



## **An Economic Framework for Licensing Reform**

*This article is based on a presentation by Ryan Nunn, Economist in the Office of Economic Policy at the U.S. Department of the Treasury, at the 2015 FSBPT Annual Meeting.*

The recent White House report on occupational licensing was an attempt to ask and answer the important questions regarding licensing and its role in the economy. In this presentation, the high points of the report were explained, including the proposals for reform. Particular emphasis was placed on the proposals and analysis relevant to the small, but rapidly growing, number of professions that have taken the important step of setting up an interstate compact.

State occupational licensing requirements hurt workers' ability to migrate in times of economic distress, stifling economic recovery and workers' ability to find work.

That's the conclusion of the White House report on occupational licensing, which was undertaken in an attempt to ask and answer questions about licensing and its role in the economy. The report urges states to work corroboratively and cooperatively to streamline licensing, enter into compacts, and rid themselves of licensing requirements that do not protect public health and safety.

To create the report, the White House and U.S. Treasury and Labor departments started by analyzing some of the newly available data to fill in the gaps on licensing's effects on workers. They also consulted with groups like the FSBPT to benefit from the expertise of stakeholders in the regulatory community. And finally they summarized what had been learned in an earlier report.

The report was sparked by several factors. Most significantly, government labor economists sought to answer why the economic recovery from the Great Recession was more prolonged than expected based on historical data. Several recent studies seemed to provide the answer.

An influential study presented last year at the Federal Reserve annual conference named occupational licenses as a possible factor in the decline in labor market flexibility. Prior to that study's release, the Treasury Department, in collaboration with the Defense Department, had worked on a project helping military spouses navigate the occupational licensing process. Military spouses often have to move across state lines and also are more likely to be in licensed

occupations. Getting them to quickly move into a new job is important to the U.S. labor market and the nation's commitment to military families.

At the same time, the nonprofit litigation firm Institute for Justice released its report, *Licensed to Work*, which detailed licensure laws in all 50 states. This information was not easy to compile because it required looking at licensure laws for each occupation. The details provided in the report allowed labor market economists to discuss licensure in greater detail than ever before.

Meanwhile, in academia, professors Morris Kleiner and Allen Krueger brought additional attention to licensing with a new analysis of licensing's labor market effects based on worker data they collected, as well as an estimate of the historical growth of licensing.

The disparities of licensing are immense. Researchers discovered more than 11,000 occupations are licensed, certified, or registered in at least one state, while fewer than 60 occupations are licensed in all 50 states.

The disparities do not end there.

While the report is limited to low- to middle-income occupations studied by the Institute for Justice, for those occupations, state education and experience requirements for licensing ranged from 100 to 700 days. (Physical therapy was not among the occupations studied.)

In many states, comparisons of substantive burden across occupations are puzzling. For example, Kleiner notes Michigan requires 1,460 days training for athletic trainers, but only 26 days for emergency medical technicians, suggesting to Kleiner and others that sometimes licensing requirements are not related to public safety. Within occupations, requirements also can vary quite a bit. Cosmetologists need to undergo 490 days of training in Iowa but only 233 days in New York and Massachusetts.

Healthcare workers are the highest licensed occupation at almost 90%. Those in the legal and education fields are also fairly high at around 65%. The share of those employed in health and education has grown particularly quickly.

Those in personal care, social service, construction, and transportation are all licensed at rates ranging from 35% to 50%. Least likely to be licensed are those in computer and mathematical occupations, office and administrative support, the arts, food preparation, and engineering, all ranging from 0 to 10%.

The interstate migration rate has been cut in half over the last 65 years. This is bad news not just for the workers, but also for wages and job quality, overall employment growth, and the resiliency of the U.S. labor market in times of distress. It's particularly in bad times that workers would benefit from moving to better labor markets. Relocation has always been what makes the U.S. bounce back particularly quickly from recessions.

Americans have historically responded to downturns by changing both their occupation and their location in search of better opportunities. Given that licensing creates barriers into some

professions and increases costs associated with movement across states, licensing quickly became a focus for those concerned about job growth.

Building on the work of Kleiner and Krueger, the Census Bureau is adding licensing-related questions to both the current population survey and the survey of income and program participation, which are two widely used data sets in economics. As a result, expect to see an explosion of licensing research with the effect to change policy for the coming years. Kleiner's research particularly informs, especially on how scope of practice rules affect employment, wages, and prices.

The report describes the basic facts in the world of licensing, much of which wasn't known before the pioneering work of Kleiner and separately the Institutes for Justice: How many workers are licensed? How has this number changed over the years? What is the range of time and expense required to secure licenses from the various states and occupations? Which occupation groups are most likely to feature licensing?

Second, the report dives a bit deeper into those facts and answers some common questions that necessitate an economic analysis. Is the increase in licensing due to an increase in healthcare employment and service sector jobs? Do differences among states and licensing rates result from the mix of occupations? In a nutshell the answer to both questions is "no" for the most part. Finally, is there a correlation between licensing and reduced state migration? The answer here appears to be "yes." This information seems particularly relevant to the Federation in terms of its compact.

The report also develops the framework for thinking about the costs and benefits of licensing. Licensing obviously has some benefits for society and some not so obvious costs. Moreover, licensing is not an all or nothing decision. There are many details of the licensing process, like scope of practice, that cumulatively determine whether overall policy is effective and well designed. The report also describes technological and economic changes that have put pressures on the existing licensing regime. Improvements in communication technology have opened up all sorts of new possibilities for the practice of physical therapy and many other professions. Unfortunately, the nation's state-based licensure system has not always kept up with the new world of instantaneous video communication linking patients and practitioners. Given that the practitioner must be licensed in the state where the patient resides, it can be prohibitively costly to exploit the opportunities presented by this new technology.

Finally, the report discusses recent developments in licensing reform and suggests some best practices that can help policy makers improve licensing policy. Only some may be relevant to physical therapists, but it represents what has been learned over many occupations and states.

Many are struck by the number of people who are licensed, particularly when compared to the small numbers who were previously licensed. About 25% of workers are now licensed at the state level. It's harder to say how the number of license occupations has changed, due largely to the degree of getting everyone to agree on occupational definitions.

Why has the licensing rate increased so much? The increase from 5 to about 25% of workers licensed at the state level takes licensing from a marginal phenomenon in the labor force to a central labor market institution. Researchers were not able to supply a definitive answer to this question, but were able to show approximately how much of the increase is due to changes in the American workforce.

What they found is that only roughly one-third of the increase in licensing was due to changes in the occupational mix, for instance the share of workers in the healthcare professions. The remaining two-thirds of the increase occurred as states extended licensing to new occupations. Also analyzed was how the current differences across states for overall licensing prevalence was due to differences in occupational mix. State variation is large. One recent dataset puts the highest license fraction at 33% of all workers in Iowa and the lowest at 12% in South Carolina.

The political orientation of the state does not seem to be a factor. For example, blue state Minnesota has a low fraction license rate of 15% while red state Kentucky has a high 28%. Blue state Washington is high at approximately 30% while red state Georgia is a low 16%. It also does not correspond to occupational concentration. For instance, Iowa does not have a high number simply because it has more healthcare workers.

#### Purpose of Licensing and its Costs and Benefits

Of course this is subject to disagreement, but government researchers thought it important to think through the theory of licensing and establish a framework in which to understand why, when, and how licensing is really appropriate. Put simply, the government requires that workers obtain permission to practice when it is thought using a less restrictive policy or no policy at all would threaten public health or safety. It's the basic policy for regulation but one that is often lost sight of, particularly when such public harms are implausible.

Economists like to apply cost-benefit analysis to occupational regulation. On the benefit side we have the reduction in harm to the public and improved quality of service. Consumers, particularly in the realm of healthcare, are ill-prepared to judge the quality of care of providers. The term for this in economic literature is asymmetric information. In some cases it's quite clear that asymmetric information is a problem and the consequences of it are quite dire. Establishing that asymmetric information exists is not enough to justify licensing, which leads to issues of certification and other ways to solve minor occupational problems. In some cases, credentialing is sufficient to give consumers the information they need to make a decision. Given that it has fewer costs involved, it sometimes makes sense as a tool for regulatory policy.

From the cost side, licensing may deter some people from entering an occupation. Notably, deterred workers are those who already have limited income. It hurts workers who can't afford the training. It also hurts consumers through higher costs and reduced access.

Secondly, state-based licensing makes it difficult for workers to practice across state lines.

Applying this to scope of practice, a simple calculus becomes clear. Overly restrictive scope of practice hurts consumers as well as those workers who are excluded from certain tasks. For

example, nurse practitioners who cannot prescribe drugs in some states benefit the workers who maintain a monopoly on those tasks. Overly restrictive refers to situations in which two or more groups of professionals are qualified to perform a certain task but only one is permitted to do so. Historically this mostly falls to the first occupation licensed to undertake the task. This mostly accords with what labor economists find when they study scope of practice. Some of the best recent licensing research is in this area where we have good opportunities to study variations in the rules across the states.

For example, some states allow dental hygienists to work autonomously, while others insist they work under the supervision of dentists. Research by Kleiner and Parkes shows that autonomous hygienists earn 10% more while dentists earn 16% less. There is no evidence that quality of care is less in states where hygienists are allowed to work independently. There is evidence advanced practice registered nurses, such as nurse practitioners (NPs), can provide a range of primary care services to patients as effectively as physicians. In some states NPs are granted prescription authority. In others they are not. Infant mortality rates and malpractice insurance rates are not detectably different across these states. However, when NPs are granted permission to prescribe drugs, their wages are substantially higher and doctors' wages are slightly lower. Costs for medical services were observed to be about 10% lower in states that gave NPs more freedom, indicating the consumers benefit from increased access to care.

The conclusion then is scope of practice liberalization is particularly well supported by existing research. All workers should be able to provide services to the full extent of their competency in large part because this improves access to important services. While such reforms does have costs to those who have previously enjoyed a monopoly of practice, these costs are outweighed by benefits to workers in lower paid occupations, reduced prices, and better access to care and overall employment growth.

Licensed workers earn about 28% more than the unlicensed. But these two groups of workers are quite different on a number of dimensions and are not immediately comparable. Licensed workers tend to have significantly more education. One approach, then, is to control for as many of these differences as possible. After doing so, the wage difference shrinks to about 10 to 15%.

Economists are eager to estimate the wage effect of licensing in part because it sheds light on the employment effect of licensing. So together the wage and employment effects give us a big part of the labor market picture. The larger the wage effect, the larger the expected employment effect and the larger overall costs to the public. Taken as a whole, this research indicates that licensing has social costs in terms of employment losses, consumer price increases, and other distortions.

But what about the benefits to licensure? Licensing has quality and safety benefits in many cases. However, with the caveat that recent research focuses on specific examples and quality is difficult to measure, most research does not find that licensing improves quality or public health and safety. That's not surprising. The best licensing rules are victims of their own success. For

instance, every state requires that brain surgery be conducted by a licensed physician. Because no state allows unlicensed surgery, economists cannot measure the benefits of licenses versus no licenses. What economists do observe are the effects of rules that are controversial across the states. These rules are controversial precisely because they are of much lower value than the uncontested prohibitions like amateur surgery.

### Interstate Migration

The ongoing decline in migration of American workers is part of what has prompted the general issue in licensing and policy and perhaps interest in interstate compacts.

As mentioned, the interstate migration rate has been cut in half during the last 65 years. The increase in licensing prevalence is one possible contributor. Unfortunately, academic research on the effects of licensure is quite limited. Consequently, Treasury researchers did some of their own work, making use of licensing data that has only become available relatively recently. They found that licensed workers were less likely to switch states and certified workers were more likely to switch states, than non-licensed, non-certified workers, even after controlling for things like education. This is consistent with expectations because licensing is usually state-specific and certifications are often national in scope. They also compared migration within and across states. As it turns out, workers in licensed occupations move about within states at about the same rate as workers in unlicensed occupations, indicating a similar general propensity to move. But those same licensed workers were much less likely to migrate across states than their unlicensed counterparts.

It appears the current state licensing system is impeding worker mobility. This is bad news not just for the workers, but also for wages and job quality, overall employment growth, and the resiliency of the U.S. labor market in times of distress. Particularly in bad times, workers benefit from moving to better labor markets. This relocation has always been what makes the U.S. bounce back particularly quickly from recessions. The good news is none of this is inevitable.

A state-based licensure system can in principle make it easier for workers to move across states and practice across states. This could come from occupational-level efforts, like that of the FSBPT and the nurse licensure compact, and indeed, recent research shows the nurse licensure compact has encouraged more migration across state lines. Another possibility is to achieve license reciprocity on a regional basis. Many Canadian workers enjoy a legal presumption that their licenses are valid across jurisdictions. However it happens, the sheer number of licensed workers makes it crucial that we find ways to make it easier for them when they move or they work across states.

Technological developments are changing the way many professionals interact with their clients. This has implications for ideal licensing policy. Licensing rules may not always keep up with these developments and the state-specific nature of the system can present difficulties. For instance, workers are finding it easier to telework, suggesting that interstate remote work is increasingly possible. But licensing can slow this innovation when it requires that professionals obtain many different licenses to interact with clients in various states. In the focus on interstate

migration, we sometimes lose sight of this problem, but solving it is also an important objective of interstate compacts and reciprocity agreements. More generally, businesses and practitioners are always inventing new ways of serving their customers but licensing rules are only occasionally modified. The rules naturally reflect the business environment that existed when they were originally written.

When an entrepreneur devises a new way to deliver services, it doesn't fit nicely in the established system. For example, companies can now electronically provide certain kinds of legal documents, such as wills, trusts, and patent applications, to their clients. But often such companies run afoul of licensing rules when they expand to a broader set of legal services. Being attentive to these innovations and striving to stay out of their way is a vital part of the balance regulators must strike.

What can be done to reform occupational licensure?

First, ensure that the substantive requirements of licensing, like education and experience requirements, are closely tied to public health and safety concerns. In some states and occupations, required curricula deviate widely from the ostensible purpose of licensing. This can contribute to unnecessarily burdensome overall requirements, which in turn reduces access to the profession and the availability of services to consumers. Poorly targeted or excessive requirements also run the risk of undermining the legitimacy of the licensing system.

Second, institute sunrise review, either through a standing commission or an independent regulatory agency, so automatic cost-benefit analysis proposals for new licensure helps give state policy makers the information they need to craft optimal regulatory policy.

Third, minimize the procedural burdens of acquiring a license in terms of fees, complexity of the requirements, processing time, and paperwork. It's easier said than done and is already the object of many ongoing efforts.

Fourth, ensure that licensing requirements do not unnecessarily exclude those with criminal records, as well as immigrants and veterans. All are at times poorly served by the existing regulatory system. Workers with criminal records are often categorically barred from licensure. Of course, it's reasonable to prevent those with relevant criminal backgrounds from obtaining licensure, for instance a DUI for a commercial driver's license, but other offenses may be less relevant. The reasoning behind such a restriction should be made explicit. Additionally, green card holders and veterans sometimes find it difficult to obtain licenses because their experience and education can differ from the typical path. Adopting competency-based standards is one way to address this.

Fifth, consider increasing the fraction of public representatives on licensing boards. Public members provide a valuable perspective on the problems faced by licensing boards. When public members are carefully selected for their drive and skills, they're integral to making good licensing policy.

Sixth, harmonize licensing requirements across states wherever possible. In many ways this is the natural extension of the suggestions already made. Given that most professions don't change much across the states — rehabilitating a broken arm presumably works the same in Michigan as in Florida — we should expect policy makers to come up with similar rules in all the states, assuming they're all working from the same principles and with the same information. Harmonizing requirements also are useful in and of themselves because they facilitate the movement of licensed workers across states. Even when workers must obtain licenses in each state, a relatively harmonized system is simpler to navigate than a system with widely varying requirements.

Finally, form interstate compacts that make it easier for licensed workers to practice and relocate across state lines, while also enabling state regulators to share practitioner performance histories and improve enforcement. The FSBPT is obviously a pioneer in this area and it's hoped many more professions will follow its lead. One really desirable feature of the FSBPT compact is it avoids categorically excluding workers with criminal records, leaving the decision to individual states. Doing so avoids getting states to agree on a common protocol. One dangerous aspect of a common protocol is it generally gives preference to the standards of the most restrictive states. Many workers can then be shut out of interstate reciprocity. Even more worrying is the potential for this highly restrictive interstate standard to eventually become the common policy of all the states. Thus, it's important to face these hard choices early while compacts are being devised and to make arrangements that are as unrestrictive as possible, consistent, of course, with maintaining effective public protection.

What was learned by writing the report?

First, licensing policy is incredibly varied and often quite complicated. The answer to so many questions depended on the occupation and the state. But many of these differences were hard to justify and moreover could be a problem for both workers and consumers. The sheer organizational difficulty of coming together and streamlining regulatory policy can be a mammoth task that requires patience, careful thinking, and determination. But doing so can be a win-win proposition for workers, consumers, and businesses, which all benefit from the increased flexibility and access provided by an interstate compact or similar arrangement.

Beyond all the differences across states and occupations, almost everyone understands the purpose of licensing to be the protection of public health and safety. This makes things considerably simpler than they otherwise might be. Our common goal therefore is to ensure public protection while minimizing costs to workers and consumers. There will of course be disagreement about how this is best accomplished but at least the report provides a common framework and language for reform.

One major application of these principles is the scope of practice, where the public is usually best served by an expansive interpretation with qualified practitioners permitted to exploit the full range of their skills. Particularly in health care, an expansive understanding of scope of practice maximizes access to care and helps accommodate rising demand for health services.

Policy makers always need to remember to take access to care into consideration and to remember there are a whole host of non-physician medical professionals who are capable of providing high-quality healthcare.

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