

THE ECONOMICS OF OCCUPATIONAL LICENSING: APPLYING ANTITRUST ECONOMICS TO DISTINGUISH BETWEEN BENEFICIAL AND ANTICOMPETITIVE PROFESSIONAL LICENSES

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I. INTRODUCTION

Licenses are used to ensure a minimum standard of quality in a wide variety of professions that are complex and potentially harmful to consumers. However, in the past century the number of professions covered by licenses has quickly grown and now includes bee keepers, lightning rod salesmen, tree surgeons,¹ tattoo artists, egg graders,² and even fortune tellers.³ Most patients want their doctors to have a certain level of knowledge, but it is less clear why consumers care about how much training and education their fortune tellers receive. The enactment of licensing laws to cover even the safest of professions has led some to conclude that licenses are being used for a much more sinister purpose. Licensing laws can both serve the public by protecting consumers and harm competition by erecting unnecessary barriers to entry, but what has been missing from the legal analysis is that licensing laws are best understood as an economic strategy. The law currently treats licensing as a political decision that is best left to legislatures, but by applying an economic framework, the precise mechanism by which licenses are used can be better understood and analyzed. Economics helped to guide antitrust law to the core anticompetitive activities by focusing the analysis on market conditions and efficiency.⁴ Courts have been better able to combat cartels

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¹ Walter Gellhorn, *The Abuse of Occupational Licensing*, 44 U. CHI. L. REV. 6 (1976).

² Robert Thornton & Andrew Weintraub, *Licensing in the Barbering Profession*, 32 INDUS. & LAB. REL. REV. 242, 242 (1979).

³ Emily Sweeney, *Town Denies Fortune-teller License*, BOSTON GLOBE, May 9, 2004, available at http://www.boston.com/news/local/articles/2004/05/09/gypsy_disputes_one_year_requirement/.

⁴ Robert Bork compared the earlier approaches in antitrust enforcement to a “sheriff on a frontier town: he did not sift evidence, distinguish between suspects and solve crimes, but merely walked the main street and every so often pistol-whipped a few people.” Since then, “the more recent cases have adopted a consumer welfare model...[and] the best evidence for the proposition is that courts now customarily speak in the language of economics rather than pop sociology and political philosophy.” ROBERT BORK, *THE ANTITRUST PARADOX* 6, 427 (1993); Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 216 (1985) (“Today more than ever antitrust decisionmakers have been forced to submit their views to another group of specialists—economists—for evaluation.”).

once they stopped looking for letters expressing an intent to collude and started looking at the elasticity of demand and market concentration.⁵ The same transition is necessary in approaching licensing laws. Traditionally courts have focused on whether a given licensing requirement is rationally connected to the skills necessary to perform the occupation being regulated. Economics can explain precisely how licenses operate as an anticompetitive mechanism, why licenses facilitate consumer welfare, and when each of these effects will be more pronounced. With greater emphasis on the market conditions surrounding licenses, it will become easier to know what kind of evidence is relevant to assessing the costs and benefits of a given licensing regulation.

Part II will explain the current legal standards under which licenses are reviewed. Licensing laws have been challenged as a violation of the Fourteenth Amendment's Due Process Clause and the Sherman Antitrust Act. Current law requires courts to be deferential to the decisions of legislatures. This reluctance to scrutinize licensing laws has allowed both beneficial and anticompetitive laws to persist.

Part III will compare licensing laws with cartels to assess the anticompetitive nature of licenses. Their similarities and differences highlight why licenses are an attractive means for artificially raising prices and harming competitors. Licensing laws can create many of the profit raising effects of cartels but are not subject to the same limitations.

Part IV will focus on the circumstances in which licensing laws can be beneficial to the consumer. In the absence of licenses, both professionals and consumers may be harmed by informational asymmetry. Generally, the reputations of professionals will provide consumers with adequate information, but there are market conditions in which reputations do not provide the necessary information. In these cases, licensing is an invaluable tool in disseminating important information about quality, which protects both professionals and consumers.

Part V will explain how the economic analysis discussed in parts III and IV can be used to inform and modify the current standards under which licenses are reviewed. By isolating the economic conditions where licensing is most subject to abuse and where it is most helpful, a new systematic standard can be developed that is better able to spot bad licensing practices. Licenses are most beneficial when information asymmetry is high, and licenses can be most abused when demand is inelastic and there are few competitors at the time the licensing law was passed. Courts can use these market characteristics to develop a more focused method in reviewing the validity of licensing laws.

⁵ John E. Lopatka & William H. Page, *Posner's Program for the Antitrust Division: A Twenty-Five Year Perspective*, 48 SMU L. REV. 1713, 1716-18 (1995). See also GEORGE STIGLER, MEMOIRS OF AN UNREGULATED ECONOMIST 165 (1988) ("The combination of the shift in attention to efficiency... has done much to weaken the arguments for an antitrust policy that seeks to deal with minor or transitory or (as in the case of vertical integration) erroneously identified monopolistic practices.").

II. THE CURRENT LEGAL STANDARD

License applications can have any number of requirements, such as fitness of moral character, education, number of years as an apprentice, and examinations.⁶ The requirements are usually set by a licensing board made up of members of the profession or by legislatures with significant input from current professionals.⁷ The two principle means through which licensing regulations have been challenged are the Fourteenth Amendment's Due Process Clause and the Sherman Antitrust Act. Licenses are challenged as a violation of due process when they restrict a person's ability to enter a profession for reasons that may be unrelated to that profession. The Fourteenth Amendment's Due Process Clause, though, has had limited reach in economic affairs because courts have tried to avoid the appearance of judicial activism. Arguments under the Sherman Act characterize lobbying for licenses as an attempt by a group of firms to restrain trade and fix prices. The Sherman Act, however, was primarily designed for private commercial activity and courts have been reluctant to apply it to state actions. After all, every regulation restrains trade, and applying the Sherman Act to all economic legislation would lead to endless litigation against states. Overall, constitutional and antitrust law arguments have had limited success in overturning licensing regulations.

A. THE FOURTEENTH AMENDMENT AND LICENSING

Licensing laws under the Due Process Clause are reviewed with a standard that is generally deferential to state legislatures. A rational basis standard is used and the key inquiry under this test is whether there is some rational connection between the regulation and a legitimate state purpose, such as health, morals, or safety.⁸ It does not matter what reasoning underlies the legislative decision, as long as the effect could conceivably advance a legitimate purpose.⁹ This means that as long as there is some connection to a state purpose, even if it is not the one the legislature originally intended, the court will end the analysis right there and uphold the law. The general position of deference was expressed in *Williamson v. Lee Optical* where the Court held that the state legislature "[m]ay exact a needless, wasteful requirement in many cases. But it is for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement."¹⁰ In *Barsky v. Board*¹¹ the Court applied a rational basis standard to a state licensing law and ruled that, "[t]he practice of medicine in New York is lawfully prohibited by the State except upon the conditions it imposes. Such practice is a privilege granted by the State under its substantially plenary power to fix the terms of admission."¹² Like other

⁶ Irwin W. Silverman, L. T. Bennett, Jr. & Irvin Lechliter, *Control by Licensing over Entry into the Market*, 8 LAW & CONTEMP. PROBS. 234, 236–37 (1941).

⁷ Jonathan Rose, *Professional Regulation: The Current Controversy*, 7 LAW & HUM. BEHAV. 103, 105–06 (1983).

⁸ Fed. Commc'ns Comm'n v. Beach Commc'ns, Inc., 508 U.S. 307, 314–15 (1993).

⁹ U.S. R.R. Ret. Bd. v. Fritz, 449 U.S. 166, 179 (1980).

¹⁰ *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483, 487 (1955).

¹¹ *Barsky v. Bd. of Regents of the Univ. of the State of N.Y.*, 347 U.S. 442 (1954).

¹² *Id.* at 451.

economic regulations, licenses are judged by a rational basis standard that gives the legislature a great amount of authority in setting occupational restrictions. A law may have serious anticompetitive effects, but such considerations play no role in the rational basis analysis.

This deferential rule grew out of a fear of returning to the infamous *Lochner v. New York* decision.¹³ In that case, the Court struck down a state law setting a maximum number of working hours for bakers on the grounds that the law violated the Due Process Clause. *Lochner* has been repeatedly criticized as an example of judicial activism, and scholars have attacked attempts to resurrect the economic rights that *Lochner* stood for.¹⁴ Even in cases where courts have found the licensing laws at issue to be unconstitutional, courts have still made a disclaimer that the decision is not a return to *Lochner*. In *Craigmiles v. Giles*, the Sixth Circuit struck down a state licensing requirement for casket makers, explaining that the “decision [was] not a return to *Lochner*, by which this court would elevate economic theory over that of legislative bodies.”¹⁵ The specter of *Lochner* has limited courts’ willingness to review state licensing laws beyond health and safety outcomes.

The rational basis test has severely limited the ability of courts to strike down licensing laws that unnecessarily restrict and exclude new professionals.¹⁶ It rarely finds grounds to overturn licensing laws because a state can usually come up with some valid purpose for the law, even if the offered purpose is completely different from the original purpose. Additionally, even if the statute did state a valid purpose, licensing abuses can be concealed within legitimate state purposes. Take for example the recent Ninth Circuit case of *Merrifield v. Lockyer*.¹⁷ *Merrifield* involved a licensing law that required all pest exterminators to have two years of experience, one year of experience as a “field representative,” and to pass a written examination.¹⁸ These requirements extended to exterminators of bats, raccoons, skunks, and squirrels. However, exterminators were exempt from the licensing requirements if they exterminate mice, rats, or pigeons.¹⁹ The equipment and techniques for bats and raccoons was no more dangerous or complicated than for that used on mice or rats. Even though the regulation of exterminators, who regularly work with dangerous chemicals and mechanical devices, was a valid state interest, its selective application served to insulate a narrower group of exterminators from the costs of applying for a license. The Ninth Circuit eventually found no rational basis for exempting only some exterminators from the licensing requirements,²⁰ but this is an example of how unnecessarily high training requirements can create a barrier to entry and still be defended as a health

¹³ *Lochner v. New York*, 198 U.S. 45 (1905).

¹⁴ See ROBERT BORK, *THE TEMPTING OF AMERICA* 44 (1990); JOHN HART ELY, *DEMOCRACY AND DISTRUST* 14 (1980).

¹⁵ *Craigmiles v. Giles*, 312 F.3d 220, 229 (6th Cir. 2002).

¹⁶ J.R.R., II, Note, *Due Process Limitations on Occupational Licensing*, 59 VA. L.REV. 1097, 1114 (1973).

¹⁷ *Merrifield v. Lockyer*, 547 F.3d 978 (9th Cir. 2008).

¹⁸ *Id.* at 982.

¹⁹ *Id.*

²⁰ *Id.* at 992.

measure. Because courts have refused to question the proportionality and application of professional training, licensing boards have selectively inserted training requirements that are excessive or only tangentially related to the job being done.

B. DIRECT APPLICATION OF THE SHERMAN ACT

Some plaintiffs have attempted to use the Sherman Antitrust Act to strike down licensing laws, but have not had much success. Most licensing boards were created or are managed by the state, and therefore are beyond the reach of the Sherman Act. In *Parker v. Brown*, the Court held that “nothing in the language of the Sherman Act or in its history suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature.”²¹ Due to the fact that the Sherman Act was never intended to limit state action, a law that was properly passed by the state legislature cannot be characterized as a restraint of trade.

III. CONDITIONS THAT FACILITATE ABUSES OF LICENSING LAWS

Critics of licensing characterize licensing boards as medieval guilds, erecting artificially high barriers to entry so that new competitors will not arise and the supply of professionals will remain low.²² Overly restrictive licenses impose two major types of losses. First, by mandating training that is tangential to the regulated occupation’s services, it forecloses certain occupations from those who are capable and who wish to practice in them.²³ Some people may be well qualified to do the job but cannot afford the excessive training requirements that anticompetitive licensing boards impose. The second loss is that the consumer will be forced to pay more for services because of an artificial reduction in the supply of professionals. In addition to raising overall prices, it cuts off consumers from choosing lower priced services.²⁴ Not all consumers demand the same level of quality; some will be satisfied with lower quality. Licenses eliminate the cheaper and lower quality services and force consumers to pay more for higher quality that they do not desire. Both of these effects impose a loss on consumer welfare and society as a whole.²⁵

On first glance, there are certainly some licensing requirements that appear unnecessary in order to practice in the profession being regulated. In the state of California for example, a person is required to complete 1500 hours of training and practice to become a barber and 1600 hours to become a cosmetologist.²⁶ Meanwhile, it only requires 1090 hours of training to become a paramedic²⁷ and 664 hours to become a police

²¹ *Parker v. Brown*, 317 U.S. 341, 350–51 (1943).

²² MILTON FRIEDMAN & SIMON KUZNETS, *INCOME FROM INDEPENDENT PROFESSIONAL PRACTICE* 12 (1945).

²³ Daniel B. Hogan, *The Effectiveness of Licensing: History, Evidence, and Recommendations*, 7 *LAW & HUM. BEHAV.* 117, 129 (1983).

²⁴ Morris M. Kleiner, *Occupational Licensing*, 14 *J. ECON. PERSP.* 189, 191 (2000).

²⁵ Avner Shaked & John Sutton, *The Self-Regulating Profession*, 48 *REV. ECON. STUD.* 217, 233 (1981).

²⁶ CAL. BUS. & PROF. CODE §7362.5 (2009).

²⁷ CAL. CODE REGS. tit. 22, §§100074, 100158 (2009).

officer.²⁸ Cutting hair may indeed be challenging, but there is no apparent reason why barbers require more training than paramedics who regularly deal with life and death situations. Or take the example of Carl Mitz, who made a living filing horse teeth. Horse teeth grow continuously, but in the wild, horses eat tough foliage which naturally wears down their teeth. When on a farm, however, horses eat softer grains and their teeth continue to grow unless they are regularly filed. Mitz has been threatened with heavy fines and imprisonment by the Texas State Board of Veterinary Medical Examiners for filing horse teeth without a full veterinarian's license.²⁹ He was ordered to graduate from a veterinary school before he could continue his old job.³⁰ Not only is veterinary school expensive, but taking care of horse teeth is not a skill that is normally part of the curriculum. The state certainly has an interest in making sure that veterinarians have all the necessary knowledge and skill to care for animals, but it is less clear why four years of graduate schooling is needed to protect horses whose teeth are too big.

Although the Sherman Act itself has limited use today in challenging licensing laws, the economic principles that guide antitrust laws are still applicable in separating 'good' licensing laws from 'bad' ones. This section will first explain why courts focus on certain market characteristics as evidence of a horizontal agreement among firms and then analyze how these same characteristics are applicable to abusive licensing laws.

A. CARTELS AND LICENSES

Cartels and oligopolies are created when a group of firms agree to coordinate their outputs so they can collectively raise or lower prices. The success of such agreements will largely depend on three factors: elasticity of demand; market concentration; and the homogeneity of the product. By decreasing their output, a group of firms can decrease the supply of a certain good which then causes the price to rise above its competitive level. Even though the firms are selling fewer goods, they are able to charge higher prices, which can create greater profits for all members of the cartel.

Such price fixing is per se illegal,³¹ and to avoid liability companies rarely leave direct evidence of an explicit agreement amongst themselves. Courts have had to rely on circumstantial evidence to infer that an agreement was made.³² Economic conditions provide one type of circumstantial evidence because oligopolies and cartels tend to be most successful and sometimes only possible when the market has certain characteristics. The Supreme Court in *Williamson Oil v. Phillip Morris*³³ explained that certain features of the industry, including a concentration of sellers, inelastic demand, and the sale of a fungible product, are some

²⁸ CAL. CODE REGS. tit. 11, §1005 (2009); 96-28 Cal. Reg. Law Bulletin 435 (1996).

²⁹ *Of Horses' Teeth and Liberty*, THE ECONOMIST, Oct. 25, 2007.

³⁰ TEX. OCC. CODE ANN. § 801.251 (2007).

³¹ *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

³² *In re High Fructose Corn Syrup*, 295 F.3d 651, 654 (7th Cir. 2002).

³³ *Williamson Oil Co. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003).

evidence of an antitrust violation.³⁴ A more detailed analysis of these conditions and their impact was made by the Seventh Circuit in the case of *In re High Fructose Corn Syrup*.³⁵

When a licensing law is being used for anticompetitive purposes, a licensing board can be thought of as a state subsidized cartel.³⁶ Like a cartel, the goal is to use the license to adjust the supply of services. A licensing board generally cannot restrict the amount of services that a professional provides, but it can reduce the number of professionals by raising barriers to entry.³⁷ The more costly and burdensome the board makes the license application, the fewer professionals there will be in the market.³⁸ This restricts the total output of services, which then causes an increase in the price that currently licensed professionals can charge.³⁹ If the economics of anticompetitive licenses operate the same way as in cartels, then licenses should be most profitable in the same circumstances where a cartel would be most profitable. Each of the three economic factors listed above will be applied to licensing laws to see how far the analogy holds. Although licensing laws have many similarities with cartels, each of these factors operates in a slightly different manner.

B. INELASTIC DEMAND

The elasticity of demand is important because it determines both how much the cartel can gain by raising prices and whether the cartel can engage in predatory pricing. Inelastic demand means that a 1% drop in supply will allow for a greater than 1% increase in price. From the perspective of a cartel, this would be a favorable situation because the members would only have to make a small decrease in their output to create a large increase in the price it could charge, and the cartel's profits would rise substantially.⁴⁰ An elastic demand curve, however, will have just the opposite effect; the firms have to drastically cut output to create a small increase in price. The greater the demand elasticity, the more money the firm will lose in foregone sales. If demand is sufficiently elastic, the loss from foregone sales may be greater than the profits gained from charging higher prices. The same pattern occurs in the opposite direction when a cartel is pursuing a predatory pricing strategy. With predatory pricing, the cartel dramatically increases output to lower prices below marginal cost, which forces all firms in the market to suffer losses. The effects can also reach similar markets that offer products that are good substitutes because customers in those markets will be drawn to the cartel's lower prices. The goal is to make competitors go out of business before the cartel goes out of

³⁴ *Id.* at 1296.

³⁵ *In re High Fructose Corn Syrup*, 295 F.3d at 656.

³⁶ Hayne E. Leland, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards*, 87 J. POL. ECON. 1328, 1338 (1979) ("As with any monopoly, extra profits can be achieved by a lower level of total supply than is socially optimal.").

³⁷ See Lawrence Shepard, *Licensing Restrictions and the Cost of Dental Care*, 21 J.L. & ECON. 187 (1978).

³⁸ Kleiner, *supra* note 24, at 192.

³⁹ Alex Maurizi, *Occupational Licensing and the Public Interest*, 82 J. POL. ECON. 399, 400-01 (1974).

⁴⁰ RICHARD POSNER, *ANTITRUST LAW* 71 (2d ed. 2001) ("If demand is inelastic at the current market price, collusion to raise the price will be particularly attractive.").

business. Inelastic demand allows for large decreases in price and makes predatory pricing easier.

Determining the exact shape of the demand curve is a difficult empirical question, but courts usually look at the presence of substitutes to determine if demand is inelastic.⁴¹ The presence of substitutes is not conclusive evidence of inelastic demand, but it is usually the best measurement a court can make without doing a rigorous statistical investigation.⁴² If a product has many close substitutes, then an increase in the price of the product will cause consumers to switch to the substitutes and the demand for the product falls rapidly. A cartel cannot expect to gain very much in these circumstances and has a much smaller incentive to organize. But when there is an absence of substitutes, consumers have nowhere to go if the price rises, and demand remains stable despite the increase in price. In these situations a restrictive horizontal agreement can be very profitable and the rise in prices should more than make up for the reduction in sales. Measuring how well one product can substitute for another is a tricky question, but it is one which courts have dealt with on numerous occasions when defining the relevant market in antitrust cases.⁴³

Inelastic demand in a licensing context is important for some of the same reasons as in an oligopoly context. The effects are similar, inelastic demand for professional service means a small decrease in the number of new entrants will lead to large profits for currently licensed professionals.⁴⁴ The more inelastic the demand curve, the more the board can raise prices and acquire a greater return with a minimal reduction in output.⁴⁵ Like with oligopolies, a court can roughly estimate the elasticity of demand for services by determining whether there are close substitutes. A licensing law regulating limousines will probably be less subject to abuse because there are taxis and buses. Demand will likely be elastic and even stringent barriers to becoming a limousine driver will not create a large increase in the price that existing professionals can charge. The demand for dentistry on the other hand is probably inelastic since there are no other professions that regularly deal with root canals. The absence of substitutes should put courts on alert for anticompetitive training requirements.

However, the two mechanisms are not the same when it comes to harming competitors because licensing boards do not need to resort to predatory pricing. If there are close substitutes in the market, the licensing board can impose costs on those firms by forcing them to apply for a license. Since the original purpose of the license was to raise the cost of entry, the same effect will occur when the substitute market is subject to the

⁴¹ *Id.* at 62.

⁴² *Id.* at 72 (“If, for example, a product has no good substitutes at the current price, that is at least some evidence, albeit not conclusive, that the demand for the product is inelastic at that price.”).

⁴³ *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 380 (1956).

⁴⁴ Thomas G. Moore, *The Purpose of Licensing*, 4 J.L. & ECON. 93, 112 (1961) (“Thus the more elastic is the supply and the less elastic is the demand, the greater will be the return to those practitioners already in the industry.”); Leland, *supra* note 36, at 1341 (“But as the demand for the product becomes relatively inelastic...the monopoly effect will tend to dominate, and the group will be led to set licensing standards above those that are socially optimal.”).

⁴⁵ Moore, *supra* note 44, at 112.

licensing restrictions. This will cut the number of competing practitioners and decrease the output of the substitute market. Since the state pays for the monitoring and enforcement costs, it also means that this strategy is more dangerous for consumers than predatory pricing because the licensing board is able to impose costs on competitors without incurring personal costs.

The case of *Cornwell v. Hamilton*⁴⁶ provides an illustration of the way licenses can impose costs on substitute markets. Cornwell made a living doing African braiding services which involves making “locks” in hair.⁴⁷ Her work did not involve straightening or curling hair, yet she was required to apply for a state cosmetology license. African braiding does not use the same training or techniques that cosmetologists do and the court decided that requiring a cosmetology license would force braiders to learn too many irrelevant tasks.⁴⁸ If all the cosmetologists were in a cartel, they would have to drop their prices to draw business away from African braiders, but licenses can reach the braiders and force them to apply for a cosmetology license. The fact that cosmetology training is unrelated to braiding means that the licensing requirement is particularly costly and burdensome. Losses are forced upon competitors just as they are in a predatory pricing strategy.

C. MARKET CONCENTRATION

The second important condition for a cartel is that there cannot be too many players in the market because a large number of firms will make the transaction costs higher in forming an agreement and also in monitoring members after an agreement is made. This first cost is straightforward, when there are more firms involved in forming an agreement, it is harder to create terms that are acceptable to everyone involved. No two firms have identical goals, and the larger the number of firms, the less unanimity there will be.⁴⁹ The result is that industries with a higher concentration will be more likely to be able to form cartel agreements.⁵⁰

The second cost has to do with enforcing the agreement once it is made. Because cartels rely upon the coordinated action of all its members, there is a strong incentive to cheat. If all members are reducing their supply to artificially raise prices, a single member can cheat by increasing its own output. That firm will sell more products while the other members continue to restrict their own sales to keep prices high. The single member is free-riding off of the restrictions the other members have placed upon themselves. As the number of firms increases, it becomes more likely that at least one firm will cheat.⁵¹ The gains a cheater can make depend upon how long the cartel takes to discover the cheating. The longer the cheater

⁴⁶ *Cornwell v. Hamilton*, 80 F. Supp. 2d 1101 (S.D. Cal. 1999).

⁴⁷ *Id.* at 1108.

⁴⁸ *Id.* at 1118.

⁴⁹ John Palmer, *Some Economic Conditions Conducive to Collusion*, 6 J. ECON. ISSUES 29, 30 (1972).

⁵⁰ *Id.* at 34.

⁵¹ Almarin Phillips, *A Theory of Interfirm Organization*, 74 Q. J. ECON. 602, 607 (1960).

can keep selling above cost without restricting its output, the more the cheater will benefit.⁵²

A successful cartel will need a mechanism to detect such free riding. In a market with two firms, this is easy since each firm knows how much it is producing. If a firm keeps restricting its supply but the total supply in the market keeps rising, it will know the other firm is cheating. If, however, there are twenty firms in the market, it is much more difficult to determine who is cheating. As the number of firms increases, the oversight body of the cartel will have less information about each member, and cheating will become increasingly likely.⁵³ Furthermore, the cost of enforcement will continue to rise because most oligopolies punish cheaters by dropping prices. Once cheating is discovered, the group will try to make all prices fall so that the cheater no longer makes any gains, and possibly incurs losses if the prices are pushed down below marginal cost.⁵⁴ The problem is that this requires coordination among all members to simultaneously raise production. As explained above, coordinating changes in production is more difficult when more firms are involved.

Market concentration plays a role in the formation of licensing laws but much less of a role when it comes to monitoring and enforcement costs. When forming an agreement the profession faces a free rider problem because if one professional lobbies for a restrictive license, then output is reduced and all existing professionals can charge higher prices. Like with cartels, professionals would want to coordinate and divide lobbying costs so that there are no free riders. Again, this is an easier task if there are fewer players in the market. This specific problem though is only relevant when a statute is initially drafted. Once a statute is in place, there are no further lobbying costs or free rider problems. So even if the profession grows in subsequent years, the key inquiry is whether the market was concentrated when the law was first proposed. Only if there was a concentration at that time can one infer that there may have been an anticompetitive purpose.

But this free rider problem is slightly different from the one cartels face because the threshold for success is different. A cartel requires that its members collectively have a large percentage of the market share so that they can better adjust total output. With licenses, the key issue is more about the threshold cost of passing a law than it is about market shares. The lobbying that is necessary to pass a law is largely fixed, and any individual company can do it. This means that one company may be able to afford the lobbying costs but have only a small market share. Although bringing in more firms will help spread out the cost, getting a large percentage of the market is not necessary to lobby for a law, it just makes it easier.

Where licenses sharply deviate from cartels is in monitoring and enforcement costs. Once a licensing law has been passed, there is no

⁵² Ian Ayres, *How Cartels Punish: A Structural Theory of Self-Enforcing Collusion*, 87 COLUM. L. REV. 295, 299 (1987).

⁵³ George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44, 59 (1964) (the less perfect the market knowledge, the more extensive the price-cutting (cheating) by members).

⁵⁴ Ayres, *supra* note 52, at 302.

equivalent to the problem of cheating that cartels face. The licensed members can increase their output as much as they like because it is the number of members that is important, not how much each member produces. Once the number is fixed, there is no reason to monitor the output of existing members. Because the mechanism is different, all the monitoring and enforcement costs relate to keeping the total number of licensed professionals steady by stopping unlicensed practitioners. This cost, however, should be negligible for two reasons. First, state agencies do most of the monitoring and enforcement, which incurs no cost on the licensing board. Not only is the monitoring cost outsourced to the state, it is probably easier to determine if a person is unlicensed than it is to determine if a firm is increasing its output. With a license, all the agency has to do is ask a person if they have the necessary paperwork. In a cartel, the enforcement arm has to look for output above the quota and keep track of exactly how much each firm is selling. With regards to punishment of a cheater, an oligopoly requires the coordination of all members to drop their production, but there is no such action required when state police enforce the licensing restrictions. The second reason why monitoring and enforcement costs are negligible is that consumers should prefer to buy from a licensed professional since a license offers some guarantee of quality. This draws consumers away from unlicensed professionals and operates to both monitor and enforce the licensing restriction.

Due to the state subsidy and automatic consumer enforcement, market concentration is of much less importance in maintaining a functioning licensing regime than a cartel. State agencies can check licenses relatively easily, and the consumer preference for licensed professionals should continue no matter how many total practitioners are in the market. This should make licensing laws more durable against an increase in the number of players. Compare this to cartels where the Department of Justice has prosecuted cartels with five members and some as high as eleven members.⁵⁵ If a market has more members than that, it is rare to find a functioning cartel.

There is also an important distinction when defining what counts as a “player” in the licensing context compared to a market context. Counting the number of professionals is not so simple because they are generally part of larger firms. A market may have a large number of professionals, but if they are all part of a small number of companies, then the transaction costs are much lower and the court should treat the market as if there were a small number of players. A union or professional association may also serve as a means of diminishing the effective number of players.

⁵⁵ William J. Kolasky, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Speech before the Corporate Compliance 2002 Conference: Antitrust Compliance Programs: The Government Perspective (July 12, 2002), available at <http://www.usdoj.gov/atr/public/speeches/11534.htm>.

D. HOMOGENEITY OF PRODUCT

The similarity among the manufacturers' products affects the transaction costs of forming a horizontal agreement. If the products are very heterogeneous, then it is difficult for the members to agree on a single price.⁵⁶ Members will likely be suspicious about any claims that one member's product has to be priced higher than everyone else's product. The group would have to investigate to determine whether the product is sufficiently different that it actually requires a higher price, and how much higher. There would have to be an arrangement assessing how much each member can charge, which complicates negotiations as more categories have to be created. Contrast this with a completely homogenous product where everyone has the same marginal cost and one price should satisfy all producers. The group does not need to carve out any exceptions and an agreement should be easy to make.

For licenses, this factor is almost exclusively an issue before the licensing law is put in place. When a licensing law is drafted, it has to reach a particular profession, and those who lobby for it will determine who should be covered by it. The lobbyists will probably select occupations that have similar training so that it will be easy to have unanimity of interest. Everyone in the occupation would prefer higher wages to lower wages, and those who are practicing at the time the law is passed would prefer to have less new competitors rather than more. Since everyone in the profession has had similar training, the existing professionals do not need to set price schedules or adjust entry requirements for a variety of classes. Since this problem is solved before the licensing law is put in place, the condition of homogeneity will likely have already been met by the time courts are ready to review the licensing law.

However, the problem of heterogeneity can still emerge after a licensing law has passed. Over time, new techniques and methods may develop, and the profession may branch out in different directions. This presents a problem if the licensing board has to adjust the training requirements to include these new techniques. If the newer methods are sufficiently distinct, they may want to charge higher prices and the licensing board has to develop two sets of pricing schedules. As the number of specializations increases, the board has to keep developing new entry requirements and new price schedules.

E. PLUS FACTORS

When proving the existence of a horizontal agreement, the economic factors are usually necessary but not sufficient. In addition to market conditions, the plaintiff must also show certain "plus factors" to demonstrate that not only was the market receptive to anticompetitive behavior, but that such actions and agreements actually took place. The presence of all the relevant economic factors was not enough to prove a

⁵⁶ POSNER, *supra* note 40, at 75.

horizontal agreement in *E.I. Du Pont v. FTC*.⁵⁷ In this case, the Federal Trade Commission (“FTC”) introduced evidence that the market had few producers, that demand was inelastic, and that the products were homogenous. Despite the presence of economic conditions favorable to a cartel, there was not enough evidence for the Court to find a horizontal agreement. The Court required that additional “plus factors” be shown to demonstrate that there was more than just a vulnerable market and that the FTC provide some evidence of either an anticompetitive intent or the absence of an independent business reason for the parallel conduct.⁵⁸ However, the absence of some market characteristics may cripple a claim of a horizontal agreement. In *Matsushita*,⁵⁹ the Supreme Court reversed a grant of summary judgment for the plaintiffs because the market was not concentrated and each firm had a strong incentive to cheat.⁶⁰ More than twenty defendants were listed and with such a high number of players it would be very unlikely that the defendants could successfully maintain a cartel.⁶¹

The economic factors listed above should be a focus in litigating licensing laws, but as with oligopolies, the presence of favorable market conditions is not sufficient evidence that there has been actual anticompetitive behavior. The presence of inelastic demand and a low number of players would make it profitable to use licenses as an anticompetitive mechanism. These factors only show that the anticompetitive effect would be much greater. Rather than declaring all licenses in these conditions per se illegal, courts should apply a higher standard of scrutiny and place a higher burden on the state to justify the necessity of a particular license.

IV. THE BENEFITS OF LICENSING

Supporters of licenses argue that they are necessary because there is a lack of information available to consumers. If consumers are not able to gauge the quality of services, this will lead to two negative effects. The first is that consumers will be unable to find the appropriate level of quality they desire and will likely pay the wrong price for what they are receiving. Since they are unable to accurately assess the quality and skill of a professional, consumers will be taken advantage of and will pay for the services of quacks. This will be especially dangerous in professions like medicine and dentistry where poor quality service can cause permanent physical injury. Licenses can alert consumers that a certain professional is poorly qualified and that the consumer’s money is better spent elsewhere.

The second negative effect is that high quality sellers will leave the market. Sophisticated consumers will know that some of the sellers are of poor quality. Taking the chance that they will receive the services of a poor

⁵⁷ *E.I. Du Pont de Nemours & Co. v. Fed. Trade Comm’n*, 729 F.2d 128, 132 (2d Cir. 1984).

⁵⁸ *Id.* at 139.

⁵⁹ *Matsushita Elec. Indus. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

⁶⁰ *Id.* at 590.

⁶¹ *Id.* at 597.

seller into account, consumers will reduce the price they are willing to pay. With no guarantee of what they are going to receive, the maximum that a consumer will pay is less than they would pay if there had been some assurance of the quality of the service. This is necessarily lower than what the value of the highest quality sellers and those sellers will have to either lower their prices or exit the market.⁶²

All of the reasons that supporters of licensing laws have given, including safety and setting a minimum quality standard, are connected to the central problem of informational asymmetry. In a world with perfect information, licenses would be unnecessary because consumers would know exactly what quality of service they were purchasing and the safety risks of that service. But we live in a world with a certain degree of informational asymmetry; the sellers of a service almost always know more about what is being sold than the consumer does. Overall, licenses benefit consumers when informational asymmetry is high and hurts consumers when information asymmetry is low.

A. THE PROBLEM OF INFORMATION

When consumers are unable to assess the quality of what they are about to purchase, it will result in higher quality sellers either leaving the market or reducing the quality of their services. In a world with complete informational asymmetry, the consumer would be unable to distinguish between the highest and lowest quality service. George Akerlof explained what such a world would look like in "The Market for Lemons."⁶³ When purchasing a product of unknown quality, a rational consumer will calculate their expected value by estimating the probability they will receive a high or low quality product.⁶⁴ For example, assume there are good used cars worth ten units and bad used cars worth five units. If the consumer cannot tell the difference between the two and there is an equal chance of buying a good or bad car, the consumer's expected value is $50\% * 10 \text{ units} + 50\% * 5 \text{ units} = 7.5 \text{ units}$. The consumer will only be willing to spend 7.5 units on a used car, which is the average cost. If consumers are only willing to pay the average cost, the high quality sellers who offer cars worth ten units will either lose money or they will stop trying to sell good used cars, since no one will be willing to pay more than 7.5 units for them. As cars worth more than 7.5 units leave the marketplace, the average quality drops even further and the consumer is willing to spend even less on a car. The above average sellers have an even greater incentive to leave the market as the pattern continues. Over time, this causes the average quality to keep falling until only the low quality sellers are left. There will only be bad used cars, and consumers are left with a market for lemons.

There are three main ways in which the informational asymmetry can be overcome: reputation, licensing, and certification. Reputation is a

⁶² George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

⁶³ *Id.*

⁶⁴ *Id.* at 489.

naturally occurring mechanism in a completely free market. Consumers only learn about sellers through repeated transactions and sellers have a desire to maintain quality in the hopes that a customer will come again. Certification is usually done through a state agency which gives a seal of approval once a seller has completed a training program. This certificate informs the consumer about the level of training a particular seller has completed. Certification guarantees a certain degree of expertise, but unlike licenses, a certificate is not required to practice. Certification is often suggested as an alternative to licensing, since it provides consumers with information but does not force competitors out of the market. The costs and benefits of certification are beyond the scope of this article. Finally, there are licenses, which serve to both inform consumers and mandate a certain level of training before a professional can practice.

B. WHEN REPUTATIONS PROVIDE NECESSARY INFORMATION

In some circumstances, reputations can prevent a market for lemons by providing the consumer with meaningful information that allows the consumer to accurately determine which sellers offer what level of quality. Even if a consumer faces information asymmetry the first time they make a purchase, the consumer will notice a pattern after several purchases. Over time a seller can establish a reputation which then tells consumers who the high and low quality sellers are. What keeps the reputation mechanism effective is that consumers always have the opportunity to switch firms.⁶⁵ Once a company starts providing poorer quality, a consumer can quickly move to another one. Reputations are dynamic and can rise and fall as the seller's quality changes or if better competitors emerge. Licenses, on the other hand, generally only offer periodic assurances of quality. Customers who are dissatisfied have no ability to affect whether or not a professional remains licensed. Licensing boards are supposed to vigilantly enforce any violation but usually suspension of a license is considered a harsh punishment and is reserved only for egregious violations.⁶⁶ Some laws try to ensure license holders maintain quality by requiring professionals to pass another exam to renew their license, or in the case of lawyers, they are required to take continuing legal education classes. Another advantage that reputations have is that they can provide a wider range of information. Licenses guarantee a certain minimum quality of service, but beyond that the consumer cannot find out who offers modest or high quality services. With reputations, a consumer can learn about a continuum of services providing different levels of quality.

Perfectly functioning reputation mechanisms can provide better information than licenses, but there are circumstances in which reputations are not effective and either convey limited information or are highly unresponsive to changes in the seller's quality. One limitation on the effectiveness of reputations is the delay between the time when the consumer receives the service and the time when any defects can be

⁶⁵ See Johannes Horner, *Reputation and Competition*, 92 AM. ECON. REV. 644 (2002).

⁶⁶ Hogan, *supra* note 23, at 124.

detected. For example, a plumber may do a poor job fixing a pipe, but it may be years before that pipe bursts and the consumer realizes how bad the service was. Because there can be a long delay between the time the service is purchased and the time when an error is discovered, reputations may take a decade to build. In contrast, when a barber provides services, mistakes are noticed by the consumer as soon as the job is complete.

Complexity also affects the length of the delay. With simple services like a car wash, consumers can spot poor service right away. With a service like car repairs though, only a sophisticated consumer will be able to catch problems right away and most will only discover the problem once the car starts breaking down again. There is the further problem that the consumer may never find the defect at all. For instance, the consumer may have sold the house by the time the plumbing problem emerges, and the low quality plumber's reputation is never established. With no established reputation, consumers will still only be willing to pay the expected value for a service and high quality sellers will be unable to charge a higher price.⁶⁷ As the lag time increases, there will be a longer period in which consumers have little information about sellers. It effectively extends the time during which the market for lemons prevails and the low quality sellers continue to profit while high quality sellers are driven from the market.⁶⁸

Reputations may also be a poor guide when the consumer rarely uses the service more than once or if there is a great risk of harm.⁶⁹ Some services may only be used once in a lifetime, like a real estate broker for example. Other services may render the consumer unable to use the same service again. When a surgeon operates, there is a chance that the patient may suffer irreparable harm, in which case there will be no second transaction. In these circumstances there is no point in the consumer learning about the seller's quality because the consumer will not need those services again. From the seller's perspective, there is less of an incentive to maintain quality when there is no prospect of repeat business. Reputations may still develop, perhaps because the successful patients communicate to other consumers. Nonetheless, the inability to make repeated transactions will limit the accuracy and speed at which reputations develop.

C. WHEN LICENSING PROVIDES NECESSARY INFORMATION

When the reputation mechanism fails, the Akerlof equilibrium will prevail, but licensing can counteract this by conveying information and requiring more training to raise the average quality. Licenses will change the average price that consumers are willing to pay. Although there is still great information asymmetry, licenses provide a basic amount of information to the consumer. Since the consumer knows which sellers are licensed and which are not, the consumer should be willing to pay more to a licensed professional because the probability of receiving bad service will

⁶⁷ Carl Shapiro, *Consumer Information, Product Quality, and Seller Reputation*, 13 BELL J. ECON. 20, 22 (1982).

⁶⁸ Leland, *supra* note 36, at 1330.

⁶⁹ J.F. Barron, *Business and Professional Licensing—California, a Representative Example*, 18 STAN. L. REV. 640, 642 (1966).

be diminished. This should raise the average price that consumers are willing to pay and thereby increase the number of higher quality sellers who are willing to stay in the market.⁷⁰ When higher quality sellers are more likely to stay there should be an overall increase in consumer welfare.

The other way in which licensing can help consumers is that it forces sellers to invest more in training which should make them more capable and willing to provide higher quality products. One model of this was proposed in Carl Shapiro's "Investment, Moral Hazard, and Occupational Licensing."⁷¹ This model analyzes the price that sellers are able to charge over the entire span of their career. In the early years, no one has developed a reputation yet, and an Akerlof Lemons situation exists.⁷² This means both high and low quality providers can only charge the average cost. However, over time, reputations will eventually separate the high quality sellers from the low quality sellers. In the later part of everyone's career, prices will adjust to reflect the respective amount of quality each seller provides.⁷³

Given that reputations take a while to develop, the length of time that a seller can capitalize on their high quality services will determine how much they invest in their training. If, for example, reputations take a very long time to establish and sellers only have a few years during which time consumers are willing to pay for high quality services, this will only be a small increase in the sellers' lifetime income. Since the high quality sellers will not make much more than average, they have very little incentive to invest in training early in their career. The later part of a professional's career is effectively a "payoff" period which will compensate the professional for spending more money on training in the early years. Shapiro predicts that the less time it takes for reputations to develop, the more time a professional has to charge higher prices for higher quality services. If the payoff period lengthens, sellers should have a strong incentive to invest heavily in training. But if reputations take a long time to develop, sellers will spend much less on training and the average quality of services will fall.⁷⁴

Licensing helps to increase the average quality of services where reputations take a long time to develop. By requiring a certain level of training, licenses reduce the appeal of selling low quality services. Normally, low quality sellers will invest very little in training, gain higher income than they deserve under Akerlof equilibrium, and then suffer a smaller income for a short period of time once reputations are established. But if licenses force these sellers to invest more in their training, the strategy of providing high quality services is more appealing. Since the seller has already been forced to invest in their training, they may as well invest a little more and start pursuing the high quality strategy. The overall effect is to push more sellers into the high quality strategy, which should

⁷⁰ Leland, *supra* note 36, at 1335.

⁷¹ Carl Shapiro, *Investment, Moral Hazard, and Occupational Licensing*, 53 REV. ECON. STUD. 843 (1986).

⁷² *Id.* at 849.

⁷³ *Id.* at 848.

⁷⁴ *Id.* at 850.

raise the overall average quality. The net effect is that licensing tends to hurt low quality suppliers while helping higher quality suppliers.⁷⁵

However, if a licensing law is used in a market with a well-functioning reputation system, this may distort consumer decisions.⁷⁶ If seller reputations are accurate, then consumers will be able to distinguish between high and low quality sellers. The prices should adjust accordingly and consumers will pay more the higher the quality they desire. If a licensing law, however, is instituted which removes low quality sellers from the market, then the state has effectively taken away viable options from the consumer. Consumers who once purchased low quality services at low prices are now forced to pay more for the higher quality service. The result is a less efficient allocation of services to consumers.

V. DEVELOPING A LEGAL STANDARD

The factors listed above will be a helpful guide in determining if a court should defer to the legislature or apply a higher standard of scrutiny. When a market has inelastic demand, a high concentration, and low informational asymmetry, then an anticompetitive licensing regulation will create large gains for the existing professionals but will provide little benefit to consumers. In these circumstances courts should use heightened scrutiny in assessing the potential anticompetitive effect of the law.

A. AN APPLICATION OF THE ECONOMIC APPROACH

Although courts have not openly applied an economic analysis to their licensing decisions, the outcomes have been the economically correct ones. In *Craigmiles v. Giles*,⁷⁷ for example, all the relevant factors were present. This case centered around the issue of whether casket retailers should be required to apply for a funeral directing license in order to sell caskets. The state law required that anyone engaged in funeral directing or the sale of caskets and urns had to be licensed. The license required that all applicants take two years of classes and pass a "Funeral Arts Exam."⁷⁸ The exam consisted largely of questions related to funeral directing and not casket-making. This forced retailers of caskets to learn how to become funeral directors, even though casket-making alone requires no interaction with people.

The Sixth Circuit held that the licensing law had no rational basis for being applied to casket retailers.⁷⁹ Creating caskets had nothing to do with funeral services and there was no reason why the two services had to be done by the same person. Furthermore, the license had nothing to do with public health and safety, for caskets that were made by licensed funeral directors were no safer than ones made by casket retailers.⁸⁰ The

⁷⁵ *Id.* at 851.

⁷⁶ *Id.* at 856.

⁷⁷ *Craigmiles*, 312 F.3d at 229.

⁷⁸ *Id.* at 222.

⁷⁹ *Id.* at 229.

⁸⁰ *Id.* at 225–26.

amendment to include the retail sale of caskets under the definition of funeral directing was “nothing more than an attempt to prevent economic competition” and the licensing requirement was “directed at protecting licensed funeral directors from retail price competition.”⁸¹ For these reasons, the court found that there was a violation of the Fourteenth Amendment’s Due Process clause.

From an economic standpoint, this was probably the right outcome. Demand for the product was probably inelastic, there are generally not many substitutes for caskets or urns, both of which were covered by the statute. The absence of alternatives means that funeral directors can make significant gains by restricting casket retailers. The market for funeral directors is also relatively concentrated.⁸² Furthermore, this was a market where there did not appear to be a severe problem of informational asymmetry. Consumers can see the casket once its completed and can inspect it for any defects right away. Since it is a fairly simple product, the lag time between when consumers receive the product and when they can detect any problems is likely to be very short. Finally, and rather grimly, this is a service that will probably be used more than once. Since the seller is concerned with retaining customers, he will be attentive to maintaining a reputation. Given these three factors, the court should have been particularly suspicious of the intent of the licensing law, and it arrived at the correct economic conclusion.

B. WHY ANTITRUST ECONOMICS AND HEIGHTENED SCRUTINY?

Even though an economic analysis of licensing laws is contrary to the current deferential position of both Constitutional and antitrust law, courts are better suited than legislatures to stop the abuses of licensing. Legislatures are susceptible to regulatory capture when there is a small and highly interested group in favor of a law and the opponents are a widely dispersed and generally disinterested majority. Furthermore, courts have had a great deal of experience in analyzing anticompetitive behavior through antitrust cases. Finally, an economic approach to licensing will help to bring more consistency in the case law than the current standard.

The concentrated gains and dispersed costs make licensing laws particularly vulnerable to regulatory capture. In “The Theory of Economic Regulation,”⁸³ George Stigler explains regulatory capture and how a cost-benefit analysis from the perspective of voters and legislators can explain why legislatures sometimes pass laws that cause an overall loss for society. When a legislator has a choice between bestowing gains to a strongly opinionated minority or giving a small benefit to each member of a largely apathetic majority, it is in the legislator’s interest to choose to help the minority. This is because the minority is much more likely to vote for the legislator in return for his or her help, but for a member of the majority the

⁸¹ *Id.* at 227.

⁸² Bruce Mohl, *Life’s Last Buy Requires Plan and Patience*, BOSTON GLOBE, Aug. 27, 1995, at Metro/Region 1.

⁸³ George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

benefit is so small that it will probably not have any effect on how he or she will vote.⁸⁴ Such is the case with licensing, which Stigler presented as the quintessential example of regulatory capture.⁸⁵ Licenses have the effect of raising the salaries of existing members of a profession, which makes it an attractive law for this group to lobby for. The average consumer will only see a small increase in the cost of the services those professionals provide. Due to such a small cost, no individual consumer has a sufficient incentive to vote against or organize to stop an abusive licensing law. The result is that a small group of professionals will be highly motivated to lobby and consumers will do nothing, even though the net costs to the consumers will probably be greater than the benefits the professionals receive.⁸⁶

In addition to the distorted incentives of voters, licensing laws are susceptible to capture because unlike certification laws where a neutral state agency sets the standards, licensing boards are generally made up of members of the regulated profession.⁸⁷ Even if a licensing law was passed for altruistic reasons, the board that executes those laws will be made up of members who have a vested interest in the regulations. The risk of regulatory capture and the presence of financially interested parties have led some scholars to argue that the Fourteenth Amendment and the Sherman Act should be able to reach licensing laws.⁸⁸ Since federal judges are appointed and have no personal interest in the licensing regulations, it is believed that they would be better able to determine if the regulations are actually in the public's interest.

Not only do courts have a more neutral perspective, but the development of antitrust law demonstrates that the judiciary may have greater institutional competence in isolating and stopping anticompetitive behavior. Over the past century, Congress has had limited involvement in antitrust law. The Sherman Act is the cornerstone of antitrust law, but for all of its importance, the most powerful sections are surprisingly short. Sections one and two of the Sherman Act contain only 180 words.⁸⁹ The relevant parts state that:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony.

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any

⁸⁴ *Id.* at 10–11.

⁸⁵ *Id.* at 13.

⁸⁶ *Id.* at 14 (“The costs of licensing imposed upon any one consumer will be small; it will not be economic for that consumer to combat the drive for licensure.”).

⁸⁷ Gellhorn, *supra* note 1, at 26.

⁸⁸ See Einer Richard Elhauge, *The Scope of the Antitrust Process*, 104 HARV. L. REV. 668 (1991); Robert G. McClosky, *Economic Due Process and the Supreme Court*, 1962 SUP. CT. REV. 34, 46 (“But most men would probably feel that an economic right such as freedom of occupation, was at least as vital to them as the right to speak their minds.”).

⁸⁹ 15 U.S.C.S. §§ 1, 2 (2009).

part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.

Beyond these words, it has been the judiciary that has developed more specific rules against price-fixing,⁹⁰ horizontal agreements,⁹¹ market divisions,⁹² and tying arrangements.⁹³ In its long history, antitrust law has operated more like common law;⁹⁴ it has been the courts, not Congress, which have identified which actions are anticompetitive and when such actions are outweighed by gains in efficiency. While it may generally be true that legislatures are better suited for analyzing detailed and factually complicated issues, in antitrust law, courts have led the way. This institutional ability and experience seems appropriate for handling the anticompetitive effects of licensing laws.

Finally, this narrower and more limited analysis should prevent a return to *Lochner* and create greater consistency in the case law. Rather than defining a sweeping right to practice one's trade, an economic analysis only seeks to stop certain anticompetitive uses of licenses. By reducing the scope of the rule, judges can strike down abusive licensing laws without being accused of judicial activism. Another advantage of an economic approach is that it does not require courts to make fact intensive inquiries about the policy implications of state laws and the health and safety effects of those laws. The current standard requires courts to make determinations regarding state interests, an issue with which the courts are often unfamiliar. Instead, the focus will be shifted to economic factors, which courts have analyzed many times in a large body of antitrust cases. Issues such as inelastic demand have been addressed repeatedly in the eighty years of cases dealing with the Sherman Act.

This narrower standard should also bring greater consistency to the case law regarding licenses because the current rational basis standard has led to a wide divergence of decisions. Compare the cases of *Schwartz*⁹⁵ and *Barsky*.⁹⁶ In *Schwartz*, a lawyer was denied entrance to the state bar because the board believed he had not shown good moral character.⁹⁷ *Schwartz* had been a member of the Communist Party and was denied his license because of his membership.⁹⁸ The Supreme Court reversed the state bar's denial of a license on the grounds that it violated Due Process, stating that "[a]ny qualification must have a rational connection with the applicant's fitness or capacity to practice law."⁹⁹ In *Barsky* on the other hand a doctor's medical license was suspended for six months because of a prior conviction for

⁹⁰ *United States v. Socony-Vacuum Oil Co., Inc.*, 310 U.S. 150 (1940).

⁹¹ *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899).

⁹² *United States v. Topco Assocs.*, 405 U.S. 596 (1972).

⁹³ *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006).

⁹⁴ *Nw. Airlines, Inc. v. Transp. Workers*, 451 U.S. 77, 98 n.42 (1982) ("In antitrust, the federal courts enjoy more flexibility and act more as common-law courts than in other areas governed by federal statute.").

⁹⁵ *Schwartz v. Bd. of Bar Exam'rs of N.M.*, 353 U.S. 232 (1957).

⁹⁶ *Barsky*, 347 U.S. at 442.

⁹⁷ *Schwartz*, 353 U.S. at 232.

⁹⁸ *Id.* at 238.

⁹⁹ *Id.* at 239.

failing to produce papers to the Committee on Un-American Activities.¹⁰⁰ The licensing regulations allowed for disciplinary action against any physician convicted of a crime. The conviction in *Barsky* resulted from the doctor's refusal to produce records related to his involvement in the Joint Anti-Fascist Refugee Committee.¹⁰¹ In that case, the Court upheld the state's licensing restriction as well as the license suspension. It is difficult to see why producing papers to the Committee on Un-American Activities is related to the practice of medicine but a person's association with the Communist Party is unrelated to the practice of law. An analysis based on more objective observations of the market conditions could provide greater certainty and consistency in judgments in situations such as these.

VI. CONCLUSION

It would be a tedious task to have to determine what skills are necessary for every occupation. What training does an egg trader really need, and how many hours must a barber practice before becoming proficient? And even if these questions could be answered, what happens when new methods are developed or if a whole new occupation arises? It would indeed be difficult for courts to separate all the necessary from unnecessary licensing requirements, but this is precisely how courts have tried to solve the problem. The problem is about more than finding connections between the license requirements and the occupation, it is about how licenses can be a device to aid or exploit the market. An analysis of how licenses impact the market clarifies what motivates those who pursue anticompetitive licenses and when they will succeed. Licensing has some similarities with cartels, but this is just a starting point. Ultimately licenses are both more harmful and more beneficial than even the best run cartel.

Instead of avoiding the question for fear of striking down beneficial licensing laws, courts should look for common patterns that will expedite the process of reviewing licensing laws. Courts have identified and remedied private anticompetitive behavior and the same cases and rules can be adapted to strike down anticompetitive regulations. Licenses can serve a procompetitive purpose; they can inform consumers and raise the quality of services that professionals provide, but without greater intervention, the number of bad licensing laws will continue to grow. By reviewing licensing laws under an economic test, courts will be able to better target licensing abuses. The presence of inelastic demand, a low number of competitors, and a functioning reputation mechanism are all indications that the abuse of the licensing law will be highly profitable and that consumers are already capable of acquiring information without regulation. In these circumstances, courts should be particularly suspect of any justification given for a license. Since courts will also be able to draw upon decades of antitrust case law, the application of this test should be easier than analyzing the health and safety impact of each licensing law. The debate

¹⁰⁰ *Barsky*, 347 U.S. at 442.

¹⁰¹ *Id.* at 444.

should not be about whether licenses do more harm than good, but how to prevent that harm. Whether a license is required for practicing medicine or for fortune telling, an economic approach will better serve all professions.

