

State of Minnesota  
Sunset Advisory Commission

Testimony of

Lee U. McGrath  
Legislative Counsel  
Institute for Justice  
527 Marquette Avenue-Suite 1600  
Minneapolis MN 55402-1330  
(612) 963-0296  
[www.ij.org](http://www.ij.org)

In Support of Limiting the Power of Licensing Boards

January 17, 2012

Representative Kiffmeyer, Senator Bonoff and members of the Sunset Advisory Commission:

My name is Lee McGrath. I am legislative counsel for the Institute for Justice. Thank you for the opportunity to testify today about the need to reform Minnesota's occupational licensing laws and boards.

The Institute for Justice is a not-for-profit public-interest law firm with offices in Minneapolis and across the country. For 20 years, IJ has represented individuals who ask for nothing more than the opportunity to earn an honest living. In over 30 cases, IJ has defended hair braiders, sign hangers, casket makers, horse teeth floaters, interior designers, taxi drivers and others wanting to apply the skills they gained in a myriad of ways. Our clients provide the services their customers want to buy. But our clients face overbroad licensing requirements that fence them out. In each of these cases, our clients did not object to reasonable health and safety standards. But they did challenge the anti-competitive barriers-to-entry that have nothing to do with health and safety and everything to do with who has the political clout to get those barriers enacted in licensing laws.

**The one big idea that I want to leave you with is that occupational licensing is bad.**

- Licensing laws are bad for consumers. Licensing laws cost consumers across Minnesota an extra \$3 billion annually in higher prices because reduced competition and reduced choices increase prices.
- Licensing laws do not increase consumer protection. They do not weed out incompetents and frauds because licenses are based on academic tests given early in people's careers and administered by boards comprised of insiders who discipline their fellow licensees only in the most extreme cases.
- Licensing laws are bad for workers and entrepreneurs. Licensing reduces jobs and blocks opportunity by limiting entry into an occupation with expensive and unnecessary requirements.

**As a general rule, the State of Minnesota should (1) have a strong policy preference for certification over licensure and (2) restrict licensing boards from limiting entry into occupations.**

### **Types of Occupational Regulations**

There are various ways for legislators to protect consumers. Starting from the least restrictive, legislators may choose to regulate by enacting (1) a cause of civil action to remedy consumer harm, (2) inspections, (3) bonding, (4) registration, (5) certification and (6) licensure.

Registration is the least restrictive type of occupational regulation. It means that you file your name and address with a government agency. You describe your services and you inform the state where you can receive service of process.

Certification is the middle form of occupational regulation. It is a titling act. It means that the legislature establishes requirements involving education or training. If the person meets those requirements he can call himself a certified X. For example, here in Minnesota we have certified interior designers. Anyone can work in the field but only certified interior designers can use that title.

Importantly, certification is voluntary. It allows the applicant to earn and use an important market signal to potential customers that he or she has met the government's standard. The power and beauty of certification is that it sends that signal without fencing out workers and reducing competition. Certification is greatly preferred over licensing because consumers benefit from the market signals but don't have to pay the higher prices caused by licensing.

Licensing is the most restrictive form of occupational regulation. It establishes requirements and tests. Only those who meet the requirements and pass those tests are allowed to work. In other words, certification and licensing are similar in that under both the legislature establishes standards but only under licensing does the state use its powers to exclude workers from pursuing their occupation. As the work of University of Minnesota Professor Morris Kleiner, the leading scholar in the world on occupational regulations, has shown licensing raises prices to consumers but there is little evidence that there is an offsetting increase in consumer protection.

### **Size of Occupational Licensing**

Licensing is one of the biggest issues in labor economics today. Twenty-nine percent (29%) of all workers are licensed by state or federal government. Licensing has grown significantly. In the 1950's only 4% of workers were licensed. But the explosion of licensing laws and the shift to a service economy has caused the growth in licensing. This rate of 29% is larger than the rate of unionism (13%) or the percentage of workers who earn the minimum wage (2.3% of all hourly-paid workers).

### **Social Justice Concerns**

Occupational licensing has a big effect on wages. Unfortunately, it tends to increase the disparity in wages. Unlike unionism that tends to increase wages for workers and shrinks the disparity between the top and bottom of pay scales, licensing tends to reward the rich and raise the wages of top earners. Thus, the professional class earns bigger rewards because licensing reduces competition and increases wages in professional fields. In essence, licensing has a reverse-Robin Hood effect.

If you are concerned about a growing income gap, you should be concerned about licensing because it exacerbates those negative trends.

Secondly, if you are concerned about the education gap, you should be concerned about the growth of licensing. Licensing is based on tests that tend to measure academic achievement and not necessarily practical skills. By basing labor policy on academic tests, the state and licensing boards are closing doors and reducing upward mobility for those who do not have access to or choose not to pursue higher education.

Third, every state legislator wants this country to fulfill its promise of being the land of opportunity. Through hard work, everyone, regardless of where they are born or their physical traits, should have the chance to live the American dream. It is important for the State not to put irrational obstacles to the realization of that dream. Licensing closes off non-traditional career paths. Lots of people learn on the job and advance to high positions. Licensing does not recognize or reward that. It does not allow for the diverse way that people learn and advance. It rigidly establishes one path, usually formal education, and makes it the only path. This is contrary to the American ideal of opportunity. It reflects the social structure and rigidity of medieval guilds of continental Europe. It should not be the dominant policy that legislators use to regulate the work in America.

Finally, licensing is undemocratic. You have experienced the parade of lobbyists who come to your offices. They want to be regulated. They are not acting on behalf of the millions of consumers in Minnesota who will pay higher prices without offsetting benefits. They are not acting on behalf of hard working Minnesotans who are not members of trade associations. They are exploiting the public-choice problem of concentrated benefits and dispersed cost. Reforming occupational regulations will not end special-interest politics but it will empower you to demand evidence of real harm and choose certification over licensing.

## **Economics Concerns**

Replacing licenses with certifications in Minnesota is good public policy because certification avoids the problems of monopolies inherent in licensing.

First, licensing reduces employment growth thereby contributing to unemployment. These barriers fence out people who may be qualified but have not gained the credentials through the exact means identified in a licensing law such as a written test or undergraduate or graduate degree.

Estimates developed by Professor Kleiner, Professor Alan Krueger, former Assistant Secretary and Chief Economist in the U.S. Treasury and Professor Alexander Mas, former Chief Economist at the Department of Labor and Chief Economist at Office of Management and Budget under President Obama,

showed the cost of licensing nationally in the form of lost jobs to be approximately 0.5 to 1.0 percent of all workers. Applying that same approach to Minnesota would result in a reduction in the unemployment rate in Minnesota or a gain of approximately 15,000 jobs if licensing were reduced in the state relative to certification or other less restrictive forms of regulation.

Secondly, licensing causes consumers to pay higher prices. By shrinking the available supply of labor, licensing increases prices by 15% or more. Certification does not influence wages and then prices. Less competition means that consumers pay more and have less variety to choose for the services they need. A number of years ago, students at the Humphrey School analyzed the cost of licensing to consumers in Minnesota. They found that the extensive use of licensing cost consumers in Minnesota to pay an incremental \$3 billion a years in higher prices, with no clear benefits.

Third, licensing alleges that it will increase consumer protection by screening out incompetents and frauds. Although we may wish this to be true, there is little to no evidence for it. Additionally, some legislators tend to grandfather in everyone working when licensing is enacted thus eliminating screening altogether. And licensing boards rarely revoke licenses and depend on the licensees for their operating budgets through the payment of licensing fees

Among the many professions that Professor Kleiner has studied are mortgage bankers. What his research with Richard Todd at the Federal Reserve Bank of Minnesota showed is that those states that licensed mortgage bankers had similar default rates as those states that did not license brokers. A major difference is that in states with licensed brokers the fees that consumers had to pay for loans were higher. Professor Kleiner has generally found those same findings in the other occupations that he has researched or seen in the research of others.

The reality is that licensing reduces employment growth and contributes to unemployment and increases costs to consumers. The main groups that win under licensing are those who are licensed. Certification has none of the problems of licensing such as raising prices or restricting employment. It provides consumers more choice at a lower price than occupational licensing.

## **Recommendation**

Legislators should have a strong public policy preference for certification and should enact legislation that turns licenses into certifications. Certification is better than licensing for three reasons.

First, certification has benefits over licensing for workers. Certification does not fence out workers or cause the type of problems in labor markets that licensing does. Licensing may cause workers to lose the opportunity to move into the middle class because of the barriers to entry. A reduction in licensing requirements could reduce unemployment in the State. Licensing further reduces the ability

of workers to move across state lines, and engage in work that is the most beneficial to them and to society. Certification of practitioners does not have these negative features.

Secondly, certification is better for consumers than licensing. Similar to licensing, certification sends a signal to consumers about who has met the government's requirements. However, it does not reduce competition and it does not cause prices to increase the way licensing does. It gives consumers more choices for the kinds of services they need.

Thirdly, certification is better for state government than licensing. It reduces the unnecessary and often excessive lobbying by trade associations to try to convince legislators to enact and the governor to implement licensing regimes under the assumption of protecting the public. Often lobbyists claim that licensing is needed to screen out frauds and incompetents. There is little evidence to support this claim. But licensing laws do offer lobbyists and their trade associations a way to deliver less competition and higher earnings for their members.

## **Conclusion**

Occupational licensing laws are a fatally flawed type of regulation. They create barriers to entry that decrease competition, jobs and consumer choices and provide no real consumer protection. Instead, legislators should free entrepreneurs to start businesses and create jobs. If truly necessary for the protection of health and safety, legislators can enact less restrictive types of occupational regulations such as certifications and inspections. This Commission should recommend that the State of Minnesota (1) establish a strong policy preference for certification over licensure and (2) reduce the authority of licensing boards to limit entry into occupations.

Thank you.