Occupational licensing – how much and what effects?

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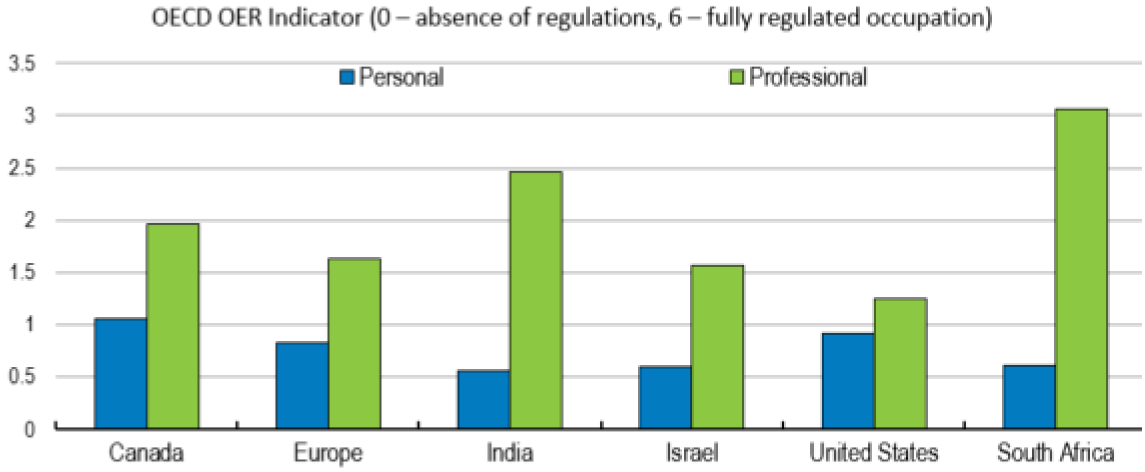
Occupational licensing – the legal authorisation from a national authority or a professional association to practice a specific occupation – is one of the fastest-growing labour market institutions since World War II (Kleiner and Krueger, 2010). It is not just lawyers, architects and engineers that have to comply with minimum human capital requirements, administrative burdens or mobility restrictions, in order to demonstrate professional aptitude and protect the public from unqualified, incompetent or unscrupulous providers. Offering skincare or hair removal services as a licensed cosmetologist in Pennsylvania, for instance, takes 1250 hours of training, a state exam and a blank criminal record, and to become a baker in France one needs to take a 7 hour long state exam (Institute of Justice, 2018; Von Rueden and Bambalaite, 2020). These occupational entry regulations (OER) often reduce both business dynamism and employment, and generate higher prices for customers. However, despite their ubiquity, evidence about the intensity, scope and effects of OER has so far been confined to selected countries and/or professions, thus impeding cross-country and cross-occupational comparability on a larger scale. Also, their potential effects on productivity growth have been ignored.

New cross-country measures call for a review of OER and the need for more regional integration

Using new data on OER, OECD economists (Von Rueden and Bambalaite, 2020) shed light on the scope and stringency of these regulations for a set of 18 OECD countries, India and South Africa – with Canada and the United States being covered at the province-level or state-level – in ten personal (aestheticians, bakers, butchers, driving instructors, electricians, hairdressers, painters, plumbers, taxi drivers, and nurses) and five professional services (accountants, architects, civil engineers, lawyers and real-estate agents). The results illustrate that even countries sharing the same public goals in terms of safety and consumer satisfaction, sometimes apply very different approaches in pursuing them (Figure 1). Looking at successful experiences abroad, countries can learn from each other about ways to achieve these goals with lighter occupational entry requirements. More strikingly, regulatory approaches vary a great deal even within federal countries such as the US or Canada or economic unions such as the EU (Figure 2). Despite a myriad of policy initiatives aimed at facilitating the movement of professionals across these areas, these findings suggest the need for further integration efforts at the federal and international level.

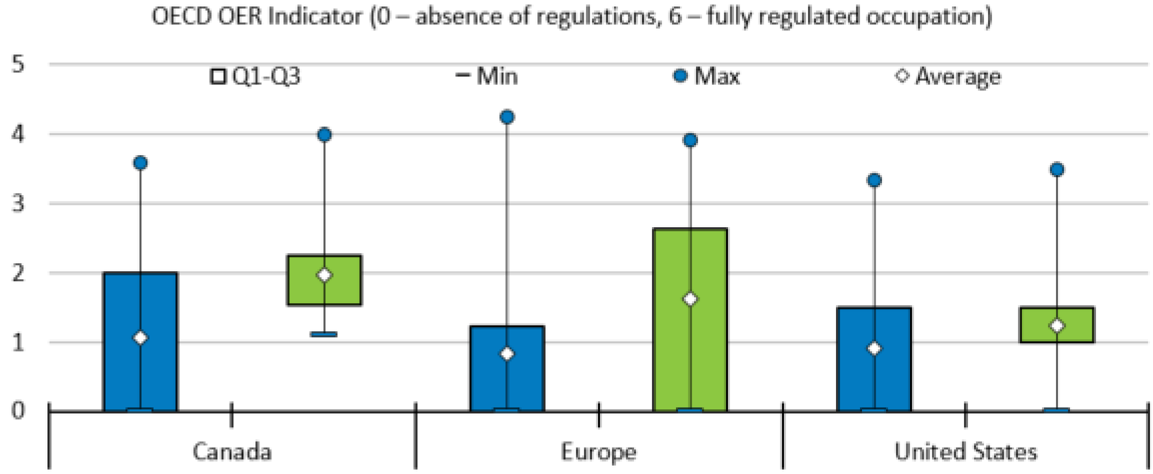
Figure 1. The stringency of occupational entry regulations varies a lot across regions



Note: The stringency of occupational entry regulations is measured by the OECD OER Indicator, where a value of 0 indicates the absence of regulations and 6 reflects a fully regulated market. Personal services reflect the unweighted average of OER scores for aestheticians, bakers, butchers, driving instructors, electricians, hairdressers, painters, plumbers and taxi drivers. Professional services capture the unweighted average for OER values of accountants, architects, civil engineers, lawyers and real-estate agents. Regulations for Canada and US are measured at province/state level. Europe refers to the unweighted average of Austria, Belgium, Finland, France, Germany, Hungary, Iceland, Italy, Poland, Portugal, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom. Regulations for India refer to the state of Delhi.

Source: Von Rueden and Bambalaite (2020).

Figure 2. The dispersion of regulatory approaches within economic areas suggests incomplete economic integration



Note: Blue bars refer to personal services (include aestheticians, bakers, butchers, driving instructors, electricians, hairdressers, painters, plumbers and taxi drivers); green bars refer to professional services (accountants, architects, civil engineers, lawyers and real-estate agents). The stringency of occupational entry regulations is measured by the OECD OER Indicator, where a value of 0 indicates the absence of regulations and 6 reflects a fully regulated market. Regulations for Canada and US are measured at province/state level. The European sample includes Austria, Belgium, Finland, France, Germany, Hungary, Iceland, Italy, Poland, Portugal, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom.
Source: Von Rueden and Bambalaite (2020).

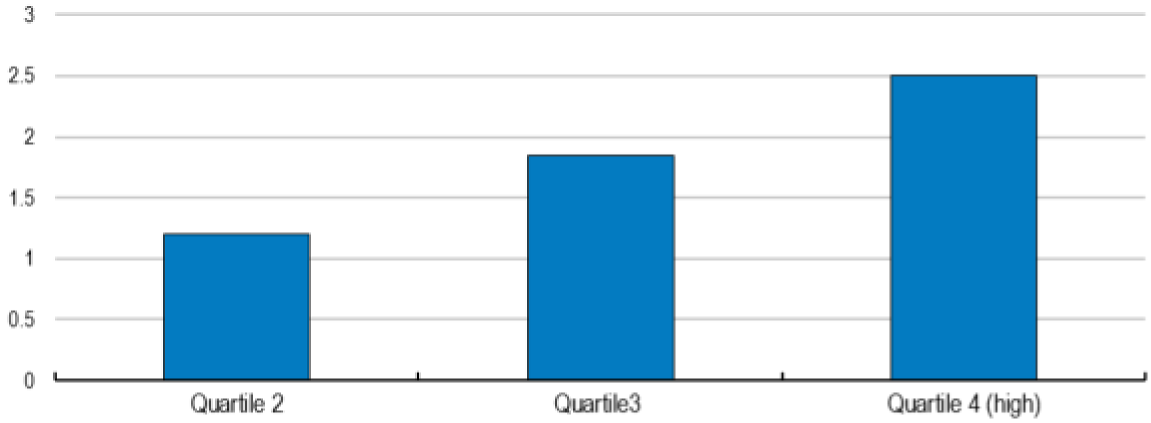
Ill-designed occupational entry regulations can curb productivity in services

While there is abundant evidence on the side effects of OER on the economy – via less firm entry, lower employment and higher prices (e.g. Athanassiou et al. 2015; Blair and Chung, 2018; Cahuc and Kramarz, 2004; Larsen et al., 2019; Kleiner et al., 2016; Kleiner, 2017; Kleiner and Soltas, 2019) – evidence on the effects of occupational entry regulations on firm-level and aggregate productivity growth is scant. Yet, by creating barriers to entry, OER might also unduly protect incumbents, stifle business dynamism and prevent the most productive firms from gaining market shares, weighing down on productivity growth in economies that are increasingly driven by entrepreneurial initiative and innovation. This concern arises especially at a time when governments are fiercely seeking ways to reverse the persistent productivity slowdown in advanced economies.

Looking at the effects of OER on the performance of firms that are subject to them, Bambalaite et al. (2020) highlight two channels through which productivity could be adversely affected. First, OER could lower firms' incentives and capabilities to improve productivity by adopting best practices and hire the best professionals by curbing entry, competitive pressures and business dynamism. Estimations suggest that if those regulations were aligned on the least stringent ones, productivity could indeed increase by over 1.5 percentage points on average across occupations and firms, with the greatest gains accruing to high productive firms (Figure 3). Considering that the average productivity growth of the firms in the sample is less than half a percentage point per year, this increase would be significant. Second, OER can undermine the ability of the most productive firms to grow by limiting the supply of skilled professionals and their ability to move across firms within occupations, across occupations and across geographic jurisdictions (Johnson and Kleiner, 2020). In this regard, Bambalaite et al. (2020) estimate that in countries like Germany or Italy (where OER are the most stringent among the EU countries surveyed) easing occupational entry requirements to meet Swedish standards (which are the most lenient) could increase by over 10 percent the contribution of labour reallocation to employment growth in the personal and professional services covered in their analysis.

Figure 3. Easing regulations would mostly benefit highly productive firms

Productivity gains from reducing the level of occupational entry regulation regulations from high (GER) to low (SWE) levels, by productivity quartile (quartile 4 = high productivity level)



Note: This figure shows the ceteris paribus impact of a reduction in the average stringency across a set of eight personal and three professional services, of occupational entry requirements from German to Swedish levels (equivalent of a one unit decrease), based on estimation results from a sample of 15 European countries used in the analysis. The stringency of occupational entry regulations are measured by the OER indicator introduced in Von Rueden and Bambalaite (2020).
Source: Bambalaite et al. (2020); Calculations based on ORBIS and OER Indicator.

For
policy makers, the time to act is now

In light of the renewed evidence on the undesired economic consequences of ill-designed regulations, appropriate strategies for reforming occupational regulations are urgently warranted. While preserving their public policy aims, occupational entry regulations could be usefully reviewed by (1) making means more proportionate to ends (e.g. aligning on successful experiences abroad); (2) shifting the focus from inputs to outputs when the purpose of the regulation is to ensure that the outcome (such as a building standard or the quality of meat sold) rather than the service itself is of desired quality (e.g. via ex-post evaluation); (3) extending mutual recognition of entry requirements across jurisdictions (especially within federal countries and economic unions) and (4) eliminating mobility restrictions that create unnecessary labour market rigidities. Regulators should also consider whether licensing systems could be replaced with lighter alternatives, such as certification schemes, and where information asymmetry concerns persist, alleviate those through online consumer information platforms (e.g. leveraging on reliable service quality review systems).

See also: Rethinking occupational entry regulations on VoxEU

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