THE COST OF EXCESSIVE OCCUPATIONAL REGULATION AND WHAT ANTITRUST LIABILITY FOR LICENSING BOARDS CAN DO ABOUT IT

By Rebecca Haw

This testimony reflects only my views on the subject and not that of Vanderbilt Law School or Vanderbilt University. It draws from Aaron S. Edlin & Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, U. PA. L. REV. (forthcoming 2014), a draft of which is available at http://ssrn.com/abstract=2384948.

Introduction

Although often overlooked, state licensing boards have become a significant exception to the Sherman Antitrust Act's ban on cartels. Boards are largely dominated by active members of their respective industries who meet to agree on ways to limit the entry of new competitors. But professional boards, unlike cartels in commodities or consumer products, are sanctioned by the state—even considered *part* of the state—and so are often assumed to operate outside the reach of the Sherman Act under a doctrine known as state action immunity.

The cost of the cartelization of the professions is on the rise. In the 1950s, only about five percent of American workers were subject to licensing requirements; now nearly a third of American workers need a state license to perform their job legally, and this trend is continuing.[1] Some recent additions to the list of professions requiring licenses include locksmiths, beekeepers, auctioneers, interior designers, fortune tellers, tour guides, and shampooers. And even the traditionally-licensed "learned professions" are seeing a proliferation of licensing restrictions and regulations.

The excesses of professional licensing are easy to illustrate. Cosmetologists, for example, are required on average to have ten times as many days of training as Emergency Medical Technicians (EMT). In Alabama, unlicensed practice of interior design was a criminal offense until 2007. In Oklahoma, one must take a year of coursework on funeral service (including embalming and grief counseling) just to sell a casket, while burial without a casket at all is perfectly legal. And in some states, nurse practitioners must be supervised by a physician, even though studies show that nurse practitioners and physicians provide equivalent quality of care where their practices overlap.[2]

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[1] *See* Morris M. Kleiner & Alan B. Krueger, *Analyzing the Extent and Influence of Occupational Licensing on the Labor Market*, 31 J. LAB. ECON. S173, S198 (2013).

[2] Morris M. Kleiner, et al., *Relaxing Occupational Licensing Requirements: Analyzing Wages and Prices for a Medical Service*, NBER Working Paper No. 19906 (February 2014).

Labor economists have shown that the net effect of licensing on the quality of professional services is unclear.[3] What is clear, according to their empirical studies, is the effect of licensing on consumer prices. Morris Kleiner, the leading economist studying the effects of licensing on price and quality of service, estimates that licensing costs consumers $116 to $139 billon every year.[4] And consumers are not the only potential losers, since more licensing means fewer jobs. To be sure, not all licensing rules are harmful. Some improve service quality and public safety enough to justify the costs, but many do not.

Despite wide recognition of the potential for economic harm associated with allowing professions to control their licensing rules and define the scope of their art, real reform is elusive. Part of the reason is that, in the professional licensing context, the most powerful legal tool against anticompetitive activity appears unavailable. Most jurisdictions interpret the Sherman Act to shield licensing boards from antitrust liability despite the fact that the boards often look and act like antitrust law's principal target. Other avenues for reform, including constitutional suits asserting the rights of would-be professionals, have done little to slow or reverse the trend towards cartelized labor markets.

Last year, in *North Carolina State Board of Dental Examiners v. FTC*,[5] the Federal Court of Appeals for the Fourth Circuit upheld an FTC decision finding a state licensing board liable for Sherman Act abuses, becoming the only appellate court to expose a licensing board to antitrust scrutiny and thereby creating a split between circuit courts. The Supreme Court has now granted certiorari, and one hopes the Court will take this opportunity to hold boards composed of competitors to the strictest version of its test for state action immunity.

In this testimony, I will cover three topics. First, I will sketch the economics of licensing, and the forces that gave rise to our system of professional self-regulation. Then I will discuss antitrust law as what I consider the most effective federal intervention in this otherwise state-level issue. Finally, I will briefly explain the legal landscape that gave rise to the circuit split over state action immunity for licensing boards and explain what I consider the Court's best course of action in next term's *North Carolina State Board of Dental Examiners*.

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[3] *See* CAROLYN COX & SUSAN FOSTER, BUREAU OF ECON., FTC, THE COSTS AND BENEFITS OF OCCUPATIONAL REGULATION 21–27, 40 (1990).

[4] MORRIS M. KLEINER, LICENSING OCCUPATIONS: ENSURING QUALITY OR RESTRICTING COMPETITION? 115 (2006).

[5] 717 F.3d 359 (4th Cir. 2013).

I. Occupational Licensing Boards: The Road to Cartelization

A. The Scope of Professional Licensing: Big and Getting Bigger

Once limited to a few learned professions, licensing is now required for over 800 occupations.[6] And once limited to minimum educational requirements and entry exams, licensing board restrictions are now a vast, complex web of anticompetitive rules and regulations. The explosion of licensing and the tangle of restrictions it has created should worry anyone who believes that fair competition is essential to national economic health.

The expansion of occupational licensing has at least two causes. First, as the U.S. economy shifted away from manufacturing and towards service industries, the number of workers in licensed professions swelled, accounting for a greater proportion of the workforce. Second, the number of licensed professions has increased. Where licensing was once reserved for lawyers, doctors, and other "learned professionals," now floral designers, fortune tellers, and taxidermists are among the jobs that, at least in some states, require licensing.

Since boards are typically dominated by active members of the very profession that they are tasked with regulating, this dramatic shift toward licensing has put roughly a third of American workers under a regime of self-regulation. A study I conducted with my co-author Aaron Edlin revealed that license-holders active in the profession have a majority on 90% of boards in Florida and 93% of boards in Tennessee. Given this composition, it is not surprising that boards often succumb to the temptation of self-dealing, creating regulations to insulate incumbents rather than to ensure public welfare.

B. The Anticompetitive Potential of Occupational Licensing

The anticompetitive potential of licensing is best illustrated with actual regulations passed by practitioner-dominated boards. What follows is by no means a complete list of excessive regulations, but it serves as a sample.

1. The New "Professions"

In Louisiana, all flower arranging must be supervised by a licensed florist, a scheme successfully defended in court as preventing "the public from having any injury" from exposed

[6] KLEINER, *supra* note 4, at 5.

picks, broken wires, or infected flowers.[7] Minnesota (along with several other states) now defines the filing of horse teeth as the practice of veterinary medicine, a move that has redefined an old vocation as a regulated profession subject to restricted entry and practice rules despite the fact that many consider the practice to be low-skill and low-risk. Similarly, state cosmetology boards have responded to competition from African-style hair braiders and eyebrow threaders by demanding that braiders and threaders obtain cosmetology licenses before they can lawfully practice their craft, even though practice requires no sharp instruments or chemicals, and involves no significant risk of infection.

2. Old Professions, New Restrictions

In many states, dental licensing boards restrict the number of hygienists a dentist can hire to two, a practice the FTC argues raises price but has no effect on quality of dental care.[8] Similarly, the advent of nurse practitioners and physician assistants has ignited a turf war between these "physician extenders" and doctors, resulting in a national patchwork of regulation related to physician supervision despite the fact that outcome studies reveal that unsupervised extenders' services are as safe and effective as that of supervised extenders. Lawyers, too, use licensing to limit competition: advertising restrictions insulate lawyers from competition from other lawyers who can claim better average outcomes for clients. Moreover, each state has its own bar exam and licensing procedure, which reduces lawyer mobility across state lines. The justification for this is colorable—a different exam is necessary for each jurisdiction because of differing state laws—but it fails to account for practices such as California's requirement that lawyers qualified in other states retake the multistate portion of the exam when sitting for the California bar.

C. How We Got Here: Why License, and Why Self-Regulate?

1. The Economics of Licensing

The past twenty years have witnessed an explosion of empirical work on the effects of licensing restrictions on service quality and price. Economists agree that a licensing restriction can only be justified where it leads to better quality professional services—and that for many restrictions, proof of that enhanced quality is lacking.

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[7] Meadows v. Odom, 360 F. Supp. 2d 811, 824 (M.D. La. 2005), *vacated as moot*, 198 F. App'x 348 (5th Cir. 2006).
[8] J. NELLIE LIANG & JONATHAN D. OGUR, BUREAU OF ECON. STAFF REP. TO THE F.T.C., RESTRICTIONS ON DENTAL AUXILIARIES: AN ECONOMIC POLICY ANALYSIS 44–47 (1987).

a. The Costs of Licensing: Higher Consumer Prices

Studies that have the statistical power to identify a relationship between licensing and wages tend to suggest that licensing requirements raise wages by 10% to 18%, which has an obvious effect on consumer prices.[9] Likewise, most studies examining practice restrictions show that when a licensing board is more heavy-handed in dictating hours, advertising, or levels of supervision within a profession, the consumer prices are higher. For example, restricting the number of hygienists a dentist may employ increases the cost of a dental visit by 7%,[10] and in optometry, restrictions on advertising have been shown to inflate prices by at least 20%.[11] Geographic restrictions—like nonreciprocity between states—also tend to increase consumer prices.[12]

But to get a complete picture of the economic harm from professional licensing, one needs a theory of how efficiently an unrestricted market would function. Advocates of licensing argue that the free market would do a poor job of efficiently allocating professional services to consumers because service quality would be too low without licensing. To the advocates of professional licensing, measuring the value of licensing by observing its effect on prices misses the point.

The notion that a free market would result in too-low quality service rests on two possible sources of failure in the market for professional services. First, absent licensing, the asymmetry of information between professional providers and consumers about the quality of service would create what economists call the "lemons problem." Second, free markets for professional services would result in sub-optimal quality because the market participants (providers and consumers) do not internalize all the costs of bad service. In other words, a free market for professional services creates negative externalities. But if licensing has *any* effect on the market failures it is designed to address, then it should improve service quality.

b. The Benefits of Licensing: Improved Quality?

The economic research on quality of service as a function of licensing paints a murky picture. Some studies show modest increases in quality, at least for some kinds of consumers, but

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[9] Morris M. Kleiner, *Regulating Occupations: Quality or Monopoly?*, EMP'T RESEARCH (W.E. Upjohn Inst., Kalamazoo, Mich.), Jan. 2006, at 2 tbl.1, *available at* http://research.upjohn.org/empl_research/vol13/iss1/1.

[10] LIANG & OGUR, *supra* note 8, at 40, 43.

[11] John E. Kwoka, Jr., *Advertising and the Price and Quality of Optometric Services*, 74 *AM. ECON. REV.* 211, 216 (1984).

[12] One study estimated that universal reciprocity between states for dentists would result in a geographical reallocation of dentists generating $52 million (in 1978 prices) in consumer surplus. Bryan L. Boulier, *An Empirical Examination of the Influence of Licensure and Licensure Reform on the Geographical Distribution of Dentists*, *in* OCCUPATIONAL LICENSURE AND REGULATION 73, 94–95 (Simon Rottenberg ed., 1980).

other studies do not find that same effect. A few studies even claim to show that licensing *reduces* quality.[13]

2. The Durability of Our System of Professional Self-Regulation

If licensing can at least theoretically benefit consumers, why do we see so many obviously harmful licensing restrictions? The answer may lie with our current system of professional self-regulation, and its striking durability in the face of wide-spread criticism. When it comes to professional regulation, states have largely handed the reins of competition over to the competitors themselves. States justify this move by arguing that expertise is essential to creating efficient regulations, but it creates an obvious temptation of self-dealing. In any other context, antitrust law could be used to prevent combinations of competitors from maximizing their own welfare at the expense of consumers. But because the dominant interpretation of antitrust immunity holds boards immune from Sherman Act scrutiny, antitrust law has until now had little impact on professional regulation. That leaves only constitutional avenues of redress, which have proven to be weak against self-dealing boards.

a. State Action Immunity Shields State Licensing Boards from Antitrust Liability

The Supreme Court first created antitrust immunity for "state action" in *Parker v. Brown*,[14] shielding state governments and bodies delegated a state's authority from federal antitrust liability. In holding that the Sherman Act does not apply to state government action, the Court found the identity of the actor—the state or private citizens—essential but provided no guidance on how to draw the line. This created serious problems for lower courts trying to apply *Parker* because states rarely regulate economic activity directly through a legislative act. Rather, states delegate rulemaking and rate-setting to agencies, councils, or boards dominated by private citizens.

The Court responded in 1982 with *California Retail Liquor Dealers Ass'n v. Midcal Aluminum*,[15] which provided a test to distinguish private action from state action. To enjoy state action immunity, the Court held, the challenged restraint must be "one clearly articulated and affirmatively expressed as state policy to restrict competition," and the policy must be "actively supervised by the State itself." Since *Midcal*, however, the Court has created a category of entities not subject to the supervision requirement at all.[16] These entities, which include

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[13] For a comprehensive discussion of this research, see Aaron S. Edlin & Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, U. PA. L. REV. (forthcoming 2014), a draft of which is available at http://ssrn.com/abstract=2384948.

[14] 317 U.S. 341 (1943).

[15] 445 U.S. 97 (1980).

[16] See Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985).

municipalities, enjoy immunity if they can meet the clear articulation prong alone. The circuits are split on whether state licensing boards are like municipalities in this respect; in particular, whether licensing boards dominated by competitors—who regulate the way they compete and exclude would-be competitors—enjoy state action antitrust immunity without being supervised by the state. The Supreme Court is poised to resolve this split in next term's *North Carolina State Board of Dental Examiners*. The last section of this testimony will further explore the legal question in that case.

b. The Common Route to Challenging State Licensing Restraints: Due Process and Equal Protection

With powerful antitrust immunities in place, the only viable avenue for consumers or would-be professionals seeking to challenge the actions of state licensing boards is to make a constitutional claim. Like all state regulation, professional licensing restrictions must not violate the due process and equal protection clauses of the Fourteenth Amendment. Due process prevents a state from denying someone his liberty interest in professional work if doing so has no rational relation to a legitimate state interest. Similarly, equal protection requires that states distinguish licensed professionals from those excluded from practice on some rational basis related to a legitimate state goal. The two analyses typically conflate into one question: did the licensing restriction serve, even indirectly or inefficiently, some legitimate state interest?

That burden is easy to meet, as illustrated by *Williamson v. Lee Optical*,[17] the leading Supreme Court case on the constitutionality of professional licensing schemes. Indeed, the Court has only once found an occupational licensing restriction to fail rationality review, in *Schware v. Board of Bar Examiners of New Mexico*,[18] and then only because an otherwise valid licensing requirement was unlawfully applied to an individual. In applying *Schware* to the activity of state licensing boards, lower courts have found even extremely thin justifications for anticompetitive licensing restrictions to suffice for rationality review. One circuit has even held that insulating professionals from competition is *itself* a legitimate state interest, making matters even more difficult for plaintiffs alleging harm to competition.

[17] 348 U.S. 483 (1955).
[18] 353 U.S. 232 (1957).

II. Why Sherman Act Liability for State Licensing Boards is a Good Idea

A. Antitrust Liability for Professional Licensing: An Economic Standard for Economic Harm

The Sherman Act--famously called "the Magna Carta of free enterprise"[19]--protects competition as a way to maximize consumer welfare. According to courts and economists alike, competition is harmed when competitors restrict entry or adhere to agreements that suppress incentives to compete. The normative question in both traditional cartel cases and licensing contexts should be the same: Does the combination, on net, improve consumer welfare? To ensure that this important question is asked and answered in the licensing context, antitrust law and its tools for balancing pro- and anticompetitive effects should be brought to bear on licensing schemes.

This close fit between the Sherman Act's intended target and the economic harm of excessive licensing can be seen in the functional equivalence of the restrictions promulgated by occupational boards and the business practices held unlawful under § 1. The Ohio Rules of Professional Conduct prohibit attorneys from advertising their prices using words such as "cut rate," "discount," or "lowest." But when similar restrictions on price advertising are imposed by private associations of competitors, rather than as a licensing requirement, it is per se illegal. Additionally, all lawyers must prove their "good moral standing" to join a state bar. But when a multiple listing service (a private entity not created by the state) comprised of competing real estate agents tried to impose a "favorable business reputation" requirement on its members, a court found the requirement to violate the Sherman Act because the standard was vague and subjective.

Thus, licensing schemes can be similar to cartel agreements in substance, which alone may justify antitrust liability. But making matters even worse for consumers, licensing schemes come in a particularly durable form. Licensing boards, by their very nature, face few of the cartel problems that naturally erode price and output agreements between competitors. By centralizing decision making in a board and endowing it with rulemaking authority through majority voting, professional competitors overcome the hurdle of agreement that ordinarily inhibits cartel formation. Cheating is prevented by imposing legal and often criminal sanctions--backed by the police power of the state--on professionals who break the rules. Finally, most cartels must fend off new market entrants from outside the cartel that hope to steal a portion of its monopoly rents. For licensed professionals, licensing deters entry and ensures that all professionals (at least those practicing legally) are held to its restrictions.

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[19] United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972).

B. Antitrust Federalism: Its Modern Justifications and Applicability to Antitrust Liability for Licensing Boards

The most serious argument against Sherman Act liability for state licensing boards is that it would upset the balance between state and federal power struck in *Parker* and its progeny. But an examination of the normative commitments behind antitrust federalism, as revealed in scholarship and in the cases, reveals that boards--as currently comprised--should not enjoy immunity. All accounts of the purpose of antitrust federalism agree that self-dealing, unaccountable decision-makers should face antitrust liability. State licensing boards fall squarely in this category when a majority of members are competitors subject to or benefitting from the boards' rules.

For state licensing boards, the temptation of self-dealing is especially high and the potential for holding officials accountable especially low. First, those most hurt by excessive professional restrictions—consumers—are particularly ill-represented in the political process of licensure. Second, and most important, occupational licensing is currently left up to members of the profession themselves. When *Parker* is used to protect the efforts of incumbent professionals to restrict entry into their markets, it creates the very situation *Midcal* warned against—it casts a "gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."[20]

Public participation in state board activity is very low because as our empirical study of boards in Florida and Tennessee confirms, the typical state board is comprised of appointed professionals, not consumers or other public members. On one hand, practitioner dominance is inevitable. Tailoring restrictions to benefit the public (namely, encouraging competent practice) usually requires experience in the profession. But the need for expertise creates a problem: those who have the most to gain from reduced consumer welfare in the form of higher prices are tasked with protecting consumer welfare in the form of health and safety—the fox guards the henhouse.

III. *North Carolina State Board of Dental Examiners* and the Future of Immunity for Licensing Boards

Because any state mandate calling for the regulation of entry and good standing in a profession is likely to meet the Court's low bar for clear articulation, a board's status under *Parker* turns on whether it is subject to *Midcal*'s requirement of supervision at all. Next term, the Supreme Court will consider this question for the first time. The case, *North Carolina State*

[20] Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 106 (1980).

Board of Dental Examiners, is an appeal from a Fourth Circuit case that held a licensing board to both *Midcal* prongs, creating a circuit split and delivering a victory to consumers and unlicensed professionals harmed by anticompetitive regulation. The Supreme Court should affirm the Fourth Circuit's decision, but also clarify, in contrast to the concurrence in the Fourth Circuit case below, that any board dominated by practitioners must pass Midcal's supervision requirement, no matter how the board's membership is elected.

The legal question in *North Carolina State Board of Dental Examiners* has its roots in *Town of Hallie v. City of Eau Claire*,[21] where the Court found a municipality immune under *Parker* because it acted pursuant to the state's clearly articulated policy to displace competition, despite being unsupervised. The Court reasoned that, for municipalities, supervision is unnecessary because there is no "real danger that [it] is acting to further [its] own interests, rather than the governmental interests of the State." Although *Hallie* did not provide a test for determining which entities, in addition to municipalities, are entitled to this fast track to immunity, a footnote provided a hint: "In cases in which the actor is a state agency, it is likely that active state supervision would also not be required, although we do not here decide that issue."

Many courts concluded that occupational boards are among the "state agencies" to which the *Hallie* Court was referring, and thus exempted them from Midcal's supervision prong. Other courts equivocated, implying the possibility of needing supervision without holding so squarely, at least until last year when the Fourth Circuit decided *North Carolina Board of Dental Examiners v. FTC*.[22] This case is correctly decided because practitioner-dominated boards are very different from municipalities, which make decisions through elected officials and civil servants. In the case of incumbent-dominated boards, it cannot be said that "there is little or no danger" of self-dealing. For that reason, the Court should affirm the Fourth Circuit opinion holding licensing boards to the strongest test for antitrust immunity.

Conclusion

Licensed occupations have been free to act like cartels for too long without Sherman Act scrutiny. With nearly a third of workers subject to licensing and a continuing upward trend, it is time for a remedy. I do not propose an end to licensing or a return to a Dickensian world of charlatan healers and self-trained dentists. But the risks of unregulated professional practice cannot be used to rationalize unfettered self-regulation by the professionals themselves. The law needs to strike a balance. That balance is the same one sought in any modern antitrust case: a

[21] 471 U.S. 34, 47 (1985).
[22] 717 F.3d 359 (4th Cir. 2013).

workable tradeoff between a restriction's salutary effects on the market and its harm to competition. Immunity from the Sherman Act on state action grounds is not justified under antitrust federalism when those doing the regulation are the competitors themselves, where they are not accountable to the body politic, where they have too often abused the privilege, and where the anticompetitive dangers are so clear. The threat of Sherman Act liability can provide the necessary incentives to occupational regulators trading off competition for public safety and welfare.