

Occupational licensing guarantees higher prices

Homeowners don't place much value on licensure

By Warren Anderson | August 2024

Governments regulate many occupations. Everyone knows doctors and lawyers need a license to practice. But that's just the tip of the iceberg. Many lower-profile jobs require licenses that do not provide much benefit to the public. Michigan regulates nearly 50 low-income occupations, such as shampooers, manicurists, milk samplers and door repair contractors.

Researchers from Harvard, Stanford, Boston University and Washington University (St. Louis) assessed the impacts that such licensing has on online transactions for home improvement services. In a new paper, they find that customers do not place much trust in licensing as a guarantee of quality. They also indicate that the main effect of a licensing requirement is to increase costs.

The study analyzed roughly 1.7 million requests for the services of electricians, masons, plumbers and others. A consumer would post a request for a specific job, and professionals on the site would then respond

with a price. These professionals made 4.5 million bids for these projects. The requestor could see the customer reviews as well as the license status of the professionals. The person needing work would choose and then rate the contractor.

The researchers found that licensed professionals were not more likely to win these bids due to their license. Customers were more likely to base a decision on customer reviews than on license status. In other words, they did not view owning a license as a signal of high-quality service.

There are different possible explanations why consumers didn't care about licensing: They didn't know; they assumed everyone had one; or something else. The authors surveyed more than 5,000 people to ask about their choice of whom to hire. Respondents ranked prices and reputation as their two major factors. Fewer than 1% listed having a license as a reason for choosing someone.

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While licensing did not matter for consumer choice, the authors did find that stricter licensing requirements led to higher costs. A license is correlated with a nearly 10% increase in the price for services that cost \$200 to \$500, roughly a 15% increase for jobs that cost \$500 to \$1,000 and then almost a 25% increase for contracts costing more than \$1,000.

If more stringent licensing leads to higher quality, it is possible that the higher costs could derive from an increased demand for the service. The authors could rule that out statistically, however. The higher prices, it seemed, simply came from restricting supply or limiting competition, which drives up prices. This is consistent with other findings.

Stricter licensing has another impact – fewer new businesses. When there are more barriers to enter the marketplace, it is harder for new workers and businesses to compete with existing establishments.

In Michigan, someone who wants to be an HVAC contractor for residential properties must have three

years of experience, pass an exam and pay \$200. Sixteen states do not require a license for HVAC contractors. If, after gaining two years of experience, you want to begin a company to service air conditioners on your own, Michigan law blocks you. By limiting competition, the state drives up costs for consumers.

Economics may be the “dismal science,” but it teaches powerful lessons. By artificially restricting supply, the government increases costs to consumers and makes it harder for entrepreneurs to form new firms. This has harmful ripple effects throughout the economy, felt especially by low-income households.”

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