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THE CASE FOR ABOLISHING OCCUPATIONAL LICENSING

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About the author

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Daniel previously worked at the Commonwealth Department of the Prime Minister and Cabinet where he analysed global and domestic macroeconomic policy. Prior to that he worked at the Commonwealth Department of Finance where he worked on regulatory reform.

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Introduction

Occupational licensing is government regulation of the conditions under which someone can legally practice an occupation. The requirements can relate to education attainment, experience, personal character, residency, and payment of membership fees to professional industry bodies. In Australia, many occupations require a license to legally operate, including doctors, lawyers, electricians, hair dressers, weed controllers, and driving instructors

Occupational licensing imposes a range of costs on Australians. Most importantly, occupational licensing raises the cost of people practicing a given vocation, and so reduces the ability of people to access their preferred type of work, or to be able to find work at all. A consequence is that many, particularly those on lower incomes, are seriously curtailed from reaching their potential and living a more satisfying life. An attendant effect is to reduce labour market efficiency – as people are in occupations they are not as suited to – which reduces economic efficiency and economic growth.

Further, a large and growing body of evidence, mostly from the United States, shows that occupational licensing reduces wages and employment for those outside of licensed professions, increases wages of incumbent employees, reduces labour mobility, and raises prices for consumers which has a regressive effect.

To make matters worse, proponents of occupational licensing claim they are supporting a noble purpose. For example, proponents of occupational licensing often claim licenses are needed to keep incompetent, predatory, and untrustworthy suppliers out of the market. But the best available evidence does not support these claims. Firstly, people should be free to purchase cheaper, and potentially lower quality items. Secondly, the preponderance of evidence shows occupational licensing doesn't raise quality or improve the safety of products and services. Thirdly, occupational licensing increases prices which falls most heavily on low income individuals. And by raising prices, occupational licensing creates incentives for people to economise on, or avoid, the use of regulated products and services. This decreases living standards and can result in injury or death. Finally, claims occupational licensing is required to address supposed information asymmetries are now largely redundant given technological development.

The Occupational Licensing System in Australia is Intractable

The occupational licensing system in Australia is so complex, expansive, and duplicative that no known estimate exists of how many professions require a license. Mikayla Novak of the Institute of Public Affairs noted that investigations for a national occupational licensing scheme by the Council of Australian Governments in 2008 found more than 800 licenses nationally across a limited group of manual trades. But this would only capture a fraction of the total number licenses. Evidence from the United States, for example, suggests that about 25-30 per cent of the total work force is licenced, which has increased from about 5 per cent in the mid-1950s.¹

Part of this growth is the result of an increase in the number of jobs and professions which require a license. And partly the result of a growth in the number of professions which typically have a greater proportion of licensed workers, such as health care.

Gideon Rozner, Research Fellow at the Institute of Public Affairs, argues that licensed occupations in Australia vary from the predictable – such as medical and legal professionals – to the esoteric.

Many occupations are licensed in some states, but not others. For example, licenses are required for:

- beekeepers in New South Wales, South Australia, Victoria and Western Australia;
- beauticians in New South Wales;
- certain casino workers – such as blackjack dealers – in Tasmania;
- introduction agents – or professional ‘matchmakers’ – in Victoria and Queensland; and
- taxidermists in Victoria, New South Wales and Tasmania.²

There is limited evidence of the extent of licensing outside of the United States. But one study found that based on information gathered in 2012 from the then twenty-seven nations in the European Union (EU), between 9 and 24 percent of European workers were covered by licensing.³

There is substantial variation between European nations. For example, Bulgaria, Estonia, Finland, France, Ireland, Latvia, Lithuania, Malta, the Netherlands, Romania, and Sweden were all found to have less than 15 per cent of their workers covered by occupational licensing. While at least 25 per cent of the workforce in Denmark and Germany, is regulated, and rates are also high in Italy and Spain.⁴

¹ The White House, “Occupational Licensing: A Framework for Policymakers”, Washington D.C., (July 2015), pg. 60

² Rozner, Gideon, “Is Australia Becoming Overqualified?”, *IPA Review*, Institute of Public Affairs, Melbourne, Australia (forthcoming)

³ Kleiner, Morris, “Reforming Occupational Licensing Policies”, *The Hamilton Project*, Brookings Institution, (2015) pg.14

⁴ Ibid.

Occupational Licensing Increase Prices

One of the most undisputed findings in the literature is how licensure affects prices. According to a report by the White House on occupational licensing, 'the evidence on licensing's effect on prices is unequivocal: many studies find that more restrictive licensing laws lead to higher prices for consumers.'⁵ The logic of this is straightforward. Licensing restricts market entry, resulting in fewer suppliers and less competition from which consumers can choose. The estimated size of the effect varies by study and depends on a range of factors, such as the stringency of licensing requirements.

A meta-analysis of studies in the United States prepared by the White House suggests occupational licensing can cause prices to increase 3-16 per cent.⁶ This results in an aggregate increase to prices of some \$203 billion across the United States.⁷ To take some specific examples, occupational licensing has been found to increase the price of a dental visit by up to 7 per cent⁸, of well-child medical exams (a medical check-up for children) by 6-16 per cent,⁹ of filling a tooth cavity by up to 11 per cent,¹⁰ and increases the probability that a mortgage is 'high-priced' by 5.4 percentage points.¹¹

The most obvious effect of higher prices is to make products and services less affordable, with a consequent reduction to real incomes and real living standards. When the price of a product or service rises, people can either choose to consume the same quantity and have a lower real income. Or they can choose to reduce, sometimes to zero, their consumption of the affected product or service, and substitute to alternatives where available. Because the price increase is indiscriminate this has a relatively larger effect on those on lower incomes.

This has a number of flow-on consequences. Firstly, it means that lower-income individuals are those who are likely to be most affected because a greater proportion of their income is consumed through price rises. Secondly, it means that, again mostly lower-income individuals, will choose to purchase relatively fewer products and services that would enhance their quality of life. This includes things such as health care, dental care, and legal services. Thirdly, this avoidance behaviour can result in a range of insidious unintended consequences. For example, Professor David Young argues that the incidence of rabies is higher in areas where there are strict limits on veterinary practice.¹² While a separate, early, and pioneering study undertaken by Sidney Carol and Robert Gaston found that rates of electrocution are higher in States in the United States that have the most restrictive licensing laws for electricians.¹³ This is because consumers opt to do their own electrical work rather than pay the high price for a certified electrician.

5 The White House, "Occupational Licensing: A Framework for Policymakers", Washington D.C., (July 2015), pg. 60

6 Ibid, pg. 2

7 Kleiner, Morris M., "Reforming Occupational Licensing Policies", The Hamilton Project, Brookings Institution, (2015)

8 Liang, J. N. and Jonathan D. Ogur, "Restrictions on Dental Auxiliaries: An Economic Policy Analysis." Bureau of Economics. Washington, DC: Federal Trade Commission, (1987)

9 Kleiner, Morris M., Allison Marier, Kyoung Won Park, and Coady Wing, "Relaxing Occupational Licensing Requirements: Analyzing Wages and Prices for a Medical Service", NBER Working Paper 19906.

10 Kleiner, Morris M. and Robert T. Kudrle, "Does Regulation Affect Economic Outcomes? The Case of Dentistry." *Journal of Law and Economics* Vol. 43, no. 2: 547-582. The University of Chicago Press.

11 Kleiner, Morris M. and Richard M. Todd, "Mortgage Broker Regulations that Matter: Analysing Earnings, Employment, and Outcomes for Consumers", *Studies of Labor Market Intermediation*

12 Young, David S. *Occupational Licensing* The Concise Encyclopaedia of Economics; available at www.econlib.org.

13 Carroll, Sidney L., and Robert J. Gaston, "Occupational Restrictions and the Quality of Service Received: Some Evidence." *Southern Economic Journal* 47 (1981): 959-76.

Occupation Licensing Reduce Wages and Employment of the Unlicensed

There is also a large and growing body of evidence which demonstrates that occupational licensing creates a wage premium for those who are licensed. As the White House report on occupational licensing notes, 'basic empirical evidence points clearly to a wage gap between licensed and unlicensed workers'.¹⁴

There are two reasons for the wage premium. Firstly, as discussed before, occupational licensing creates a barrier for new workers to enter the market. This reduces competition and therefore raises the wages of incumbent licensed workers. Secondly, because obtaining a license can be an expensive process – such as meeting education requirements and paying fees – licensing results in there being far fewer workers in licensed relative to unlicensed professions. As Gideon Rozner argues:

"occupational licensing can be a substantial handbrake on labour market efficiency that disproportionately affects poor and unskilled workers. Training and accreditation requirements often impose substantial up-front costs for those entering the workforce or seeking to change careers."¹⁵

The higher supply of workers in unlicensed professions reduces the wages of workers in those professions, which makes these workers worse off. Lower wages, in turn, reduce the return to work which reduces labour force participation and employment amongst those in unlicensed professions.

This results in a zero-sum game: workers in licensed professions, who are typically more educated and have a higher income, receive higher wages because people in unlicensed professions, who are typically less educated and on a lower income, receive lower wages.

However, what is perhaps more important is that licensing causes people to miss out on their preferred occupation. A consequence of this is that the ability of many, particularly those on lower incomes, to reach their potential and live a more satisfying life is seriously curtailed. An attendant effect is to reduce labour market efficiency – as people are in occupations they are not as suited to – which reduces economic efficiency and economic growth.

As with the estimated magnitude of the effect on prices, evidence, again, mostly from the United States, varies depending on specifications of the estimates. A 2013 study by Kleiner and Kruger¹⁶, for example, found licensing is associated with 18 per cent higher wages for those who obtain a license. This figure could be interpreted as an upper bound because the difference in earnings between licensed and unlicensed workers partly reflects differences between the two groups of workers, such as education attainment, skill level and productivity, that are independent of licensing. However, studies which control for these characteristics suggest that licensing results in a 10-15 per cent premium on wages for licensed workers relative to unlicensed workers.¹⁷

To take some specific examples, certain licensing provisions have been found to increase barbers'

14 The White House *Occupational Licensing: A Framework for Policymakers*, Washington D.C., July 2015, pg. 60

15 Rozner, Gideon, "Is Australia Becoming Overqualified?", *IPA Review*, Institute of Public Affairs, Melbourne, Australia (forthcoming)

16 Kleiner, Morris M. and Alan B. Krueger "Analysing the Extent and Influence of Occupational Licensing on the Labor", *Market Journal of Labor Economics*, Vol. 31, No. 2

17 Kleiner, Morris and Alan Krueger, "The Prevalence and Effects of Occupational Licensing." *British Journal of Industrial Relations*, 48 (4), (2015)

earning by between 11 and 22 per cent relative to unlicensed workers with similar education levels.¹⁸ Massage therapists working in States with licensing receive a wage premium of up to 16 per cent compared to massage therapists in States without licensing.¹⁹ Local licensing of electricians is associated with approximately a 12 per cent wage premium beyond that afforded by state regulations and that certain aspects of occupational requirements of state licensing, such as age and education, as well as exam requirements, raise the wages of electricians by about 6 percent to 8 percent.²⁰

And while there is less evidence on the employment effects of licensing, the available research suggests it can be substantial. Research by the Brookings Institute, for example, estimate that there are 2.85 million fewer jobs across the United States as a result of licensing.²¹ More specifically, Professor Morris Kleiner investigated three professions that are licensed in some states but not in others, and found that employment growth was higher in the unlicensed states relative to the licensed ones. Dr Kleiner also compared employment growth rates in several occupations that have different levels of licensing and found licensing is associated with slower employment growth.²²

Indeed, in part because of concerns over the employment effect of occupational licensing, the Polish Government has undertaken substantial liberalisation of its regulation of professions. The Prime Minister's office stated that "according to expert estimates, deregulation may increase employment within the regulated occupations by 15–20 percent."²³

18 Timmons, Edward and Robert J. Thornton, "The Licensing of Barbers in the USA," *British Journal of Industrial Relations* 48, no. 4 (2010): 740–57.

19 Thornton, Robert J. and Edward J. Timmons, "Licensing One of the World's Oldest Professions: Massage." *Journal of Law and Economics*, 56(2): 371–388, (2013)

20 Kleiner, Morris M. and Kyong Won Park, "Life, Limbs and Licensing: Occupational Regulation, Wages, and Workplace Safety of Electricians, 1992–2007", *Monthly Labor Review*, U.S. Bureau of Labor Statistics, (2014)

21 Kleiner, Morris M, "Reforming Occupational Licensing Policies", The Hamilton Project, Brookings Institution, (2015)

22 Kleiner, Morris, "Licensing occupations: Enhancing quality or restricting competition?" Kalamazoo, MI: Upjohn Institute, (2006)

23 Kleiner, Morris M, "Reforming Occupational Licensing Policies", The Hamilton Project, Brookings Institution, (2015)

Occupational Licensing Reduces Labour Mobility

The final, but equally important, cost of occupational licensing is that it reduces labour mobility. Many occupations are licensed at the state level. This means that licensed practitioners typically have to acquire a new license when they move states, or make modifications to an existing license. This results in red-tape through fees, paper work, new requirements in relation to education, experience, and testing.

As noted by the Productivity Commission in its report on barriers to geographic labour mobility:

‘the negative consequences of some poorly designed policies, such as taxation, housing and occupational licensing, include reduced geographic labour mobility. Reform in these areas would lessen impediments to geographic mobility.’²⁴

The Commission further noted that ‘the community has been poorly served by the lack of progress in occupational licensing [reform].’²⁵

The current system of jurisdiction-based occupational licensing creates an artificial barrier that hinders the capacity for people to easily relocate interstate. It may also limit geographic labour mobility for contract or short-term work, such as during natural disaster recovery or for nationally significant projects.²⁶

When it is harder for people to move there are effects on labour market efficiency. People cannot move to jobs they are better at – which results in lower productivity and economic growth. This also makes it harder for people to leave areas of high unemployment areas which can further entrench social and economic problems.

There is limited empirical evidence on the magnitude of the consequences. But analysis prepared by the White House found that over an eight-month period starting in late 2012, licensed workers were about 20 per cent less likely and certified workers were about 60 per cent more likely than non-licensed, noncertified workers to change states. The report also found that these patterns were broadly similar when a range of demographic variables were controlled for, suggesting “licensing may indeed limit interstate mobility when compared to similar workers who hold certifications.”²⁷ The White House report went on to find that interstate migration rates for workers in the most licensed occupations are lower by an amount equal to nearly 15 percent of the average migration rate compared to those in the least licensed occupations.²⁸

Similarly, research by the Cato Institute found that states with a 10 percent lower relative number of occupational licensees experience a 6.5 percent higher in-migration rate for individuals without a college education.²⁹

24 Productivity Commission, “Geographic Labour Mobility”, Canberra, Australia, (May 2014)

25 Ibid

26 National Occupational Licensing Authority, “Submission to the Productivity Commission in Relation to Geographic Labour Mobility Issues Inquiry”, Canberra, Australia, (August 2013)

27 The White House, “Occupational Licensing: A Framework for Policymakers”, Washington D.C., (July 2015), pg. 65

28 Ibid, pg. 66

29 Mulholland, Sean E. Young, Andrew T, “Occupational Licensing and Interstate Migration” *Cato Journal*, Vol. 36, No. 1 (Winter 2016)

Occupational Licensing does not Improve Product Quality or Health and Safety Outcomes

The preponderance of evidence shows that occupational licensing increases prices, reduces wages of unlicensed workers and decreases labour mobility. But some argue that these costs are a necessary evil that we have to live with because occupational licensing protects vulnerable, low-income consumers from low-quality produce and untrustworthy producers. However, the best available evidence does not support this view.

Firstly, it is morally illegitimate for one group of people to impose their preferences on others. Quality is subjective. What one person takes to be high quality another might consider low quality. It should be up to consumers to use their judgement about the quality and price they are willing to pay for products and services.

Secondly, even if it were morally appropriate, the preponderance of evidence suggests that occupational licensing doesn't improve quality, health or safety. As noted in the White House report 'most research does not find that licensing improves quality or public health and safety'.³⁰ Thirdly, higher prices reduce real incomes – and this effect is concentrated on those with lower incomes. And they purchase fewer regulated products and services or stop purchasing them altogether. This leads to poorer health outcomes, lower living standard and a heightened risk of injury and death.

Finally, some argue that occupational licensing is a way to reduce the information asymmetries which are held to exist in markets between producers and consumers. However, many information asymmetries have been negated via technological development, such as through decentralised, consumer-based services like Yelp!³¹

30 The White House "Occupational Licensing: A Framework for Policymakers", Washington D.C., (July 2015), pg. 65

31 Tabarrok, Alex, Cowen, Tyler, "The End of Asymmetric Information?" *Cato Unbound*, (April 2015)

Conclusion

Hundreds of thousands of Australians are missing out on the dignity of work. One of the key public policies contributing to this is occupational licensing which imposes a substantial barrier to employment.

Occupational licensing makes it more difficult for Australians to enter a vocation of their choosing, increases prices for consumers, which disproportionately affects low income individuals; reduces wages for those who are unlicensed, and reduces labour mobility. At the same time, the weight of the evidence suggests that occupational licensing does not improve health and safety outcomes, or improve the quality of regulated products and services. Instead, by increasing the price of regulated products, occupational licensing results in people economising on the use of those products and services, which can result in worse health outcomes and a lower standard of living.

Australian governments should move to substantially reduce, if not entirely abolish, occupational licensing in Australia. Policymakers should take into consideration how alternative mechanisms, such as economic competition and decentralised consumer review platforms, can help ensure accurate provision of information to consumers and enable them to make more informed decision making.

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