

How Regulation and Taxation Stifle Entrepreneurship

Walter E. Williams, the John M. Olin Distinguished Professor of Economics at George Mason University, delivered the third annual Lovett C. Peters Lecture in Public Policy on April 4, 2000. A provocative speaker, Dr. Williams is widely known as the author of a syndicated newspaper column and a radio talk show guest host. In addition, he has written six books, including, most recently, More Liberty Means Less Government, has frequently given expert testimony before Congress, and provided commentary on popular television news programs.

In introducing Professor Williams, Cathy E. Minehan, President of the Federal Reserve Bank of Boston, noted, "Walter E. Williams would seem to embody the goals for which the Lovett C. Peters Lecture Series was founded in 1998. He is both an intellectual and a man of the world. Through his participation in the mass media, newspaper columns, radio shows, and television, Dr. Williams has been able to translate a scholar's devotion to free markets in ways that resonate with the audience and challenge them to question even cherished viewpoints."

The following is an edited transcript of Dr. Williams' remarks.

In a society that seeks to preserve and promote liberty of the individual, it's generally assumed that government's role is mainly that of guaranteeing enforcement of contracts, protecting private property rights, adjudicating disputes, and the provision of certain public goods as an economist would define them. Typically, governments have gone far beyond these legitimate functions. One example of this is occupational and business licensure—just one of many kinds of government regulations that stifle entrepreneurship.

There are close to 1,000 occupations that are licensed in at least one state. The learned professions such as medicine and law are licensed; other occupations requiring considerably less training are also licensed, such as barbers, cosmetologists, and plumbers. Some occupations are licensed that one would not expect to be licensed, such as beekeepers, lightning rod installers, taxidermists, septic tank cleaners, tree surgeons, and fortune tellers.

There are highly questionable licensing requirements. Some states authorize their cities and towns to make local residency a requirement for licensing of plumbers, engineers, and other occupations. In order to become a licensed barber in California, one must pass an examination on the chemical composition of bones. Most states require barbers to receive instruction in bacteriology and diseases of the skin, hair, glands, nails, and nerves. Georgia has an unusual requirement for those who seek to become a licensed commercial photographer—they must pass a Wasserman test for syphilis. I don't know about you, but a photographer has never been quite that close to me that whether he has syphilis would be a concern.

Licensing laws stifle entrepreneurship in many ways. The most immediate effect of licensing is a restriction on the number of practitioners, because of the higher entry costs to meet the qualifications of the licensed activity. Some licenses require many months of schooling, as for cosmeticians and barbers. Other licensing laws require the installation of costly health and safety equipment. Yet others require the purchase of a license or a certificate of authority from an incumbent practitioner that can cost into the millions of dollars, as was the case when interstate trucking was highly regulated in our country. Some licensing jurisdictions issue only a fixed number of licenses or authorizations. All of these requirements raise the cost of entry which in turn leads to a restricted number of practitioners. A secondary effect is that the price of the good or service is higher than it otherwise would be. And, of course, it means higher income for the practitioners in the licensed activity.

Licensing laws are administered by people who are selected from or elected to boards of commissioners by those already practicing the occupation or trade. About three-quarters of all licensing boards in our country are comprised solely of practitioners in the occupation that the board controls. Some people justify this obvious conflict of interest by asserting, for example, "Who can best regulate doctors but other doctors?" That is, why should anybody else except doctors be on the licensing board for doctors? But with that kind of reasoning, we would have made Al Capone Attorney General-after all, who can best regulate criminals but other criminals?

The self-interested behavior behind the advocates of occupational licensing is evident. Partial evidence of this is that most licensure laws are the result of intense lobbying, not by consumers, but by incumbent practitioners. When incumbents in an unlicensed trade lobby for licensing, or when the already existing incumbents in a licensed activity lobby for higher entry requirements, they virtually always seek a grandfather clause that exempts them from meeting all the requirements of the licensing. The burden of higher entry costs is borne by new entrants. The violation of licensing codes by practitioners, such as price cutting and extra hours, are nearly always reported to a licensing board by incumbent practitioners-not by irate customers complaining about too low a price.

A particularly egregious example of business licensing is the licensing of taxis in New York City. A 1936 law permitted licensing 11,787 taxis in the city. Today, while New York's population is much larger, there are still 11,787 taxis. The license price to own and operate one taxi has been as high as \$140,000. Of course, if entry were open to all would-be taxi owners, the amount of money that people would pay for a license would be zero. But people are willing to pay \$140,000 for a license because they expect to earn a higher than normal rate of return in a state-protected monopoly market.

These licensing restrictions have the most adverse effect on poor people, since they don't have \$140,000 or bank credit to get a loan for \$140,000 to get into the taxi-cab business. But I'm proud of many of the poor people in New York City because it's estimated there are between 5,000 and 14,000 illegal cabs-so-called "gypsy" cabs-operating on the streets of New York. I'm proud of these people because they're earning an honest-albeit illegal-living. They provide services for people in poor, high crime neighborhoods. As a matter of fact, some of the gypsy cabs have a little sign painted on the side of them saying, "We're not yellow. We go anywhere."

There are also egregious examples in the licensing of cosmetologists. In 1993, 15-year-old Monique Landers, who lived in a poor neighborhood of Wichita, Kansas, was a participant in the New York-based National Foundation for Teaching Entrepreneurship (NFTE). NFTE seeks to introduce ghetto youngsters to the world of entrepreneurship by teaching them to devise business plans and then helping them start a business. Businesses operated by these youthful participants include car washing and detailing, party magicians, stereo equipment installation, and babysitting. Monique started a hair braiding business called "A Touch of Class." She braided the hair of her friends and her family for \$15 or \$20 and was so successful that Monique was invited to New York City to be honored as one of the five outstanding high school entrepreneurs. That was when her trouble started.

A local newspaper in Wichita published the story about her award. Having read about Monique's success, several beauty school operators and hundreds of angry hairdressers complained to the Kansas Cosmetology Board about Monique's lack of a license. In the name of public health and safety, the Kansas State Cosmetology Board issued a formal letter of warning to Monique, informing her that it was illegal for her to touch hair for profit without a license, and if she did not immediately cease her practice she would be subject to a fine and/or 90 days imprisonment. While the stated motivation for shutting down "A Touch of Class" was that of protecting public health and safety, the real purpose was to protect the monopoly income of practitioners. It's not a violation of Kansas law to braid hair, per se-it becomes a violation when money is involved, therefore threatening the incomes of the incumbent cosmetologists. Clint Bolick, director of litigation for the Institute for Justice in Washington, D.C., remarked that the case is equivalent to restaurants shutting down kiddie lemonade stands in the name of protecting the public health and safety.

The larger irony of this case is that while the authorities cannot shut down youthful drug traffickers and crime in Wichita, they can shut down a youngster trying to earn an honest-albeit illegal-living. But there's room for optimism. In 1997, the Institute for Justice filed a lawsuit in the Federal District Court in San Diego challenging California's licensing practices as applied to practitioners of African hairstyling. The lawsuit alleged violations of the fourteenth amendment's equal protection clause, due process, and privileges and immunities guarantees, as well as similar protections under California's constitution. African hairstyling-braiding, corn-rowing, locking, twisting, or weaving-is a form of natural styling that does not use chemicals or any other harsh processes that alter the hair's texture. But in the name of protecting public health, California requires that an individual performing any kind of hairstyling complete 1,600 hours of classes at a state-approved cosmetology school-at a tuition cost of \$5,000-before sitting for the state examination. And the schooling does not even teach hair braiding! It teaches using hot irons and chemicals.

To make a long story short, the District Court struck down California's cosmetology licensing scheme as it applies to African hairstylers. Judge Rudy Brewster found that the California law failed to pass constitutional muster under the due process equal protection clause of the fourteenth amendment. He said that in the cases of African hairstylists, the training was wholly irrelevant to the task that was to be done by the stylist, and added that there are limits to what a state may require before its dictates are deemed arbitrary and irrational.

To criticize, as I have, occupational licensing laws is not to argue that information about quality is not important for consumers. However, it is by no means clear that licensing is the most effective way to produce that information about quality. Indeed, licensing may lower the received quality of the service in question because by making entry costs higher, there are fewer practitioners. Fewer practitioners mean the cost of the service is higher, and as a result of the higher cost, some consumers resort to do-it-yourself methods, which may result in a lower quality actually received. For example, several economists have found that in jurisdictions where there is strict licensing of electricians, there is a higher incidence of fires of an electrical origin. Many people can't afford the high services of electricians, so they jury-rig wiring themselves and use extension cords, thereby increasing the risk of fire.

Additionally, higher standards imposed by licensing requirements make consumers worse off. A spectrum of quality from high to low is consistent with the optimal stock of goods. Being forced to purchase a higher quality service or good when a lower quality is wanted is non-optimal. Some people might say, "What are you talking about? We think higher quality is always better." But in the interest of high quality cars, would we allow only one kind of car-and it has to be a Rolls Royce? A lot of people would be walking! The existence of Pintos and Hyundais-lower quality cars-are part of the optimal stock of cars.

There are ways to produce information about quality without having all the restrictions imposed by occupational licensing laws. Certification is one method. A person can take a test-if he scores a 90, he has the right to declare himself a "class A" practitioner; if he scores an 80, he has the right to call himself "class B." Such a method would give consumers information about quality while leaving them free to choose.

Let me change focus and discuss how taxation stifles entrepreneurship as well. Most economists agree that when we tax something, we get less of it. And when we subsidize something, we get more of it. When we tax income, it stifles entrepreneurship and higher income. However, government spending-not taxation-is the true measure of the burden of government activity, and that's what we need to address.

Throughout most of our history-up to World War I-the federal government spent no more than three or four percent of the gross national product (GNP), except during wartime. Today, the federal government, if you include so-called off-budget expenditures, spends about 27 percent of the GNP. Adding state and local governments, we're talking about spending 43 to 50 percent of the GNP.

When the federal government spent only three or four percent of the GNP, it did not make much of a difference which form of taxation supported federal government activity. In fact, until World War I- before the income tax-the federal government got all of its revenue from excise taxes. There wouldn't be much of a problem even with the income tax if the federal government were only taking three percent of the GNP.

But the income tax code is so complex and cumbersome that it does have an impact on our economy. In 1913, the income tax code, or the 1040 form, consisted of two pages. Today, it's 17,000 with 703 different forms. Since 1986, there have been 6,000 changes in the tax code. The 1997 tax bill alone added 285 new sections to the tax code, and amended 824 others. According to a recent survey, 53 percent of Americans cannot file their income taxes-they have to go to a tax accountant.

The flat tax proposed by Congressman Armey and others would instantly increase our GNP because with our complex tax code, Americans spend more than six billion hours each year simply complying with the code-through record keeping, tax planning, preparing tax returns, audits, and court appearances. If those hours were spent productively, we could produce the entire annual output of the automobile industry, the truck industry, and the aircraft industry. But I doubt whether we'll ever get a simple tax code in our country. The tax code is how Congress plays favorites with different Americans, and with a simple tax code Congress could not play favorites.

Be it taxation or regulation through occupational licensure, there's absolutely no problem in our economy that less government and more liberty would not solve. The framers of the Constitution feared a strong government and wanted to make it as limited as possible but able to do its mandated functions. For example, they gave us the 10th amendment, which says that powers not delegated to the federal government belong to the people and the states. We, too, should worry about government, but I don't think we are worried enough. We Americans better be careful or we're going to lose our freedom.

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