field without satisfying new requirements, which typically requires an outlay of both time and money. These observations lead to the summary view that occupational licensing practices have both social benefits and economic costs, and that the two need to be weighed against each other. There is no one-size-fits-all conclusion to draw since different industries, occupations, and localities will have their own right balance.

In a new discussion paper, Morris M. Kleiner of the University of Minnesota proposes four ways to reform the current system of occupational regulation to better balance the social costs and benefits. Specifically, he recommends that a state's decision to license an occupation be based on an analysis of its costs and benefits, that the federal government establish a competitive grant program for states to determine best practices with regard to occupational regulation, that states move toward recognizing occupational licenses granted in other states, and that certain licensed occupations be reclassified to a system of lesser regulation such as certification. The author contends that if governments were to undertake these proposals, available evidence suggests that employment in these regulated occupations would grow, consumer access to goods and services would expand, and prices would fall.

The Challenge

Despite the rationale for public health and safety, the rapid growth of occupational licensing in the past several decades has come mainly at the behest of professional associations, not consumer advocacy or public interest groups. Indeed, Kleiner explains that most of the economics literature shows that occupational licensing requirements restrict entry into an occupation—often resulting in fewer practitioners—and can therefore increase prices and reduce the availability of services. Furthermore, the research shows that, in some contexts studied, occupational licensing practices do not appear to result in improved quality and safety for consumers.

The current proliferation of occupational regulation does not appear closely related to health and safety considerations. For example, physicians are licensed in all states and presumably no state would find such licensing to be unwarranted. However, several states license occupations that would seem to pose little threat to consumer health and safety, such as auctioneers and travel guides. Additionally, there is large variation across states in the licensing requirements even for the same occupation, suggesting that government's propensity to license professions may not closely relate to the ability of individuals to perform their tasks safely. (For example, locksmiths are licensed in only thirteen states. Why would unlicensed locksmiths pose a threat in thirteen states, but not the others?) Moreover, new licensing rules often "grandparent" current practitioners, allowing them

to continue practicing without meeting the new requirements. If the new criteria were truly necessary to protect consumers, then it would not be acceptable to grandparent in existing practitioners. These practices raise the possibility that in some states, for some occupations, there is excessive licensing that requires thoughtful reconsideration.

Kleiner explains that numerous studies have attempted to estimate the influence of licensing on the quality of services. It is worth noting that some of these studies do not necessarily compare full licensure to no regulation, but instead often compare it to different degrees of regulation. Kleiner cites recent studies in dentistry that find no effect of requiring certain procedures, such as gold foil fillings, on patients' dental health outcomes. Other studies—of both health-care occupations such as optometrists and non-health-related occupations such as construction contractors—indicate that the impact of occupational regulation on service quality remains ambiguous.

On the other hand, economic research does suggest that occupations that are licensed have slower employment growth relative to the same occupation in a similar state that does not require a license. The enactment of licensing and the higher entry standards it often brings may serve as barriers to new entrants, limiting the number of practitioners in that occupation and reducing competition. Kleiner points to research showing that individuals with a license appear to earn more—between 10 and 15 percent more per hour—than similar individuals without a license. However, these wage effects of licensing vary by occupation, and the evidence suggests that the benefits accrue mainly to individuals who are already in relatively well-paying occupations.

The wage gains of licensed practitioners come at the expense of consumers, who pay higher prices. The impact of licensing-related practices on prices, Kleiner argues, ranges from 5 to 33 percent, depending on the occupation and location. For example, restrictions on the tasks that a nurse practitioner can provide without the supervision of a physician can raise the price of well-child exams by 10 percent. While it is possible that consumers are paying for higher-quality goods and services, the lack of evidence for improved quality seems to indicate otherwise.

Furthermore, although many licensed workers benefit from higher wages, they are not necessarily better off on all fronts. Since licensing is typically established at the state level, many of the requirements and investments for obtaining a license (e.g., passing exams, working with or for local practitioners) must be repeated to practice in another state, making it harder for workers to take advantage of job opportunities in other states. In the absence of reciprocity agreements, in which states accept an occupational license granted by another state, the requirements for relicensure can be prohibitive in terms of

both time and money. Recent empirical evidence confirms that licensing affects cross-state and even international migration rates. This issue is particularly salient for spouses of members of the armed forces, who are often relocated across state lines and who then have to seek reaccreditation at considerable costs.

Overall, Kleiner's review of the recent empirical evidence leads him to conclude that, within a range of professions, occupational licensing can frequently hinder workers' opportunities and raise prices while providing little tangible improvements to public safety or service quality.

A New Approach

Kleiner proposes four policy changes that would lead to a reduction in the regulatory costs of licensing while increasing employment opportunities and expanding consumer access to services. If state and local governments were to undertake these proposals to streamline occupational licensing, available evidence suggests that employment in these occupations would grow and the prices for services would fall.

Cost-Benefit Analysis to Evaluate Occupational Licensing

Kleiner recommends that state governments, together with the relevant occupational associations, perform cost-benefit analysis prior to establishing new licenses or adopting new requirements for existing licenses. If the benefits to the public exceed the costs of the proposed licensing regime, then the state government and professional association should demonstrate that the proposed changes to licensing are the least restrictive form of regulation necessary to meet the desired goals. Additionally, the author advocates that governments also develop and execute plans to perform cost-benefit analyses for existing occupational requirements. These plans would fall under the purview of regulatory commissions or departments, such as Colorado's Department of Regulatory Agencies, which could serve as a model for other states.

In carrying out these cost-benefit analyses, state governments should rely on existing studies, conducted either by other states or by academic researchers, if outside experts deem those studies to be rigorous. For new studies, Kleiner proposes a set of questions that the regulatory agencies should consider and address in the analyses. These questions focus on the necessity for new regulation (rather than on better enforcement of current regulation) in order to protect the public, the possibility of alternatives to occupational licenses (e.g., nonprofit monitoring, industry regulations, litigation through state and local courts), and the expected impact of the proposed licensing on practitioners as well as on consumers. The author also provides guidelines for how the answers to the posed questions should affect the decision to license an occupation.

Federal Engagement to Promote Best Practices

In order to help states carry out thoughtful cost-benefit analyses, Kleiner proposes that the federal government use available research and experiences across states to promote particular types of regulatory policies. Specifically, an interagency working group, to be led by the Departments of Labor and Commerce, would establish and endorse a set of best practices in occupational regulation. (The National Center for Education Statistics' current Interagency Working Group on Expanded Measures of Enrollment and Attainment performs a similar role in education.)

To induce states to adopt the recommended practices, the federal government would encourage states (or groups of states working together) to compete for federal grants for evaluating and improving the current system of occupational licensing. Because administrative costs are relatively low, Kleiner contends that the financial award would not need to be large, say \$10 million per state, to promote take-up. States would submit proposals that outline specific steps they would take to align their system of occupational licensing with the best practices endorsed by the working group. A panel of experts from the group would review the plans and distribute partial awards to the states (or consortia of states) with the most meritorious plans, withholding the remaining funds until states have met certain progress benchmarks. Overall, Kleiner argues that every dollar spent on this initiative is likely to generate more than a dollar in new economic activity.

State Reciprocity

Kleiner also proposes that states and localities accept occupational licenses granted elsewhere in the country. States already, for example, universally accept other states' driver's licenses despite differences in requirements and road conditions among states. Licensed workers living in states that have policies of reciprocity (establishing mutually agreed licensing requirements) or endorsement (flat out accepting licenses earned in other states) for their occupation have lower barriers to moving in pursuit of a job than do licensed workers not living in such states. The Nurse Licensure Compact, in which states agree to accept nursing licensure applicants from other states in the compact without further requirements, illustrates how these agreements can function.

The author notes that the Departments of Defense and Treasury have called for similar policy recommendations to assist the families of military personnel who have had a difficult time pursuing careers after moving across states. Kleiner contends that this proposal would help offset a long-standing decline in cross-state migration and alleviate uneven geographic distributions of practitioners (e.g., the dearth of health-care practitioners in rural states); according to his calculations, targeting even just the ten states with the most mobility between them would reduce many of the current barriers to migration.

Roadmap

- Regulatory commissions or departments within state governments, together with the relevant occupational associations, will perform cost-benefit analysis. Analyses will be performed prior to establishing new licenses or adopting new requirements for existing licenses, and for reviewing existing occupational requirements. The analyses will rely on new or existing studies when available. For new studies, the commissions or departments will consider and address a comprehensive set of questions to guide their analysis.
- A federal interagency group, to be led by the Departments of Labor and Commerce, will establish a set of best practices in occupational regulation using available research and experiences across states. States will also be encouraged to apply for federal grants for evaluating and improving their current system of occupational licensing. A panel of experts from the federal working group will review the grant proposals and distribute partial awards to the states (or consortia of states), withholding the remaining funds until grantees meet certain progress benchmarks.
- Using existing interstate arrangements (such as the Nurse Licensure Compact) as a model, states will develop reciprocity agreements to more readily accept occupational licenses granted by other states with similar licensing requirements.
- If the cost-benefit analysis demonstrates that the social benefits of licensing do not outweigh the economic costs, states will consider transferring a system of licensing to a lesser form of regulation, such as certification or registration, or even to no regulation. Furthermore, state legislatures or regulatory agencies will consider, in certain cases, granting certifying organizations the authority to qualify individuals to do the work of licensed individuals.

Certification Policies as a Substitute for Licensing

Kleiner argues that many currently licensed occupations do not pose sufficient risk to individuals' health and safety to warrant the full regulation of licensure. As a result, there may be some occupations where it may be beneficial to implement lesser forms of regulation, such as certification or registration, or even no regulation at all. Unlike licensing, a system of certification allows anyone to perform the service for pay, but allows only workers granted certification to claim (and advertise) the certified title. For example, only workers granted the CFA certification can claim to be chartered financial analysts. Registration, on the other hand, requires only that

Learn More about This Proposal

This policy brief is based on The Hamilton Project discussion paper, “Reforming Occupational Licensing Policies,” which was authored by:

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workers apply to be on an official roster maintained by a government agency. The author thus proposes that if the costs of regulation exceed its benefits, then states should move these occupations from licensing to certification or to other forms of regulation. This approach has recently received consideration in Minnesota and Iowa.

Acknowledging the political difficulty of removing occupational licensure, Kleiner also proposes that states grant selected private certifying organizations the authority to qualify individuals in low-risk occupations (as determined by cost-benefit analyses) to provide all of the services of a licensed individual legally, and to do so without risk of a penalty or fine. These certified individuals would be required to post an appropriate job-specific bond (similar to those held by mortgage brokers or contractors) to protect consumers against low-quality service. The author maintains that fee revenue would provide certifying organizations with an incentive to provide reputable training programs, and that states could impose a registration fee to recoup the costs of administering the process.

Conclusion

Occupational licensing has been among the fastest growing labor market institutions in the United States since World War II, but evidence indicates that, in some cases, such licensing limits worker opportunity and raises prices more than it protects public safety or improves service quality. In order to promote a more rational system of occupational regulation that weighs the interests of both workers and consumers, Morris M. Kleiner of the University of Minnesota offers four policy proposals that favor greater justification for occupational regulation, adoption of best practices, recognition of other states’ occupational credentials, and lesser forms of regulation where appropriate.

The author argues, based on available evidence, that adoption of these proposals would lead to employment growth in regulated occupations, greater consumer access to goods and services from more providers, and lower prices, with minimal impact on safety or product quality. Although these reforms

would not be costless up front, since states would lose revenue from licensing fees for occupations that are deregulated, estimates from the economics literature suggest that increases to income and payroll taxes from higher employment and additional transactions could partially or wholly replace the lost revenue stream.

BOX 1.

The Case of Uber and Taxi Driver Licensing

The growth of information technology in recent years, especially mobile devices, has allowed consumers and service providers to connect with each other with increasingly detailed levels of information about each party, in ways that challenge the traditional role of occupational licensing. Users of Uber, an app-based transportation network and taxi company, have the ability to directly contact suppliers of these services and to access information about the driver. Customers and drivers rate each other immediately after a trip; potential customers and drivers can access this information so that their quality can be evaluated. The drivers, who function as independent contractors, are vetted through the company and have private driver’s licenses, but, unlike most taxi drivers, Uber does not require them to have a taxi or chauffeur’s license through the state, county, or city. Consequently, they do not pay these licensing fees to the government, and Uber is not subject to other regulations of taxis, such as metered fares and guaranteed coverage of certain destinations.

In essence, Uber drivers perform a function very similar to a licensed occupation—taxi driver—but are not themselves commercially licensed; the law to date is murky on the legality of Uber. Many customers seem to enjoy the benefits of competition with conventional taxis, such as the chance of lower prices, and in some cities Uber drivers almost serve as the family chauffeur. On the other hand, taxi companies and drivers and government officials have expressed public safety concerns about Uber’s lack of regulation, with some cities, including Portland, Oregon, attempting to ban Uber drivers in the city. Moreover, the increased competition among driving services as a result of car-service apps including Uber has led to declining prices for taxi medallions—licenses that many cities require before an individual is allowed to operate a taxi—and a stalling of medallion sales. As an example, New York City’s individual taxi medallions have decreased in price by 23 percent between 2013’s peak and 2015.

The fate of Uber and similar services, even as they continue to grow, will likely be determined through court battles and, potentially, legislation.

Questions and Concerns

1. Are there lessons to be learned from existing temporary and provisional licensing practices, such as reciprocal relationships for veterans?

Numerous states have passed laws allowing veterans to count their hours of military training toward state licensing qualifications for several occupations, ranging from emergency medical technicians in health care to electricians and plumbers in construction. Thirty-four states waive the driving skills test for veterans with a record of safely operating vehicles similar to the trucks and buses for which a commercial driving license is required. No negative consequence of using military training as a substitute for state licensing requirements has been noted. These initial results suggest that greater use of reciprocity-based agreements is unlikely to lead to a reduction in the quality of services provided.

2. Are there ways to ensure that the proposed state process of cost-benefit analysis remains objective?

All state governments contain agencies that are designed to be nonpartisan. In Minnesota, for example, the Office of the Legislative Auditor analyzes policy issues and submits factual reports to the legislature, but it does not advocate specific policy choices. The analysis provided by this agency has considerable weight with the legislature and

is viewed as nonpartisan. In Colorado, the Department of Regulatory Agencies (DORA) serves as a model of a nonpolitical agency that provides analysis on occupational licensing policy. At the federal level, the Government Accountability Office issues nonpartisan reports that are generally not considered to be politically motivated. While the ultimate decision to regulate an occupation rests with the legislature and governor, experience suggests that the data and analysis generated by these nonpartisan agencies would carry substantial weight in the decision.

3. Why not call for the federal government to simply require that certain occupations not be licensed?

Nations as diverse as China and the United Kingdom have legislation governing the regulation of many occupations at the national level. In 1889, however, the U.S. Supreme Court established in *Dent v. West Virginia* the right of states to grant licenses to protect the health, welfare, or safety of their citizens. Consequently, the states view occupational regulation as their appropriate domain, and are not likely to give up their jurisdiction. It would be difficult to pass national legislation that would hamper the ability of the states to craft laws that best fit their social and economic climate. Although national legislation on occupational regulation could harmonize licensing laws, it does not appear to be politically feasible or, if local interests were considered, necessarily economically desirable to do so.

Highlights

Morris M. Kleiner of the University of Minnesota offers four proposals with the goal of systematizing and harmonizing occupational licensing regulation. Together, these proposals would reduce the regulatory and economic costs of occupational licensing among states while increasing employment opportunities and expanding consumer access to services.

The Proposal

Cost-Benefit Analysis to Evaluate Occupational Licensing. State governments, together with the relevant occupational associations, would perform cost-benefit analysis on new and existing occupational licensing regulations. The analyses would rely on both new and existing studies.

Federal Engagement to Promote Best Practices. The federal government would establish a federal interagency group to promote best practices in occupational regulation. States would also be encouraged to apply for federal grants for evaluating and improving their current system of occupational licensing.

State Reciprocity. States would develop reciprocity agreements to more readily accept occupational licenses granted by other states with similar licensing requirements.

Certification Policies as a Substitute for Licensing. When the costs of licensing exceed its benefits, states would consider transferring away from licensing to a lesser form of regulation, such as certification or registration, or even to no regulation.

Benefits

If state and local governments were to undertake these proposals to streamline occupational licensing, available evidence suggests that employment in these occupations would grow, the prices for services would fall, and access to services would increase, all while minimizing harm to public health and the economic well-being of certain regulated workers. These reforms would not be costless since states would lose revenue from licensing fees for occupations that are deregulated. Estimates suggest, however, that increases to income and payroll taxes from higher employment and more-frequent consumer transactions could partially or wholly replace the lost revenue stream.



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