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OCCUPATIONAL LICENSING AND ASYMMETRIC INFORMATION: POST-HURRICANE EVIDENCE FROM FLORIDA

David Skarbek

Federal, state, and county governments accept the argument that occupational licensing protects consumers and improves their welfare. This argument stands in stark contrast to the apparent rent seeking that occurs with licensing. In return for gains from state-created barriers to entry, coalitions built along occupational lines support politicians (Stigler 1971: 3–21).

This article will show that government action in times of crisis is often inconsistent with its rhetoric. Licensing is typically justified on the grounds that market mechanisms will not mitigate the problems associated with asymmetric information. In the wake of Hurricanes Frances and Katrina, Florida reduced restrictions on construction contractors, yet in times of crises informational asymmetries are more likely to be problematic. By examining the volume of work completed, I find little evidence of significant detrimental effects from the policy change. Given the relative success of reducing restrictions and the government's explicit recognition of licensing's limiting effect on the availability of roofers, reform of licensing, at least to the extent done in crisis, should be adopted permanently.

Why Occupational Licensing?

The dominant position in economics is that licensing restricts supply, increases prices, and transfers wealth from consumers to producers. This

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position extends as far back as Adam Smith's warning of the monopolistic tendencies of licensing in *The Wealth of Nations* (1994: 136–37) where he wrote, "The exclusive privilege of an incorporated trade necessarily restrains the competition, in the town where it is established, to those who are free of the trade." In the 20th century, Friedman and Kuznets (1945), Friedman (1962: 137–60), and Kleiner (2006), among many others, reiterated and expanded the argument that licensing is monopolistic and is intended to secure rents to practitioners.

On the other hand, many economists argue that information asymmetries justify licensing laws. Akerlof's "lemons model" (1970) demonstrates that markets may be thin or nonexistent when buyers and sellers cannot adequately convey information about product quality. If average quality dictates price, then higher quality products would not receive acceptable remuneration and would be withheld from the market. Poor quality products, in contrast, receive greater remuneration than if the market has perfect information; individuals are thus encouraged to dilute the market with more lemons. The result is that exchanges do not take place.

Leland (1979) applies Akerlof's framework to occupational licensing laws and finds that a minimum quality standard can improve welfare. However, he notes that this conclusion does not consider alternative methods of reducing the problems associated with asymmetric information; other policies may achieve this end more effectively. Law and Kim (2005) discuss the historical development of licensing laws during the Progressive Era and examine what they consider the dominant view among economists—that licensing restricts entry and reduces competition. They argue informational asymmetries, which were exacerbated due to increasing urbanization and advances in knowledge, explain the enactment of many of these laws and provide justification for them on economic grounds.

There are many market mechanisms in place that mitigate the problems associated with asymmetric information. As Akerlof himself suggested, sellers often offer warranties and establish a brand name in order to provide information to buyers about product quality (Akerlof 1970). The desire for repeat business gives producers an incentive to provide true information about the quality of goods. Certification from third parties, such as the Better Business Bureau or *Consumer Reports*, provides another means for buyers to obtain assurances about product quality (Klein 2001).

Government's justification for licensing is generally not as sophisticated or explicit as the explanations put forth by economists; however, the language used to indicate legislative intent does suggest the presumption of information asymmetry problems. Florida Statute 32, chap. 489.101 and 489.113, discussing construction contractors, states: "The Legislature

deems it necessary in the interest of the public health, safety, and welfare to regulate the construction industry,” and that purpose is realized by “establish[ing] . . . competency and qualifications.” This statute presumes that consumers are not capable of adequately identifying the competency and qualifications of roofing contractors, and that the state of Florida can benefit the public through licensing.

Government in Action: The Case of Florida’s Roofers

In 2004, Hurricane Frances made landfall in Florida causing over \$9 billion in damages. In response, Governor Jeb Bush issued executive order 04-188, which temporarily reduced restrictions on roofing contractors.

The executive order stated that a “certified, or registered, general, building, or residential, contractor is not required to subcontract roofing work.” Temporary licenses were offered to contractors presenting an affidavit of competency from their original jurisdiction. The Department of Business and Professional Regulation (DBPR) issued a press release announcing the intentions of the executive order: “This Order provides relief for Hurricane Frances victims by creating a larger pool of licensed individuals to choose from” (Department of Business and Professional Regulation 2004).

Less than a month later, Governor Bush extended this order to all counties in Florida. The *Tampa Bay Business Journal* described the executive order: “City and county governments can now issue specialty-roofing licenses without the need for additional local enacting ordinances. The specialty licenses can be issued to both in-state and out-of-state contractors who fulfill the requirements” (*Tampa Bay Business Journal* 2004).

The language of the executive order, the DBPR press release, and the interpretation of local journalists, all recognize that reducing restrictions would increase the availability of roofers. Licensed roofers from out of state, as well as Florida contractors not licensed to roof, flooded into the counties worst hit and assisted in the rebuilding process.

In 2005, following Hurricane Katrina, Governor Bush issued executive order 05-148, which similarly extended 60-day provisional licenses to roofers who were not normally allowed to practice.

The Impact of Reducing Restrictions

If licensing is justified by asymmetric information, it is in times of crises that asymmetric information is likely to be most problematic. Market

mechanisms that mitigate asymmetric information are operating more poorly, partly due to the licensing reductions themselves. For example, out-of-state roofers who are forbidden from practicing in-state year round are less likely to develop reputations for quality. If they were allowed to work in Florida all of the time, then these sellers would be able to capture the long-term benefits that a good reputation and repeat business brings.

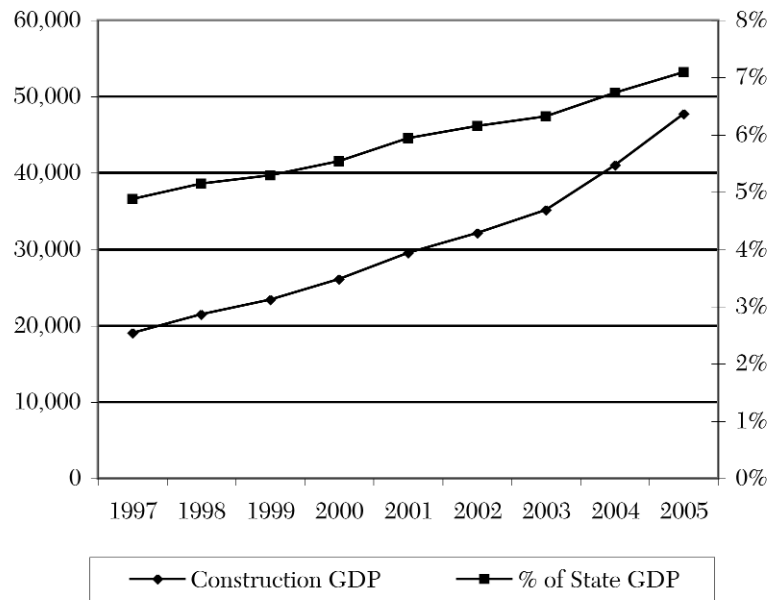
Asymmetric information may also worsen because search has become more expensive. In times of crisis, there are often higher costs associated with search. In normal times when a roof is aging an owner has time to shop around and gather information on a roofer's reputation, but when a roof has been ripped off in a storm any delay while obtaining information could result in greater damage to the home. Obtaining information about product quality is more costly. The difficulty of even getting an estimate from a roofer aggravated this problem. Hector Perez, who needed his roof fixed in 2005, shared his experience: "I don't trust anybody, I double-check everything, but we had called literally 50 roofers, and Leo Pass was the only one who called back" (Holland 2006). People are less likely and capable of obtaining information about product quality after a storm.

The economy was also subject to greater uncertainty due to Florida's price-gouging laws, which came into force when the emergency was declared. In times of crisis, roofers are apprehensive about giving estimates because of the increased volatility of supplier prices and the fear of prosecution under price-gouging laws if they overestimate future supply prices. Roofing contractor Rob Kornahrens used to keep price quotes available for 30 days. The increase in supply prices following the 2005 hurricane season forced him to change his policy: "We can't keep a price quote open for more than 10 days anymore because our costs are rising so fast" (Benedick 2005). During this time, producers are unsure of how the prices will change and how price-gouging laws will be applied. As a result, prices convey less information and supply is withheld.

Asymmetric information is potentially inefficient because it leads to exchanges not taking place at all. Standard welfare theory defines the purchase of poor quality products as simply a transfer of wealth rather than a cost. Quality per se, then, is not the focus; the ultimate concern is foregone exchanges.

If the existence of asymmetric information were a significant problem, then when general contractors and out-of-state roofers began practicing, we would expect to see the quantity of work decline. Figure 1 shows the amount of Florida's GDP that is from the construction industry and its percentage of total state GDP. Ideally, we would have data on just the roofing industry, but the most specific data available are at the broader

FIGURE 1
CONSTRUCTION INDUSTRY GDP
(Millions of Current Dollars)



level of the construction industry. These data give some idea of how the roofing industry grew. Clearly, both the volume of work and the percentage of total state GDP are increasing, which suggests that asymmetric information did not thin the market.

News accounts indicate the roofing industry was booming. Steve Munnell, director of the Florida Roofing, Sheet Metal and Air Conditioning Contractors Association, reported, “roofers are swamped” (Pleasant 2004a). Representatives at building departments in the counties of Lake Wales, Lakeland, Winter Haven and unincorporated Polk said there was an exponential increase in the number of roofing permits (Pleasant 2004b).

If the existence of asymmetric information were a significant problem, then when general contractors and out-of-state roofers began practicing, we would expect to see the quantity of work decline. This did not happen. Another approach for gauging the effects of asymmetric information is to examine the quality of goods received. While this is not the standard welfare theory concern, examining data on product quality is useful in judging

the ability of markets to handle asymmetric information in emergencies.

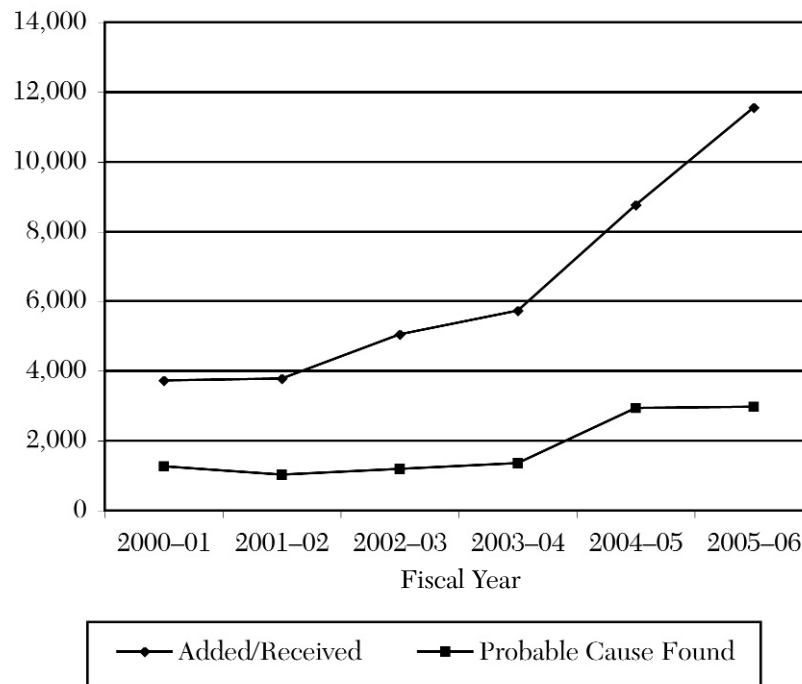
Measuring product quality is difficult because there are many aspects of a good that are impossible to quantify or even identify explicitly. Still, news stories and complaints filed with the Department of Business and Professional Regulation can help paint a partial picture of conditions in the roofing market.

After the 2004 and 2005 hurricane seasons, local newspapers noted an increase in complaints against contractors. There are many reasons that complaints against contractors may have increased. First, and most obviously, the increase in construction activity after the hurricanes would tend to increase the number of complaints filed. More work is going to lead to more complaints. Second, a portion of the complaints probably stems from overbooking by honest contractors who were simply overwhelmed by the surge in demand. J. D. Hasselbach, vice president of sales for a Florida roofing supplier, described the magnitude of the situation: “We have 50 gallons we’re trying to put in a one-quart jar when it comes to demand” (Pleasant 2004b). Third, the lack of building supplies, which subsequently led to long waits, frustrated homeowners. Hasselbach said the supply shortage “is the worst I’ve seen it in 30 years. It’s worse than Hurricane Andrew and Hurricane Hugo” (Pleasant 2004b). One news article reported that the wait time for materials was 20 weeks (Pacenti 2005).

Valerie Messier of the Martin County Contractor Licensing office recognized the frustration of consumers but offers the tempered view that the complaints reflect on only a small minority of contractors: “We have 4,500 (contractors) on file. A handful has caused problems” (Taylor 2006). Natural disasters often make communities the targets for con men. Joel Dramis, technical services manager for Port St. Lucie’s building department, noted that many of the complaints are directed at people who are simply “smooth-talking salesmen, not contractors” (Taylor 2006). Licensed Florida contractors have also been found guilty of fraud—evidence that licensing is not a magic bullet to end corruption.

According to the Department of Business and Professional Regulation’s Annual Reports, the number of complaints against businesses in the construction industry did increase in 2004 and 2005 (Figure 2). “Complaints Received” includes any complaint filed by a consumer, and the complaints with “Probable Cause” are those that were determined possibly to involve an actual legal violation or inadequate workmanship. Despite increases in complaints received, there was only a minor increase in the number of complaints found to have probable cause. To give some perspective, recall the increasing volume of work performed by the con-

FIGURE 2
COMPLAINTS AGAINST THE CONSTRUCTION INDUSTRY



struction industry (Figure 1). The number of complaints cannot be weighted directly for volume of work because they are collected by the fiscal year, which starts on July 1, and the industry-specific GDP data are collected by the calendar year. Nonetheless, even using the earlier GDP year to compare the fiscal year's number of complaints (which would tend to overstate the frequency of complaints per dollar of work) there would still be only 2,981 complaints with probable cause for \$47.7 billion in construction work—one for every \$16 million of work done.

Although asymmetric information did not prevent the market from operating and there were few complaints given the volume of work, there was a more than proportional increase in complaints filed compared to the increase in construction volume. construction industry revenue increased 35.5 percent from 2003 to 2005, complaints increased 101 percent, and complaints with probable cause increased 120 percent from fiscal year 2003-04 to 2005-06. Since roofing as a percentage of Florida's construction GDP was rising over this time period, the data likely overstate the proportional change in complaints. Examining the period after

the restrictions were first reduced, however, indicates that construction industry revenue increased 16.2 percent and complaints received increased 32 percent, but complaints with probable cause increased only 1.1 percent. After an initial spike in both complaints received and complaints with probable cause, the complaints with probable cause leveled off. Data limitations prevent us from knowing exactly why this happened, but it may be that contractors adapted to the new regulatory regime, supply volatility, and demand shocks.

The severity of the 2004 and 2005 hurricane seasons, which led to surges in demand and supply shortages all along the Gulf Coast, contributed to an economic environment that was more volatile. Although these data are less than ideal because they look at the entire construction industry, it appears that reductions in licensing restrictions, and the increase in asymmetric information that would follow, did not lead to a fall in the quantity of work.

Florida is not the only state to reduce licensing restriction in times of emergency. Louisiana reduced licensing restrictions in the weeks following Hurricane Katrina. Governor Kathleen Blanco issued executive orders that reduced restrictions on medical professionals and personnel, veterinarians, towing operators, charter schools, and proprietary schools. While there may have been extenuating circumstances due to the severity of the crisis, such as the inability to accept licensing fees or offer examinations, to reduce restrictions in such times suggests that there may be public choice rather than public interest reasons for licensing in the first place.

Conclusion

Hurricanes Frances and Katrina were impetus for Florida to reduce licensing requirements. This response raises questions about the extent of state intervention in the economy in normal times.

People recovering in the wake of a hurricane have less information about goods and services. The usual market mechanisms, which guide individuals by providing information and encouraging cooperative behavior, are impaired. During a disaster, asymmetric information is likely to worsen. Yet, it is in the aftermath of two of the worst hurricanes in U.S. history that Florida chose to relax the licensing laws that allegedly mitigate these problems.

This then raises the question, If citizens of Florida are capable of judging the quality of roofing services in the wake of Hurricanes Frances and Katrina, then why are they not capable of doing so in non-crisis situations

when they have more time to gather information? It is unlikely that a state of emergency informs or empowers. Coupled with the explicit admission that reduced licensing requirements increases the supply of roofers, individuals should be free to hire out-of-state roofers year round. Florida's post-hurricane reforms should be extended to citizens in times of calm as well as crisis.

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