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*Occupational Licensing: A Looming Barrier to Entrepreneurship and Upward
Mobility*
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Chairman Nava, Vice Chairman Kaye, and members of the Commission, thank you for the opportunity to testify about the importance of entrepreneurship and the barriers to new business formation caused by occupational licensing.

The Ewing Marion Kauffman Foundation is the world's largest private foundation dedicated to the study and promotion of entrepreneurship. Founded by the late entrepreneur and philanthropist Ewing Kauffman, the Kauffman Foundation is a nonpartisan foundation based in Kansas City, Missouri that aims to foster economic independence by advancing educational achievement and entrepreneurial success. At the Kauffman Foundation, we believe in the power of entrepreneurship to change individual lives and create economic opportunities for many others in society.

Entrepreneurship is an invaluable catalyst for economic growth, creating vibrant communities where opportunity abounds. There are a number of economic indicators pointing to the importance of entrepreneurship. Foremost is the role of new and young businesses in job creation. Nearly all net new jobs are created by new and young companies¹. In 2013, new businesses created 2.29 million jobs in the United States². In California, 53,731 new employer firms created more than 317,000 jobs that same year³.

¹ John Haltiwanger, Ron S. Jarmin and Javier Miranda, "Who Creates Jobs? Small vs. Large vs. Young," *Review of Economics and Statistics*, 2013, at http://www.mitpressjournals.org/doi/pdf/10.1162/REST_a_00288

² Business Dynamics Statistics, United States Census Bureau, at http://www.census.gov/ces/dataproducts/bds/data_firm.html

³ Ibid

Startups are also responsible for a disproportionate share of innovative activity, which raises living standards for all and pushes the boundaries of science, technology, and human knowledge⁴.

This is the good news of entrepreneurship. The bad news is that entrepreneurship, even high-growth entrepreneurship, has been in decline⁵, as epitomized by a slowdown in the usually high-powered technology industry.⁶ Firm entry rates were lower, for example, between 2009 and 2011 than they were between 1978 and 1980 in every state⁷.

The Kauffman Index: Startup Activity is a measure of entrepreneurship that allows states to compare their entrepreneurial performance to others. The Index accounts for three factors: the annual rate of new entrepreneurs; the opportunity share of new entrepreneurs, which are those who were employed before starting their new ventures; and startup density, or the number of new employer businesses by total population in a given area. According to this measure, California ranked 14th out of 50 states in 2015. While this is better than most, California had been ranked nine spots higher in 2014⁸.

If one thing is clear from the data, it is that entrepreneurship cannot be taken for granted. The policy environment matters. Decisions by government officials at the federal, state, and local levels interact to create conditions that are either favorable to new business creation and growth or not. One public policy with particular effects on entrepreneurship is occupational licensing, which

⁴ Natarajan Balasubramanian and Jeongsik Lee, "Firm age and innovation," *Industrial and Corporate Change*, 2008, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1314522; Jesper B. Sørensen and Toby E. Stuart, "Aging, obsolescence, and organizational innovation." *Administrative Science Quarterly*, 2000, at <http://www.jstor.org/stable/2666980>

⁵ Ryan Decker, John Haltiwanger, Ron Jarmin and Javier Miranda, "The Secular Decline in Business Dynamism in the U.S.," Working Paper, 2014, at http://econweb.umd.edu/~haltiwan/DHJM_6_2_2014.pdf

⁶ John Haltiwanger, Ian Hathaway and Javier Miranda, "Declining Business Dynamism in the U.S. High-Technology Sector," The Kauffman Foundation, 2014, at: http://www.kauffman.org/~media/kauffman_org/research%20reports%20and%20covers/2014/02/declining_business_dynamism_in_us_high_tech_sector.pdf

⁷ Ian Hathaway and Bob Litan, "Declining Business Dynamism in the United States," Economic Studies at Brookings 2014, at http://www.brookings.edu/~media/research/files/papers/2014/05/declining%20business%20dynamism%20litan/declining_business_dynamism_hathaway_litan.pdf

⁸ Arnobio Morelix, Robert Fairlie, Joshua Russell, and E.J. Reedy, "The 2015 Kauffman Index: Startup Activity, State Trends," The Kauffman Foundation, 2015, at http://www.kauffman.org/~media/kauffman_org/research%20reports%20and%20covers/2015/05/kauffman_index_startup_activity_state_trends_2015.pdf

creates barriers for would-be entrepreneurs and strengthens incumbent businesses.

The Kauffman Foundation was not the first to recognize the harmful effects licensing has on entrepreneurs, but we have worked to advance understanding of occupational licensing, build awareness about its effects, and educate policymakers about alternative strategies of occupational regulation that facilitate entrepreneurial entry and competition.

In 2012, we published “A License to Grow,” which details several state and federal barriers that can prevent innovative activity in industries like medicine and legal services. That same year, our “Startup Act for the States” report highlighted occupational licensing reform as one of several key issues for state governments to consider. In 2014, we funded a study by the Goldwater Institute that examined the effects of occupational licensing on low-income entrepreneurship. We are currently supporting research lead by Dr. Morris Kleiner at the University of Minnesota to develop a comprehensive database of state licenses and their requirements. We also are working with the Institute for Justice, which is planning several forums to discuss opportunities and options for state-level reform. Through these projects and others, we have refined our understanding of how occupational licensing restricts entrepreneurship.

Undesirable Effects of Licensing

Put simply, occupational licensing fences out entrepreneurs. When states regulate the practice of an occupation through the imposition of a license, the license creates a barrier to entry into the occupation or business. This “fence” is not impermeable, but scaling it can be difficult. To enter a licensed profession, an applicant will commonly have to prove a minimum number of years of education or experience; pay initial licensing fees, which can exceed \$500; pass one or more exams; and be of good moral character and in good legal standing. Many licenses also require licensed professionals to engage in continuing education and pay renewal fees to maintain the license.

Once these requirements are met, the licensed enjoy the protection the “fence” provides them—mainly in terms of higher pay⁹. For this reason, licensing is most often sought by those in the occupation—not by the public or consumer interest groups concerned about ensuring public health and safety. Protected by

⁹ Morris Kleiner, “Occupational Licensing,” *Journal of Economic Perspectives*, 2000, at <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.14.4.189>

the “fence,” the licensed can then control the supply of providers of the service and box out competition¹⁰.

In addition to limiting the number of individuals who can practice that occupation, occupational licensing also restricts how the occupation is practiced, and this limits business innovation.

Entrepreneurs are most successful when they create a new way of doing something or delivering a new product consumers want. This type of “out-of-the-box” thinking is precisely what occupational licensing discourages by mandating specific ways in which the work of an occupation is done. Low cost legal clinics and African hair-braiding are among the new types of services that have been hindered or disallowed because the licensing regulations dictate specific education and training to practice. In the case of an African hair-braider in Utah, she was prohibited from practicing without a valid cosmetology license, even though the cosmetology courses included little to no training for African hair-braiding¹¹.

When entrepreneurs envision new ways to deliver a good or service but are restricted from doing so by license regulations, the economy as a whole suffers. For example, innovations in law and legal services have opened up new markets and providers for services like wills and trusts, but this expansion has not reached broader legal services due to licensing restrictions¹².

As one scholar wrote, “in many fields, advances have resulted from the very ‘crackpots,’ ‘quacks,’ and ‘outsiders’ who have no standing in the profession and whom licensing seeks to eliminate.” According to this scholar, Thomas Edison could not be a licensed engineer under today’s guidelines and architectural greats like Mies van der Rohe and Frank Lloyd Wright would not qualify to sit for the architects’ examination¹³. One wonders what innovations society has missed because occupational licensing prohibited entrepreneurs from pursuing new ideas.

¹⁰ Morris Kleiner and Alan B Krueger, “Analyzing the Extent and Influence of Occupational Licensing on the Labor Market,” *Journal of Labor Economics*, 2013, at <http://archive.hhh.umn.edu/people/mkleiner/pdf/Final.occ.licensing.JOLE.pdf>

¹¹ Jacob Goldstein, “So You Think You Can Be a Hair-Braider?,” *The New York Times*, 2012, at <http://www.nytimes.com/2012/06/17/magazine/so-you-think-you-can-be-a-hair-braider.html>

¹² The White House “Occupational Licensing: A Framework for Policymakers,” 2015, at https://www.whitehouse.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf

¹³ S. David Young, “Occupational Licensing,” *The Library of Economics and Liberty*, 2002, at <http://www.econlib.org/library/Enc1/OccupationalLicensing.html>

The effects of occupational licensing do not end there. Licensing also can restrict upward economic mobility.

Entrepreneurship can function as a ladder, allowing individuals to climb upward to achieve greater economic security. Yet, for those of lesser means and education, licensing fees, the cost to obtain requisite training or coursework, and the time it takes to complete these requirements, may put a licensed job and greater financial security out of reach. Furthermore, character and legal standing requirements may block one avenue of upward mobility for those with a criminal record.

In a study of low-income entrepreneurship, research showed entrepreneurship dropped by 11 percent in states that licensed a high percentage (50 percent or more) of traditionally low-income occupations¹⁴.

Finally, because occupational licensing limits competition (i.e., by restricting the number of people who can perform the occupation), licensing increases consumer costs. Higher prices might be justified if they paid for higher quality, but studies have found little evidence that licensing enhances quality.

For example, an analysis of licensed interior designers in one state and certified interior designers in another state found no difference in the number of consumer complaints registered¹⁵. Another study documented higher rates of electrocution in states with the most restrictive licensing laws for electricians. In this instance, the licensing laws actually failed to have the intended effect and did not increase safety¹⁶.

Growth of Occupational Licensing

These effects are amplified across the economy as more occupations are subject to licensure. Research shows an increase in the percentage of the

¹⁴ Steve Slivinski, "Bootstraps Tangled in Red Tape: How State Occupational Licensing Hinders Low-Income Entrepreneurship," Goldwater Institute, 2014, at <http://www.goldwaterinstitute.org/en/work/topics/free-enterprise/entrepreneurship/bootstraps-tangled-in-red-tape/>

¹⁵ Dick Carpenter, "Regulation Through Titling Laws; A Case Study of Occupational Regulation," *Regulation and Governance Vol 2, Issue 3*, 2008, at <http://onlinelibrary.wiley.com/doi/10.1111/j.1748-5991.2008.00041.x/full>

¹⁶ Morris Kleiner, "Stages of Occupational Regulation: Analysis of Case Studies," Upjohn Institute Kalamzoo, Michigan, 2013.

population that requires a license to practice, from 5 percent in the early 1950s to 29 percent of all American workers in 2009¹⁷.

The growth in licensing has two main sources—one benign, the other more harmful. Economic and demographic changes have contributed to the growth of some occupations that have long been subject to licensure. The number of registered nurses, for example, grew 24.1 percent from 2000 to 2010¹⁸. This natural growth in expanding sectors of the economy like health care and services contrasts with the other source of licensing growth: newly created state licenses.

The number of occupations subject to public occupational licensing is growing in absolute terms. Though no comprehensive dataset on licensing yet exists, anecdotal evidence confirms the push to subject occupations to licensure. Last year in the State of Missouri (where the Kauffman Foundation is located), at least three pieces of legislation were introduced in the General Assembly to create new occupational licenses¹⁹.

Government at all levels (federal, state, and local) is guilty, but most occupations are licensed by the states. Yet, there is little uniformity in what occupations are licensed and the requirements to obtain a license. Security alarm installers, for example, are licensed in 34 states, including California. The State of California requires these workers to pay a fee, pass an exam, and complete more than 900 days of education or training. Neighboring Nevada, however, has no education or training requirement for security alarm installers²⁰. California licenses a number of occupations that are licensed in few states, including tree trimmers (seven other states), landscape workers (ten states), and dental assistants (seven states)²¹.

¹⁷ Morris Kleiner and Alan B Krueger, "Analyzing the Extent and Influence of Occupational Licensing on the Labor Market," *Journal of Labor Economics*, 2013, at <http://archive.hhh.umn.edu/people/mkleiner/pdf/Final.occ.licensing.JOLE.pdf>

¹⁸ Health Resources and Management Association, "The U.S. Nursing Workforce; Trends in Supply and Education," 2013, at <http://bhpr.hrsa.gov/healthworkforce/reports/nursingworkforce/nursingworkforcefullreport.pdf>

¹⁹ H. 109 to license advanced radiology practitioners or radiologic technologists:

<http://www.house.mo.gov/billssummary.aspx?bill=HB109&year=2015&code=R>;

S. 154 to license those practicing music therapy:

http://www.senate.mo.gov/15info/BTS_Web/Bill.aspx?SessionType=R&BillID=216703; and

S. 250 to license electrical contractors:

http://www.senate.mo.gov/15info/BTS_Web/Bill.aspx?SessionType=R&BillID=1225934.

²⁰ Dick Carpenter, "License to Work: A National Study of Burdens from Occupational Licensing," 2012, at <http://licensetowork.ij.org/ca>.

²¹ Ibid

Alternatives to Licensure

Advocates for new occupational licensure frequently argue that licensure is needed to ensure quality and protect the public from unscrupulous, negligent, or dangerous providers. While this may be sufficient and legitimate reason to license some occupations, the case is harder to justify for others.

Policymakers are not faced with a binary choice—to license or not. Licensure is just one option among several forms of occupational regulation. Other forms of regulation can blunt the negative effects licensing has on entrepreneurship and economic mobility while still addressing concerns about public health and safety.

A less-restrictive form of regulation is certification, which allows any individual to perform the service but recognizes those who have achieved a certain level of competency with a certificate. Such a certificate can be issued by the state or a private organization. With certification, consumers have a choice as to whether they want to give their business to a provider with a certificate or not. In this way, certification increases competition, while at the same time opening the door to potential innovation in the practice of an occupation.

An even less restrictive form of regulation is registration, which requires professionals only to record their qualifications with the state. With a list of registered professionals, the state can exercise oversight of the occupation.

In some cases, no regulation may be justified and existing licenses, certificates, or registration requirements eliminated.

Evaluating New Requests for Licensure

The question, then, for policymakers is how to evaluate both existing occupational regulation and new requests for licensure.

To begin, policymakers should assess whether public safety is or has been put at risk by unregulated practice of the occupation. Here, the experience of other states can be useful. While some occupations are licensed by all states, others are licensed only by a few. For example, California licenses travel agents while Texas does not. Has the public been harmed in Texas by unlicensed travel agents? The answer may shed light on the necessity of California's license.

For occupations licensed by multiple states, the requirements can be quite different. As mentioned previously, California is one of more than 30 states that license security alarm installers. To obtain that license in California, an individual

must complete more than 900 days of education or training. Yet, in Texas, only 733 days of education or training are required. And in Nevada, no education or training are required at all²². Do outcomes differ in these states with less rigorous education and training requirements?

If regulation of an occupation is deemed necessary, policymakers next have to decide on the appropriate level of regulation. Protecting public health and safety may be possible with a lesser form of regulation than licensing. The principle to abide by is to apply the appropriate protection at minimal burden. The lower and fewer barriers to entry, the better for entrepreneurship and economy of California.

Finally, states should consider whether there are other more valuable signals of quality than licensing, including online reviews from websites like Yelp and Angie's List. These are free to the state, popular with consumers, and can serve as a guide to assess quality.

Making the System Better for Entrepreneurs

To the extent policymakers value new business creation, innovation, economic mobility, and competition, they should reexamine the necessity of many licensing laws. We recommend the following:

1. Policymakers should eliminate onerous licensing requirements and replace them with less burdensome regulations, if regulation is necessary.
2. If elimination of licenses is politically unfeasible, policymakers should reduce the burdens imposed by licensure by lowering fees and scaling back education requirements to let more entrepreneurs in to facilitate competition and upward economic mobility.
3. Policymakers should resist calls from special interests and operate according to the maxim of "let entrepreneurs compete," recognizing the many benefits of entrepreneurship.
4. Policymakers should consider reforming licensing boards to give greater representation to non-licensed practitioners to protect against regulatory capture.

Thankfully, there is growing interest by conservatives and liberals in reforming occupational licensing laws. Those on the right may be drawn to the issue by their concern for economic liberty and a preference for competition.

²² Dick Carpenter, "License to Work: A National Study of Burdens from Occupational Licensing," 2012, at <http://licensetowork.ij.org/>

Those on the left may be motivated by concerns over wage inequality (which occupational licensing worsens), the burden higher prices place on low-income consumers, and opportunities for upward economic mobility. Whatever the motivation, opportunity exists for bipartisan consensus and action that can positively impact a range of constituents.

State governments in Idaho, Michigan, and Wisconsin have all realized the need to ease the burden licensing places on workers and entrepreneurs. Idaho's governor vetoed a bill last year that would have licensed sign-language interpreters. Michigan Governor Rick Snyder wrote a letter urging legislators to reconsider the licensing regime in the state. And Wisconsin lawmakers passed a bill last year that prevents local governments from establishing new licenses²³.

Interest in reform has also come from the White House. Last year, the President's Council of Economic Advisors published a report laying out the different labor effects of occupational licensing and encouraging states to adjust their licensing policies to better accommodate growth.²⁴

Even the U.S. Supreme Court has weighed in on the anti-competitive effects of occupational licensing. In *North Carolina Board of Dental Examiners v. Federal Trade Commission* the court found that the Board of Dental Examiners was not immune from antitrust laws because the state exercised insufficient oversight of the board, which was controlled by market participants.²⁵

These are encouraging trends. But after decades of unchecked growth in occupational licensure, much work remains to be done. While potentially challenging, if done right, the list of benefits can be substantial, including greater opportunity for entrepreneurs to form businesses, create jobs, and innovate. As entrepreneurs achieve their dreams they advance up the economic ladder, enhance standards and quality of living, and provide new opportunities for those around them.

²³ Eric Morath, "Anti-Licensing Movement Scores a Victory," *The Wall Street Journal*, 2015, at <http://www.wsj.com/articles/anti-licencing-movement-scores-a-victory-1447433906>

²⁴ The White House, "Occupational Licensing: A Framework for Policymakers" 2015, at https://www.whitehouse.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf

²⁵ Brent Kendall "Supreme Court Affirms FTC Antitrust Authority Over Licensing Boards," *The Wall Street Journal*, 2015 at <http://www.wsj.com/articles/supreme-court-affirms-ftc-antitrust-authority-over-licensing-boards-1424881999>